



# Investment Strategy Statement

**March 2020**

## Introduction and background

This is the Investment Strategy Statement (“ISS”) of the East Sussex Pension Fund (“the Fund”), which is administered by East Sussex County Council, (“the Administering Authority”). The ISS is made in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (“the Regulations”).

The ISS has been prepared by the Pension Committee (“the Committee”) having taken advice from the Fund’s investment adviser, Hymans Robertson LLP. The Committee acts on the delegated authority of the Administering Authority. The ISS, which was approved by the Committee on 16 March 2020, is subject to periodic review at least every three years and without delay after any significant change in investment policy. The Committee has consulted on the contents of the Fund’s investment strategy with such persons it considers appropriate.

The Committee seeks to invest in accordance with the ISS, any Fund money that is not needed immediately to make payments from the Fund. The ISS should be read in conjunction with the Fund’s Funding Strategy Statement.

## The suitability of particular investments and types of investments

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependents, on a defined benefits basis. This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund’s assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary and/or inflation increases.

The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund. This benchmark is consistent with the Committee’s views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund’s liabilities. The Committee discusses the appropriateness of the Fund’s strategic asset allocation at least once a year.

The Fund carries out an asset liability modelling exercise in conjunction with each actuarial valuation. A number of different contribution and investment strategies are modelled and the future evolution of the Fund considered under a wide range of different scenarios. The Committee considers the chances of achieving their long term funding target and also considers the level of downside risk in the various strategies by identifying the low funding levels which might emerge in the event of poor outcomes.

This approach helps to ensure that the investment strategy takes due account of the maturity profile of the Fund (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit (relative to the funding bases used).

In addition, the Committee monitors investment strategy on an ongoing basis, focusing on factors including, but not limited to:

- Suitability given the Fund’s level of funding and liability profile
- The level of expected risk
- Outlook for asset returns

The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation and has implemented a rebalancing policy Appendix A.

To help clearly define the strategic approach adopted by the Committee it has set out its investment beliefs Appendix B.

## Investment of money in a wide variety of investments

### Asset classes

The Fund may invest in quoted and unquoted securities of UK and overseas markets including equities, fixed interest and index linked bonds, cash, property and commodities, either directly or through pooled funds. The Fund may also make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products for the purpose of efficient portfolio management or to hedge specific risks.

The Committee reviews the nature of Fund investments on a regular basis, with particular reference to suitability and diversification. The Committee seeks and considers written advice from a suitably qualified person in undertaking such a review. If, at any time, investment in a security or product not previously known to the Committee is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.

The Fund's target investment strategy is set out below. The table also includes the maximum percentage of total Fund value that it will invest in these asset classes. In line with the Regulations, the authority's investment strategy does not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007.

**Table 1: Fund allocation**

Asset class	Target allocation %	Maximum invested* %	Role within the Strategy
Global Equity	33.0	44.0	Growth Assets
UK Equity	7.0		Growth Assets
Absolute Return	21.0	24.0**	Growth Assets
Private Equity	5.5	7.5	Growth Assets
Property	10.0	13.0	Income Assets
Infrastructure	4.0	6.0	Income Assets
Private Debt	3.0	5.0	Income Assets
Absolute Return Bonds	8.0	9.0	Income Assets
Index-Linked Gilts	5.0	6.0	Protection Assets
Fixed Interest Bonds	3.5	4.5	Protection Assets
Cash	0.0	2.0	Protection Assets
Total	100.0		

\*The maximum invested figures are based on the rebalancing ranges agreed by the East Sussex Pension Committee within its rebalancing policy.

\*\* Additional allowance of 1% to rebalancing figures whilst allocations to infrastructure and private debt take place.

### Restrictions on investment

The Regulations have removed the previous restrictions that applied under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The Committee's approach to setting its investment strategy and assessing the suitability of different types of investment takes account of the various

risks involved and a rebalancing policy is applied to maintain the asset split close to the agreed asset allocation target. Therefore it is not felt necessary to set additional restrictions on investments.

## **Managers**

The Committee has appointed a number of investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Committee, after seeking appropriate investment advice, has agreed specific benchmarks with each manager so that, in aggregate, they are consistent with the overall asset allocation for the Fund. The Fund's investment managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market and asset class, the managers will maintain diversified portfolios through direct investment or pooled vehicles. The manager of the passive funds in which the Fund invests holds a mix of investments within each pooled fund that reflects that of their respective benchmark indices.

When the Committee decide to invest in a new fund, a shortlist of options is recommended by the Investment Advisor and discussed by the Committee.

## **The approach to risk, including the ways in which risks are to be measured and managed**

The Committee is aware that the Fund has a need to take risk (e.g. investing in growth and income assets) to help it achieve its funding objectives. It has an active risk management programme in place that aims to help it identify the risks being taken and put in place processes to manage, measure, monitor and (where possible) mitigate the risks being taken. The investment section of the Risk Register is reviewed at least every six months by the Committee.

The principal risks affecting the Fund are set out below. We also discuss the Fund's approach to managing these risks and the contingency plans that are in place:

### **Funding risks**

- Financial mismatch – The risk that Fund assets fail to grow in line with the developing cost of meeting the liabilities.
- Changing demographics – The risk that longevity improves and other demographic factors change, increasing the cost of Fund benefits.
- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Fund's liabilities.

The Committee measures and manages financial mismatch in two ways. As indicated above, the Committee has set a strategic asset allocation benchmark for the Fund, which is reviewed on at least an annual basis. This benchmark was set taking into account asset liability modelling which focused on probability of success and level of downside risk.

The results from the 2016 analysis highlighted that the Fund - utilising its current stabilisation parameters for contributions – has a good chance of being fully funded in future at the end of the projection period used without adopting an over prudent approach towards its investment strategy. The Committee assesses risk relative to the strategic benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. The Committee also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

The Committee also seeks to understand the assumptions used in any analysis and modelling so they can be compared to their own views and the level of risks associated with these assumptions to be assessed.

The Committee reviews the demographic assumptions of the Fund every three years as part of its triennial valuation to mitigate the risk that any changes to longevity and other factors would have on the Fund.

The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

## **Asset risks**

- Concentration - The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Fund’s assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Environmental, social and governance (“ESG”) – The risk that ESG related factors reduce the Fund’s ability to generate the long-term returns. The Fund believes that climate change poses material risks to the Fund but that it also presents positive investment opportunities.
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

The Committee measure and manage asset risks as follows.

The Fund’s strategic asset allocation benchmark invests in a diversified range of asset classes. The Committee has put in place rebalancing arrangements to ensure the Fund’s “actual allocation” does not deviate substantially from its target. The Fund invests in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, help reduce the Fund’s asset concentration risk. By investing across a range of assets, including liquid quoted equities and bonds, as well as property, the Committee has recognised the need for access to liquidity in the short term.

The Fund invests in a range of overseas markets which provides a diversified approach to currency markets; the Committee also assesses the Fund’s currency risk during their risk analysis. Details of the Fund’s approach to managing ESG risks are set out later in this document.

The Committee has considered the risk of underperformance by any single investment manager and have attempted to reduce this risk by appointing more than one manager and having a large proportion of the Fund’s assets managed on a passive basis. The Committee assess the Fund’s managers’ performance on a regular basis, and will take steps, including potentially replacing one or more of their managers, if underperformance persists.

## **Other provider risk**

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee seeks suitable professional advice.

- Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.
- Stock Lending- The Fund will participate in any stock-lending arrangements in the future as part of the LGPS ACCESS pool. The Committee will ensure that robust controls are in place to protect the security of the Fund's assets before entering into any stock lending arrangements. The manager(s) of pooled funds may undertake a certain amount of stock lending on behalf of unit-holders. Where a pooled fund engages in this activity the extent is fully disclosed by the manager (unless the assets are invested in LGPS pooled arrangements in which case this will be delegated to the Pool Operator).

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Fund, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). The Committee has the power to replace a provider should serious concerns exist.

A separate schedule of risks that the Fund monitors is set out in the Fund's Funding Strategy Statement.

## **The approach to pooling investments, including the use of collective investment vehicles and shared services**

The Fund is a participating scheme in the ACCESS Pool. The proposed structure and basis on which the ACCESS Pool will operate was set out in the July 2016 submission to Government.

### **Assets to be invested in the Pool**

The Fund's intention is to invest its assets through the ACCESS Pool as and when suitable Pool investment solutions become available. The ACCESS Pool has launched several sub-funds in which the East Sussex Pension Fund now participates and there are further launches planned for later in 2020 which East Sussex plan to be involved with.

The Fund's investment mandates with Longview, Ruffer and Newton have been transferred into ACCESS to date.

An indicative timetable for investing through the Pool was set out in the July 2016 submission to Government. They key criteria for assessment of Pool solutions will be as follows:

1. That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund
2. That there is a clear financial benefit to the Fund in investing in the solution offered by the Pool, should a change of provider be necessary.

At the time of preparing this statement the Fund has elected not to invest the following assets via the ACCESS Pool:

**Table 2 – Assets held outside the pool**

Asset class	Manager	Target % of Fund assets	Benchmark	Reason for not investing via the ACCESS Pool
Private Equity	Harbourvest Partners / Adam Street Partners	5.5%	MSCI All Countries World	Existing illiquid asset programmes will run off at normal lifecycle to avoid crystallising exit costs and loss of illiquidity premium earned.
Infrastructure	M & G Infracapital / UBS Infrastructure / Pantheon	4.0%	GBP 3 Month LIBOR	Existing illiquid asset programmes will run off at normal lifecycle to avoid crystallising exit costs and loss of illiquidity premium earned.
Private Debt	M & G	3.0%	GBP 3 Month LIBOR	Existing illiquid asset programmes will run off at normal lifecycle to avoid crystallising exit costs and loss of illiquidity premium earned.
Operational cash	East Sussex County Council	0.0%	N/A	East Sussex Pension Fund needs to manage its cash flow to meet statutory liabilities, including monthly pension payroll payments, therefore, a reasonable level of operational cash will be required to maintain efficient administration of schemes and would be held outside the Pool.

Any assets not currently invested in the Pool will be reviewed at least every three years to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money. The next such review will take place no later than 2022.

## Structure and governance of the ACCESS Pool

East Sussex is a member of the ACCESS pool along with the following 10 other pension funds:

Cambridgeshire	Kent
Essex	Norfolk
Hampshire	Northamptonshire
Hertfordshire	Suffolk
Isle of Wight	West Sussex

All eleven funds are committed to collaboratively working together to meet the criteria for pooling and have signed a Memorandum of Understanding to underpin their partnership. ACCESS is working to a project plan in order to create the appropriate means to pool investments.



The ACCESS Funds have set out how they meet the pooling criteria, the pool's structure, governance arrangements and services to be shared in the submission made to the Government in July 2016, which is available on ACCESS's website <http://www.accesspool.org/>

The "ACCESS Pool" is not a legal entity. However a Joint Committee (JC), comprising elected Pension Committee Chairmen from each Administering Authority and supported by the Officer Working Group has been established via an Inter Authority Agreement. Papers from previous and future ACCESS JC meetings papers can be found using the following link: <https://democracy.kent.gov.uk/mgOutsideBodyDetails.aspx?ID=898>

ACCESS has taken advice on its sub-fund design and is implementing the consolidation of a significant portion of participating Authorities' liquid assets in the initial set of sub-funds. This sub-fund proposal will allow the Operator to make rapid progress in preparing and submitting an application for authorisation of the ACCESS ACS and a set of "pilot and pipeline" sub-funds.

Investments under Pool Governance (Passive) - The value of assets to be held within the Pool includes passively managed assets which will be held in Life Policies. The Life Policies themselves will necessarily remain an agreement between the participating Authority and the appointed external investment manager. This was acknowledged as an acceptable outcome by Government. All passive assets will therefore be held out-side the Authorised Contractual Scheme (ACS) and will not be managed or administered by the Pool Operator.

## **How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments**

To clearly define the approach adopted by the Committee to these issues it has approved a Responsible Investment (RI) Policy which is included as Appendix C. Within this it is recognised that environmental social and corporate governance factors can influence long term investment performance and the ability to achieve long term sustainable returns. The Committee considers the Fund's approach to responsible investment with four core principles:

- a. We will apply **long-term thinking** to deliver **long-term sustainable returns**.
- b. We will seek **sustainable returns** from **well-governed assets**.
- c. We will use an **evidence-based** long term investment appraisal to inform **decision-making** in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.
- d. We will evaluate and manage **carbon exposure in order to mitigate risks to the Fund from climate change**.

More detail on the way in which these principles are incorporated into the Fund's investments is contained in Appendix C. The Committee takes RI matters very seriously and conducts a regular review of its policies in this area and its investment managers' approach to RI.

At the present time the Committee does not take into account non-financial factors when selecting, retaining, or realising its investments.

To date, the Fund's approach to Social investments has largely been to delegate this to their underlying investment managers as part of their overall RI duties.

The Fund does not hold any assets which it deems to be social investments.



## The exercise of rights (including voting rights) attaching to investments

### Voting rights

The Committee has delegated the exercise of voting rights to the investment manager(s) on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the Fund's managers have produced written guidelines of their process and practice in this regard, which is considered as part of the appointment of an investment manager process. The managers are strongly encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2)(f). The Committee will publish an annual report of voting activity as part of the Fund's annual report.

### Stewardship

The Committee understands that stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. The Committee has formally agreed to adhere to the Stewardship Code as published by the Financial Reporting Council. A copy of the Fund's statement of compliance with the Stewardship code can be found on the Fund's website

<https://www.eastsussex.gov.uk/yourcouncil/pension-fund-policies/>.

The Committee expects its investment managers to be signatories or comply with the Stewardship Code as published by the Financial Reporting Council. Asset manager signatories have been categorised in three tiers.

- **Tier 1** – Signatories provide a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary.
- **Tier 2** – Signatories meet many of the reporting expectations but report less transparently on their approach to stewardship or do not provide explanations where they depart from provisions of the Code.
- **Tier 3** – Significant reporting improvements need to be made to ensure the approach is more transparent. Signatories have not engaged with the process of improving their statements and their statements continue to be generic and provide no, or poor, explanations where they depart from provisions of the Code.

### Investment Managers Stewardship Rating

#### Tier 1

- UBS Asset Management
- Newton Investment Management
- Ruffer LLP
- Schroder Investment Management Limited
- M & G Investment Management
- Longview Partners
- Northern Trust Global Investments

#### Tier 2

- None

#### Tier 3

- None

The Committee expects both the ACCESS Pool and any directly appointed fund managers to also comply with the Stewardship Code. In addition to the Fund's views on the Stewardship Code, the Fund believes in collective

engagement and is a member of the Local Authority Pension Fund Forum (LAPFF), through which it collectively exercises a voice across a range of corporate governance issues.

## **Appendices**

Appendix A – Rebalancing Policy

Appendix B – Investment Beliefs

Appendix C – Responsible Investment Policy



## Rebalancing Policy

**September 2018**

## Appendix A

### Rebalancing Ranges

The following ranges have been agreed by the Committee to set as points at which rebalancing should take place.

Asset class	Strategic target (%)	Range (%)
Global Equities	33.0	36.0 – 44.0
UK Equities	7.0	
Private Equity	5.5	3.5 – 7.5
Absolute Return	21.0	19.0 – 23.0
<b>Total Growth</b>	<b>66.5</b>	<b>60.0 – 73.0</b>
Property	10.0	8.0 – 12.0
Infrastructure	4.0	2.0 – 6.0
Private Debt	3.0	1.0 – 5.0
<b>Total Income</b>	<b>17.0</b>	<b>15.0 – 19.0</b>
Absolute Return Bonds	8.0	7.0 – 9.0
Fixed Interest Bonds	3.5	2.5 – 4.5
Index-Linked Gilts	5.0	4.0 – 6.0
Cash	0.0	0.0 – 2.0
<b>Total Protection</b>	<b>16.5</b>	<b>15.0 – 18.0</b>
<b>Total</b>	<b>100.0</b>	

### Rebalancing for the Fund – General Rules

The following general rules will determine how a rebalancing process for the Fund will operate.

- **Rebalancing would apply only to equities, absolute return funds and bonds** - Due to the transaction costs and illiquidity associated with the other investments such as property, rebalancing for those asset classes will be considered on an annual/ad hoc basis;
- **Rebalancing would be monitored on a quarterly basis**
- **Each benchmark allocation would have a weighted tolerance range** – A tolerance range will be defined for growth and matching assets and each underlying mandate; these tolerance ranges will be used in determining when rebalancing will occur;

## Appendix A

- **Cash holdings to be used for rebalancing.** Where possible any net investments or disinvestments should be used to manage allocations, for example, by investing any surplus cash into the most underweight asset class.
- **Rebalancing will occur at two levels; at the growth vs matching level, and at the mandate level –** The rebalancing process will determine if rebalancing is required between growth and matching assets, and separately if rebalancing is required between asset classes. However, it is more important to be willing to incur transaction costs if necessary to rebalance between bonds and equities, for example, than switching between managers with similar mandates (e.g. Longview and L&G global equities).
- **Rebalancing transactions will aim to rebalance allocations out with their tolerance ranges to the midpoint (at least) of the tolerance range –** The mid-point of the tolerance range is the mid-point between a benchmark allocation and its upper or lower tolerance limit. Assuming an asset class with a 60% allocation and a 54%-66% tolerance range, the upper mid-point would be the halfway point between 60-66% (i.e. 63%). The lower mid-point would be the halfway point between 54% and 60% (i.e. 57%). Analysis suggests that this is the best way of balancing the impact of transaction costs against returns.

The allocations to private equity and infrastructure (and to a lesser extent property) will vary with general market movements and are not easily altered, due to the illiquid nature of the asset classes. Therefore we do not anticipate any rebalancing being carried out in relation to the Fund's private equity or infrastructure investments.



## Investment Beliefs

## Appendix B

### March 2020

#### Fund specific investment beliefs

The Pension Committee has prepared a set of investment beliefs based on their experience of the workings of the Fund and the nature of the underlying investments held. These are set out below:

##### **Belief: Clear and well defined objectives are essential to achieve future success**

The Committee is aware that there is a need to generate a sufficient level of return from the Fund's assets, while at the same time having a clear understanding of the potential risks and ensuring there is sufficient liquidity available to pay members' benefits as they fall due.

Evidence of Belief in Practice: The objectives of the Fund are considered every three years as part of the actuarial valuation process and the accompanying review of the long term investment strategy.

##### **Belief: Strategic asset allocation is a key determinant of risk and return, and thus is typically more important than manager or stock selection**

The Committee understands that having the appropriate strategy in place is a key driver of the Fund's future success. As a result, priority is given to more strategic investment matters.

Evidence of Belief in Practice: The appropriateness of the strategic asset allocation is currently considered by the Committee on at least an annual basis. The intention is to also establish a Working Group tasked with conducting a more detailed review of investment strategy on a more frequent basis.

##### **Belief: Funding and investment strategy are linked**

The Committee understands that a number of funding related aspects feed into investment strategy decisions, including maturity, financial risk of the employer and level of required return. Given this, actuarial and investment matters, most notably setting investment strategy, are looked at in tandem by the Committee.

Evidence of Belief in Practice: The Scheme Actuary and Investment Adviser are both invited to attend meetings where investment strategy and funding are discussed in detail. Regular asset liability modelling exercises incorporate long term projections for the nature of the Fund's liabilities alongside the expected returns and risks arising from the Fund's invested assets.

##### **Belief: Long term investing provides opportunities for enhancing returns**

The Committee believes that investors with long term time horizons are typically less constrained by liquidity requirements and able to better withstand periods of price volatility. As a long term investor, the Fund may choose to gain additional compensation by investing in assets that are illiquid (e.g. property, infrastructure and private equity) or may be subject to higher levels of volatility (a premium return is required for any such investments). Having this long-term focus also helps the Fund tolerate periods of active manager underperformance when the manager's investment style is out of favour with the market.

Evidence of Belief in Practice: The Committee invests in illiquid asset classes comprising private equity, infrastructure, private debt and property. These investments are expected to benefit from an additional illiquidity return premium over time.

##### **Belief: Equities are expected to generate superior long term returns**



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The Committee believes that, over the longer term, equities are expected to outperform other liquid assets, in particular government bonds. The Committee is therefore comfortable that the Fund maintains a significant allocation to equities in order to support the affordability of contributions.

Evidence of Belief in Practice: Almost half of the Fund's assets are invested in either listed or unlisted equities (45.5% in aggregate).

### **Belief: Alternative asset class investments provide diversification**

The Committee believes that diversification across asset classes can help reduce the volatility of the Fund's overall asset value and improve its risk-return characteristics. The Committee believes that investing across a range of asset classes (including, but not restricted to, equities, bonds, absolute return funds, infrastructure and property) will provide the Fund with diversification benefits.

Evidence of Belief in Practice: The Fund invests in nine different asset classes, two of which are diversified growth and absolute return credit, which themselves provide exposure to a wider range of asset classes.

### **Belief: Government bonds provide liquidity and a degree of liability matching**

Government bonds have characteristics that are similar to the assumptions used in valuing pension liabilities e.g. sensitive to changes in interest rates and (for index-linked) to changes in market-implied inflation. This makes them a suitable asset for reducing the Fund's funding risks. In addition, this asset class has proven to be highly liquid at times of market stress, enabling it to be used for rebalancing and to help meet any outflows that may fall due. Given this, the Committee hold a proportion of the Fund's assets in this asset class.

Evidence of Belief in Practice: The Fund has a target allocation of 3.5% to corporate bonds and 5% to index linked gilts. The Committee consider this to be an appropriate allocation for providing liquidity at times of stress, whilst taking into account the long-term nature of the Fund's investment strategy and the lower expected return these asset classes have relative to other asset classes.

### **Belief: Fees and costs matter**

The Committee recognises that fees and costs reduce the Fund's investment returns. The Committee considers the fees and costs of its investment arrangements to ensure the Fund is getting value for money and to minimise, as far as possible, any cost leakages from its investment process.

Evidence of Belief in Practice: The Fund employs a combination of active and passive management for its equity and bond assets. Of the Fund's equity allocation, a large proportion is currently invested passively. The Fund also participates in the ACCESS Pool which, in part, seeks to achieve lower annual management charges by benefitting from pooling assets into a more attractive proposition for fund managers.

### **Beliefs: Rebalancing can add value**

Academic studies show that regular rebalancing can help add value over the long-term. As a result, the Fund has put in place agreed tolerance ranges for their liquid assets, with the intention that assets will be rebalanced, at least towards target, should these ranges be breached.

Evidence of Belief in Practice: The Fund has a rebalancing policy and, when individual mandates or asset categories are in breach of a limit, this is discussed at Committee meetings with a view to agreeing upon the most appropriate course of action.

### **Belief: Active management can add value but is not guaranteed**

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The Committee recognises that certain asset classes can only be accessed via active management. The Committee also recognises that active managers may be able to generate higher returns for the Fund (net of fees), or similar returns but at lower volatility, than equivalent passive exposure. The Committee will aim to minimise excessive turnover in its active managers. By carefully selecting and monitoring active managers and recognising that periods of underperformance will arise, the Committee seeks to minimise the additional risk from active management, and continue to monitor active managers to ensure their mandates remain appropriate for the Fund.

Evidence of Belief in Practice: The Fund employs active managers to manage 62% of the Fund's assets. Performance of these managers is reviewed on quarterly basis. For many asset classes, there is no passive management option. However, active managers are employed for bond and equity mandates where a passive equivalent is available.

### **Belief: Passive management has a role to play in the Fund's structure**

The Committee recognises that passive management allows the Fund to access certain asset classes (e.g. equities) on a low cost basis and when combined with active management can help reduce the relative volatility of the Fund's performance.

Evidence of Belief in Practice: The Fund employs a passive manager to manage 38% of the Fund's assets, across equity (33%) and index-linked gilts (5%).

### **Belief: Choice of benchmark index matters**

The Committee recognises that, for each asset class, there is a range of benchmark indices that they could use. As a result, the Committee focus on the benchmark's underlying characteristics and consider how they may be appropriate for the Fund. Choice of benchmark is particularly relevant for passive mandates where the manager's job is to track the index as closely as possible.

Evidence of Belief in Practice: There is a benchmark regional equity allocation in place with the Fund's passive equity manager, which means that a broad allocation to different equity regions is maintained over time. The Fund also invests in a passive fund that replicates an index that is constructed based on a set of factor-based rules (RAFI) and a passive fund that replicates an index that is constructed in such a way as to benefit from a long-term transition to a low carbon economy (Climate Aware Fund).

### **Belief: Environmental, social and corporate governance ('ESG') issues can have a material impact on the long term performance of its investments**

The Committee recognises that ESG issues can impact the Fund's returns and reputation. Given this, the Committee aims to be aware of, and monitor, financially material ESG-related risks and issues through the Fund's investment managers. The Committee commits to an ongoing development of its ESG policy to ensure it reflects latest industry developments and regulations.

Evidence of Belief in Practice: The Committee maintain a responsible investment policy included as an appendix in the ISS and an ESG statement published on the Fund's website.

### **Belief: Climate change presents a financial risk to the future investment returns from the Fund.**

The Committee recognises that climate change issues can impact the Fund's returns and reputation. The impacts of climate change on the returns of the Fund in the future are unknown at this point but the Committee recognises that they need to allocate sufficient time and resource to monitor the possible risks and also identify any investment opportunities which may become available as a result. The committee is aware that not all companies and sectors are affected in the same way by climate change.

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Evidence of Belief in Practice: The Fund's fossil fuel exposure is monitored on a quarterly basis and discussed at Committee meetings. The Fund invests in the UBS Climate Aware Fund which aims to benefit (relative to a market-cap index) from a long-term transition to a low carbon economy.

**Belief: Close engagement with - and challenge to - the investment managers will improve understanding of these risks.**

The Committee believes that investors with long term time horizons are more exposed to certain risks and requires that its investment managers are aware of and consider these when making investments. It is acknowledged that investment managers carry out detailed research on the prospects for individual companies and industries and have access to company management. The Committee meets with investment managers at their regular meetings and has the opportunity to discuss relevant developments in detail. To challenge investments to ensure these are being followed and that all relevant risks have been considered.

Evidence of Belief in Practice: At least one of the Fund's managers is invited to present at quarterly Committee meetings and is questioned on approach to responsible investment. Voting and engagement information is collected on a quarterly basis and used to update the ESG statement.

**Belief: Individual stock selection decisions will be delegated to active managers but the Fund will retain the right to sell holdings in exceptional circumstances.**

The Committee believes that it is the role of its active managers to do the necessary due diligence on each individual stock selection they make. The Committee requires that its active managers provide on request the investment rationale for each investment that they have made. Where the Committee has determined through this engagement with the active manager that the risks posed by a stock outweighs the potential gain they will retain the right to instruct its active managers to sell those holdings. As a result, no restrictions are currently placed on the Fund's active investment managers.

Evidence of Belief in Practice: The Fund's active managers provide quarterly reporting that justifies the purchase, and sale, of a particular holding. Further explanation is also provided when managers present at Committee meetings.

**Belief: The Fund will aim to collaborate with other investors where this is expected to have a positive impact**

The Committee recognises that through active shareholder engagement it can get those companies it is invested in to improve their corporate behavior. Improvements made by these engagements lead to an increase in the long term value of the Fund's investments. The Committee believes that these can be maximized by collaborating with other like-minded investors to increase the pressure for change and encourages improvements to be made.

Evidence of Belief in Practice: The Fund is a member of the LAPFF (Local Authority Pension Fund Forum) which engages widely with companies representing the interest of over 70 LGPS funds. The Fund has also been instrumental in developing the approach of the ACCESS pool in using its influence in this area.

**Belief: The nature of the underlying benchmark is an important consideration, most notably for passive mandates.**

The Committee understands that the underlying benchmark they set their investment managers will drive the behaviour of the managers and the investment risks they will take. The Committee also recognises that for its passive mandates the manager will only buy the stocks within the benchmark they are tracking. The Committee is aware that to ensure it is investing in the way that meets the needs of the Fund it needs to ensure it provides suitable benchmarks for each investment mandate. Therefore, the

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choice of benchmark index by the Committee is very important, will continue to explore the potential for using low carbon indices.

Evidence of Belief in Practice: The Fund has a wide range of equity benchmarks that are replicated by UBS, including a 'fundamental indexation' index (RAFI) and a market-cap index with a discretionary climate change overlay (Climate Aware). The Committee has also recently reviewed the benchmarks and targets in place for the Fund's managers, and amended its reporting accordingly.

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Appendix C



# Responsible Investment Policy

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# Responsible Investment Policy

### Introduction and background

Regulation 7(2) (e) The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 requires an administering authority to demonstrate that it considers any factors that are financially material to the performance of the Fund's investments, including social, environmental and corporate governance factors, depending on the time horizon over which their liabilities arise.

The East Sussex Pension Fund ("the Fund") is a long term responsible investor aiming to deliver a sustainable Pension Fund for all stakeholders. The Fund complies with and follows the principles of the UK Stewardship Code and working within the spirit of the United Nations Principles of Responsible Investment ("UNIPRI").

East Sussex County Council ("the Council") is the administering authority of the Fund and has a fiduciary duty to act in the best, long-term, interests of the Fund's employers and scheme members. The Fund believes that in order to fulfil this duty, it must have a clear policy on how it invests in a responsible manner.

Responsible Investment is a fundamental part of the Fund's overarching investment strategy as set out in its Investment Strategy Statement. That is, to maximise returns subject to an acceptable level of risk whilst increasing certainty of cost for employers, and minimising the long term cost of the scheme. The Fund believes that consideration of Environmental, Social and Corporate Governance ("ESG") factors are fundamental to this, particularly where they are likely to impact on the overarching investment objective.

The Fund's approach aims to ensure that consideration of ESG factors is embedded in the investment process, utilising the various tools available to manage ESG risks and to harness opportunities presented by ESG factors.

### What is our policy on Responsible Investment?

The Fund's core principles of responsible investment are:

- a. We will apply **long-term thinking** to deliver **long-term sustainable returns**.
- b. We will seek **sustainable returns** from **well-governed assets**.
- c. We will use an **evidence-based** long term investment appraisal to inform **decision-making** in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.
- d. We will evaluate and manage **carbon exposure in order to mitigate risks to the Fund from climate change**.

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### What will we do to ensure that these core principles are met?

Core Principle	Associated Actions
<b>We will apply long-term thinking to deliver long-term sustainable returns</b>	<ul style="list-style-type: none"> <li>• The Fund's long-term investment objectives will be detailed in its Investment Strategy Statement.</li> <li>• The Fund will set longer-term performance objectives for its investment managers.</li> <li>• The Fund will seek to ensure that its long term interests are aligned with that of its investment managers on all issues including on RI considerations.</li> <li>• Policies relating to RI will be considered at the Fund's annual investment strategy day as part of the Fund's long term investment planning process.</li> </ul>
<b>We will seek sustainable returns from well-governed assets</b>	<ul style="list-style-type: none"> <li>• The Fund will apply a robust approach to stewardship, linked to the Fund's belief that engagement can positively and effectively influence behaviours.</li> <li>• The Fund will engage with companies when we believe engagement will add value to the Fund or change corporate behaviour for the better.</li> <li>• The Fund is committed to compliance with the UK Stewardship Code and working within the spirit of the United Nations Principles of Responsible Investment ("UNIPRI").</li> <li>• We will hold our investment managers to account to ensure compliance with this policy.</li> <li>• The Fund is committed to collective engagement through its membership of the Local Authority Pension Fund Forum (LAPFF), the ACCESS LGPS pool and other opportunities that arise from time to time.</li> <li>• The Fund will exercise its voting rights in all markets where practicable.</li> </ul>
<b>We will use an evidence-based long term investment appraisal to inform decision-making in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.</b>	<ul style="list-style-type: none"> <li>• The Fund will consider the potential financial impact of RI related issues on an ongoing basis (e.g. climate change or executive remuneration).</li> <li>• The Fund will consider the potential financial impact of investment opportunities that arise from RI related factors (e.g. investment in renewable energies or housing infrastructure).</li> <li>• The Fund will consider investment opportunities that have positive impacts and recognises that the changing external environment presents new opportunities i.e. Renewable energy and social impact investments.</li> </ul>
<b>We will evaluate and manage carbon exposure in order to mitigate risks to the Fund from climate change</b>	<ul style="list-style-type: none"> <li>• The Fund has identified climate change as a potential long-term financial risk.</li> <li>• The Fund will regularly review the tools and solutions available to assess and manage carbon exposure.</li> <li>• The Fund will review its carbon foot print annually both at the Fund and investment manager level.</li> <li>• The Fund will incorporate climate risk assessment as part of the annual investment strategy review (considering the Fund's investment strategy under a range of climate change scenarios, including a 2°C scenario).</li> <li>• The Fund will review the Fund's passive equity benchmarks and consider increasing the use of indices tilted towards low carbon.</li> </ul>



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### How will we monitor our performance on Responsible Investment?

The Fund will ultimately be transparent and accountable in terms of its performance on Responsible Investment. This will be achieved through the following approach:

- The Fund will publish its Investment Strategy Statement on its website in line with the scheme regulations.
- Decisions relating to the setting of investment policy will be explained.
- The Fund will publish its RI policy on its website. We will review it on an ongoing basis, including consulting the Local Pension Board, at least every three years in line with the fund ISS.
- The Fund will monitor closely its appointed investment managers whom the Fund rely on to implement its RI policy.
- The Fund (through the Pension Board) will undertake an annual review of corporate governance, voting and engagement activity undertaken by the Fund and its underlying managers.
- The Fund will publish an annual summary of voting and engagement activity.
- The Fund will disclose the results of the Fund's equity carbon footprint.
- The Fund will ensure that its decision makers are properly trained and kept abreast of ESG issues in order to make informed decisions, including regular RI/UN Sustainable Development Goals training.
- The Fund will include RI as a standing item on Pensions Committee and the Pension Board agendas (with a view to reporting on manager performance in relation to RI investing and noting any hot topics / issues arising).
- The Fund will undertake a fundamental review of any specific RI issues considered by the Pension Committee to be of potentially material financial impact.
- The Fund actively considers RI capabilities and advice when selecting and monitoring its investment advisors.
- The Fund expects its investment advisors to proactively consider and integrate RI issues when providing investment advice to the Fund.
- The Fund will consider and respond to feedback from stakeholders in relation to issues of concern.

### Responsible Investment and ACCESS LGPS

The implementation of the Fund's investment strategy will be undertaken by the ACCESS Pool. These are eleven funds committed to collaboratively working together to meet the criteria for pooling and have signed an Inter Authority Agreement to underpin their partnership. It is expected that the Fund's ability to invest in a responsible way will be enhanced through the ACCESS LGPS Pool due to the inherent benefits of scale and innovation that will result from the collaboration.

### Engagement versus Exclusion

East Sussex Pension Fund has never sought to implement a policy that explicitly excludes certain types of investments, companies or sectors except where they are barred by UK law. The Fund believes that its influence as a shareholder is better deployed by engaging with companies, in order to influence behaviour and enhance shareholder value. The Fund believes that this influence would be lost through a divestment or screening approach. Ultimately the Fund will always retain the right to disinvest from certain companies or sectors in the event that all other approaches are unsuccessful and it is determined that the investment is no longer aligned with the interests of the Fund or that the issue poses a material financial risk. Under pooling it is likely that any such decision will need to be made in conjunction with other members of the ACCESS pool.

The Fund's approach to engagement recognises the importance of working in partnership to magnify the voice and maximise the influence of investors as owners. The Fund appreciates that to gain the attention of companies in

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addressing governance concerns; it needs to join with other investors sharing similar concerns. It does this primarily through:

- Membership of representative bodies including LAPFF;
- Membership of the Pensions and Lifetime Savings Association (PLSA);
- Giving support to shareholder resolutions where these reflect concerns which are shared and affect the Fund's interests;
- Joining wider lobbying activities when appropriate opportunities arise.

### Exercise of Voting Rights

The Fund continues to exercise its ownership rights by adopting a policy of actively voting stock it holds, and delegate's responsibility for voting to its appointed investment managers who are required to vote wherever the Fund has a voting interest. Wherever practicable, votes must be cast in accordance with the voting guidelines for investment managers of ACCESS ACS (Authorised Contractual Scheme).

The ACCESS Pool appointed operator, Link Fund Solutions Limited ("LFS") recognises that as the Manager of the ACCESS ACS, it has a responsibility as a shareholder, and to its investors the ACCESS funds, to promote good corporate governance and management in the companies in the ACS, which the Fund invests and it requires investment managers appointed to manage the Fund to exercise the voting rights attached to investments held in the Fund unless market circumstances make it impossible to do so. The document sets out guidelines to which LFS expects investment managers to have regard in the exercise of voting rights on behalf of the Fund however LFS recognises that in certain cases there may be good reasons not to follow the guidelines set out in this document and in those circumstances LFS expects its investment managers to exercise their discretion having regard to the long-term interests of the shareholders in the Fund and the principles of good corporate governance. LFS requires investment managers to report on voting activity monthly.

Where investment managers do not adopt the positions set out in these guidelines, it is required that they should provide a robust explanation of the position adopted. LFS also expects that investment managers will be signatories to and comply with the Financial Reporting Council's Stewardship Code (the Code) and United Nations Principles of Responsible Investment (UNPRI). If they have not signed up to either the Code or UNPRI they should be prepared to explain the reasons.

The Fund is committed to the UK Stewardship Code and has developed a statement of compliance for assessment by the Financial Reporting Council.