CT/18/92
Investment & Pension Fund Committee
16 November 2018

STRATEGIC INVESTMENT REVIEW

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Board before taking effect.

Recommendations: **That the Committee:**

(1) Allocates an initial £100 million to the Brunel Low Volatility Equities Portfolio, consistent with the medium term target allocations set out in the Investment Strategy Statement.

(2) Commissions Mercer investment consultants to carry out a refresh of the investment review carried out in 2016/17 with a view to bringing a report to the February meeting of the Committee with proposals for revising the Investment Strategy Statement for 2019/20.

1. Introduction

1.1. During 2016/17 Mercer Investment Consultants conducted a strategic review of the Fund's Investment Strategy. The outcome of the review was presented to the Investment and Pension Fund Committee and fed into the Investment Strategy Statement that was agreed by the Committee in February 2017. The Mercer report recommended a long term plan with intermediate steps, and the asset allocation strategy included in the Investment Strategy Statement encompasses the first steps towards the long term plan recommended.

1.2. Over the last two years the world economy has moved on, and the committee has considered at recent training events some emerging risks and new investment ideas. There is also more clarity around the timetable for transition to the Brunel portfolios. However, before considering bringing new ideas into the investment strategy it would be sensible to consider how they would fit into the current strategy and the potential impact on the overall strategy of a change in direction for some elements of the asset allocation.

1.3. This report therefore reviews the current position of the Devon Pension Fund, and proposes that the Committee should commission Mercer to undertake a "refresh" of their previous report and recommendations, with a view to bringing a report to the February meeting of the Committee with proposals for revising the Investment Strategy Statement for 2019/20.

2. Current Position

2.1. The current approved Investment Strategy Statement is set out at Appendix 1 of the report. In response to the previous review undertaken by Mercer a number of initial steps were proposed that have subsequently been taken forward. These include:

- A phased move of the passive equity allocation from UK to global, in order to reduce the risk of over-concentration of the UK market in financial services and the mining sector.

- Transfer of all of the allocation managed by Wellington to their multi-sector credit fund. Previously it had been split between multi-sector credit and global bonds.
- Making a commitment of 3% of the fund to private debt, of which as at the end of September around 1% had been drawn down.
- An additional £75 million has been committed to Infrastructure, and is awaiting investment by Brunel.

2.2. In addition to the above the Investment Strategy Statement includes a commitment to some further changes in the medium-term target allocation. These include:

- Transfer of the specialist funds into the Brunel Global Small Cap Portfolio when it is launched.
- Transfer of the global bonds mandate currently managed by Lazard into the Brunel Sterling Corporate Bonds Portfolio when it is launched.
- Transfer of 7% of the total fund from Global Passive Equity to Active Low Volatility Equities, in order to reduce risk.

2.3. Two of the changes set out in paragraph 2.2 are awaiting the launch of portfolios by Brunel which are still some time off. However, the move to low volatility equities could be undertaken fairly quickly, as Brunel have completed the procurement of managers for their Low Volatility Equities Portfolio and are due to launch it within the next month. This is considered in section 3 of the report.

3. Low Volatility Equities

3.1. Low volatility equity strategies invest in stocks which when combined provide a portfolio which has a lower expected absolute volatility than a traditional market cap index, thereby reducing risk. They can provide a useful counter-balance to higher-risk areas of the market (such as small cap equities and emerging markets). While it would generally be expected that higher risk assets generate higher returns over the longer term, there is now evidence suggesting that high volatility stocks have not earned superior returns relative to low volatility stocks over long periods. They can therefore provide useful exposure to uncorrelated drivers of return.

3.2. As with any change in strategy the timing of the change is often key to its successful implementation. At the time of Mercers' review it was considered that low volatility stocks looked relatively expensive compared to the broader market. In addition, low volatility equities have been seen by yield-seeking investors as a proxy for fixed income assets. With interest rates beginning to rise, there was the potential for low volatility stocks to underperform. President Trump's proposed expansionary fiscal policy and infrastructure spending was expected to support cyclical stocks and therefore benefit those stocks at the expense of the defensive stocks found in low volatility indices.

3.3. As a result the allocation to low volatility equities was put into the medium term target allocation, but not proposed for implementation in the short term. However, recent consideration of increased risks to equity markets suggests that now would be the time to consider making an initial allocation. The 7% medium term target allocation would currently equate to around £300 million. Mercers' original recommendation was that an allocation to low volatility equities should be built up over time and should be phased in as market conditions (and the availability of suitable vehicles through the Brunel Pool) make the opportunity more attractive. Mercers have confirmed that this advice would still stand.

3.4. It is therefore proposed that an initial £100 million should be allocated to the Brunel Low Volatility Equity portfolio at the earliest opportunity, to be funded from the current Developed World Passive Equity allocation. Further allocations would then be made in due course subject to further review.

4. Further Risk Management Considerations

4.1. In recent meetings and at training days the Committee have considered the current risks facing the fund, together with the improved indicative funding level provided by the Fund Actuary. In September the Committee approved the addition of a risk linked to Brexit to the Fund's risk register.

4.2. Training days have also addressed risks in relation to global trade, interest rate rises and the elevated level of world share indices. The last training session addressed the question of whether now is the time to de-risk, and looked at potential de-risking strategies, such as equity protection using derivatives.

4.3. However, the consideration of potential de-risking strategies needs to be looked at in the context of the Fund's medium to long term investment plan. Taking a scatter-gun approach to making allocations to new investment ideas for short term advantage may risk longer term investment objectives.

4.4. Therefore, it is proposed to re-commission Mercer to undertake a further review of the Fund's investment strategy. The aim of the review would be to look at the recommendations previously made, taking into consideration the current environment and fresh ideas around risk management. Given that a large element of the review would be based on the work previously undertaken, it would be more of a "refresh" than starting with a blank piece of paper. A significant element of the original review was to recommend changes that would help to reduce the overall level of risk, but without reducing the Fund's investment return potential, and a refresh would therefore build on that approach, and could therefore be undertaken at a lower cost than would be the case for a full review.

5. Conclusion

5.1. It is a statutory requirement to keep the Fund's investment strategy under review. The proposal to commission Mercer to undertake a refresh of their previous work will meet this requirement, and also enable the full consideration of current thinking on risk management. Given the timescale required for the review it will not enable changes to be made in time to safe guard the Fund's position at the 2019 Triennial Valuation, or to mitigate the perceived risks to markets in the next 6 months from Brexit. However, it will enable the Fund to take a considered view of its medium to long term investment strategy, rather than reacting to short term events.

5.2. At the same time, it is proposed to make an initial allocation to Brunel's Low Volatility Equities Portfolio, given that it is in line with the current strategy included within the Fund's Investment Strategy Statement, and is also in line with Mercers' current thinking.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
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Appendix 1

Devon County Council Pension Fund Investment Strategy Statement

Revised by the Investment and Pension Fund Committee
23 February 2018

1. Introduction

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require administering authorities to formulate and to publish a statement of its investment strategy, in accordance with guidance issued from time to time by the Secretary of State. The administering authority must invest, in accordance with its investment strategy, any Fund money that is not needed immediately to make payments from the Fund.

The regulations provide a new prudential framework, within which administering authorities are responsible for setting their policy on asset allocation, risk and diversity. The Investment Strategy Statement will therefore be an important governance tool for the Devon Fund as well as providing transparency in relation to how Fund investments are managed.

The Devon Pension Fund's primary purpose is to provide pension benefits for its members. The Fund's investments will be managed to achieve a return that will ensure the solvency of the Fund and provide for members' benefits in a way that achieves long term cost efficiency and effectively manages risk. The Investment Strategy Statement therefore sets out a strategy that is designed to achieve an investment return consistent with the objectives and assumptions set out in the Fund's Funding Strategy Statement.

We are long term investors: we implement our strategies through investments in productive assets that contribute to economic activity, such as equities, bonds and real assets. We diversify our investments between a variety of different types of assets in order to manage risk.

The Investment Strategy Statement will set out in more detail:

(a) The Devon Fund's assessment of the suitability of particular types of investments, and the balance between asset classes.
(b) The Devon Fund's approach to risk and how risks will be measured and managed, consistent with achieving the required investment return.
(c) The Devon Fund's approach to pooling and its relationship with the Brunel Pension Partnership.
(d) The Devon Fund's policy on how social, environmental or corporate governance considerations are taken into account in its investment strategy, including its stewardship responsibilities as a shareholder and asset owner.

Under the previous regulations the Fund was required to comment on how it complied with the Myners Principles. These were developed following a review of institutional investment by Lord Myners in 2000, and were updated following a review by the National Association of Pension Funds in 2008. While a statement on compliance with the Myners Principles is no longer required by regulation, the Devon Pension Fund considers the Myners Principles to be a standard for Pension Fund investment management. A statement on compliance is included at Annex 1.

This statement will be reviewed by the Investment and Pension Fund Committee at least triennially, or more frequently should any significant change occur.

2. Investment strategy and the process for ensuring suitability 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 dependants, in accordance with LGPS Regulations.

The Funding Strategy and Investment Strategy are intrinsically linked and together aim to deliver stable contribution rates for employers and a reduced reliance on employer contributions over time. The Funding Strategy Statement can be found on the Fund's website at:

https://www.peninsulapensions.org.uk/pension-fund-investments/devon-county-council-investments/devon-fund-key-documents/

The investment objective is therefore 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 Fund. Having a thorough understanding of the risks facing the Fund is crucial and these are covered later in this statement

The Fund has the following investment beliefs which help to inform the investment strategy derived from the decision making process.

- Funding, investment strategy and contribution rates are linked.
- The strategic asset allocation is the key factor in determining the risk and return profile of the Fund's investments.
- Investing over the long term provides opportunities to improve returns.
- Diversification across asset classes can help to mitigate against adverse market conditions and assist the Fund to produce a smoother return profile due to returns coming from a range of different sources.
- Managing risk is a multi-dimensional and complex task but the overriding principle is to avoid taking more risk than is necessary to achieve the Fund's objectives.
- Environmental, Social and Governance are important factors for the sustainability of investment returns over the long term. More detail on this is provided in Section 5.
- Value for money from investments is important, not just absolute costs. Asset pooling is expected to help reduce costs over the long-term, whilst providing more choice of investments, and therefore be additive to Fund returns.
- Active management can add value to returns, albeit with higher short-term volatility.

The Fund's current investment strategy, along with an overview of the role each asset plays is set out in the table below:

Asset Class	Target Allocation 2018/19 (%)	Medium Term Target Allocation (%)	Role(s) within the Strategy
Equities	58	58	
Global and UK Passive	43	36	Generate returns through capital gains and income through exposure to the shares of domestic and overseas companies; indirect links to inflation. The Fund invests in a range of actively and passively managed equity strategies to gain diversified exposure to global equity markets, using active managers and non-market cap indexation where appropriate and in the expectation that these will add value. Within this allocation are holdings in a number of specialist equity funds to gain exposure to a diverse range of return drivers (including small cap equities and focussed, activism funds).
Global Active	5	5	
Emerging Markets Active	5	5	
Specialist Funds	5	-	
Low Volatility Equity	-	7	
Global Small Cap Equity	-	5	
Fixed Interest	13	13	
Global Bonds	6	-	The Fund invests in a number of global bond investments, to provide diversified exposure to sovereign and corporate bond markets. These are expected to generate less volatile returns than equities, but also to generate returns above those available on domestic sovereign bonds ("gilts"). Within these holdings, the Fund uses active management, and permits its fund managers a degree of flexibility to switch between underlying asset classes and credit qualities to enhance expected returns
Corporate Bonds	-	6	
Multi-Sector Credit	6	6	
Cash	1	1	Held to meet benefit payments

Asset Class	Target Allocation 2018/19 (%)	Medium Term Target Allocation (%)	Role(s) within the Strategy
Alternatives / Other	29	29	
Diversified Growth	13	9	Deliver returns in excess of inflation, with a reasonably low correlation to traditional equity markets and providing a degree of downside protection in periods of equity market stress; opportunity for dynamic asset allocation.
Property	10	10	Generate inflation linked returns through income and capital appreciation via investment in global property markets, whilst providing some diversification away from equities and bonds.
Infrastructure / Private Markets	6	10	The Fund invests in a diversified portfolio of infrastructure investments, in order to gain exposure to attractive returns and investments with a degree of inflation linkage in the income stream generated. In the medium term, the Fund intends to increase exposure to private markets (equity and credit) to benefit from diversified sources of return (including illiquidity and complexity premia).

Full details of the current investment managers and their respective performance benchmarks are included in Annex 2.

Asset allocation varies over time through the impact of market movements and cash flows. The overall balance is monitored regularly, and if the allocations move more than 2.5% away from the target consideration is given to rebalancing the assets taking into account market conditions and other relevant factors.

The Investment and Pension Fund Committee is responsible for the Fund's asset allocation which is determined via strategy reviews undertaken as part of the valuation process. The last review of the investment strategy was in 2016/17 and was both qualitative and quantitative in nature, and was undertaken by the Committee in conjunction with officers and independent advisers. The review considered:

- The required level of return that will mean the Fund can meet its future benefit obligations as they fall due.
- An analysis of the order of magnitude of the various risks facing the Fund.
- The requirement to meet future benefit cash flows.
- The desire for diversification across asset class, region, sector, and type of security.

Following the latest investment strategy review, the Committee agreed in 2017 to a number of revisions to the long term investment strategy. These changes include increasing diversification within the equity and fixed income holdings, and also implementing an allocation to private market investments in order to generate returns in excess of inflation, through exposure to companies that are not publicly traded and which therefore provide an "illiquidity premium" whilst providing some diversification away from listed equities and bonds. Details of the agreed medium-term strategy are given in the "medium term target allocation" column above.

In accordance with the requirements of the LGPS (Management and Investment of Funds) Regulations 2016, the Investment Strategy will not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with the Authority within the meaning given by applicable legislation.

3. Risk measurement and management

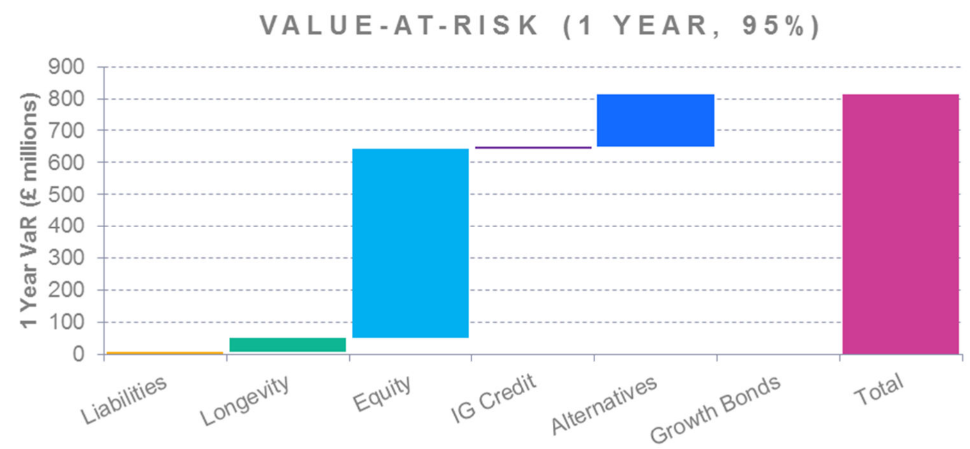
Successful investment involves taking considered risks, acknowledging that the returns achieved will to a large extent reflect the risks taken. There are short-term risks of loss arising from default by brokers, banks or custodians but the Fund is careful only to deal with reputable counter-parties to minimise any such risk.

Longer-term investment risk includes the absolute risk of reduction in the value of assets through negative returns (which cannot be totally avoided if all major markets fall). It also includes the risk of under-performing the Fund's performance benchmark (relative risk).

Different types of investment have different risk characteristics and have historically yielded different rewards (returns). Equities (company shares) have produced better long-term returns than fixed interest stocks but they are more volatile and have at times produced negative returns for long periods.

In addition to targeting an acceptable overall level of investment risk, the Committee seeks to spread risks across a range of different sources, believing that diversification limits the impact of any single risk. The Committee aims to take on those risks for which a reward, in the form of excess returns, is expected over time.

The graph below provides an indication of the main sources of investment risk (estimated by Mercer) to the funding position, as measured using a 1 year Value at Risk measure at the 5% level.



Note: "IG Credit" risk represents investment grade credit risks within Fund's fixed income mandates.

The key investment risks that the Fund is exposed to are:

- The risk that the Fund's growth assets in particular do not generate the returns expected as part of the funding plan in absolute terms.
- The risk that the Fund's assets do not generate the returns above inflation assumed in the funding plan, i.e. that pay and price inflation are significantly more than anticipated and assets do not keep up.
- That there are insufficient funds to meet liabilities as they fall due.

- That active managers underperform their performance objectives.

At Fund level, these risks are managed through:

- Diversification of investments by individual holding, asset class and by investment managers.
- Explicit mandates governing the activity of investment managers.
- The appointment of an Independent Investment Advisor.

The external investment managers can control relative risk to a large extent by using statistical techniques to forecast how volatile their performance is likely to be compared to the benchmark. The Fund can monitor this risk and impose limits.

The Fund is also exposed to operational risk; this is mitigated through:

- A strong employer covenant.
- The use of a Global Custodian for custody of assets.
- Having formal contractual arrangements with investment managers.
- Comprehensive risk disclosures within the Annual Statement of Accounts.
- Internal and external audit arrangements.

The ultimate risk is that the Fund's assets produce worse returns than assumed by the Actuary, who values the assets and liabilities every three years, and that as a result, the solvency of the Fund deteriorates. To guard against this the Investment Principles seek to control risk but not to eliminate it. It is quite possible to take too little risk and thereby to fail to achieve the required performance.

The Fund also recognises the following (predominantly non-investment) risks:

Longevity risk: this is the risk that the members of the Fund live longer than expected under the Actuarial Valuation assumptions. This risk is captured within the Actuarial Valuation report which is conducted at least triennially and monitored by the Committee, but any increase in longevity will only be realised over the long term.

Sponsor Covenant risk: the financial capacity and willingness of the sponsoring employers to support the Fund is a key consideration of the Committee and is reviewed on a regular basis.

Liquidity risk: the Committee recognises that there is liquidity risk in holding assets that are not readily marketable and realisable. Given the long term investment horizon, the Committee believes that a degree of liquidity risk is acceptable, given the potential return. The majority of the Fund's assets are realisable at short notice.

Regulatory and political risk: across all of the Fund's investments, there is the potential for adverse regulatory or political change. Regulatory risk arises from investing in a market environment where the regulatory regime may change. This may be compounded by political risk in those environments subject to unstable regimes. The Committee will attempt to invest in a manner which seeks to minimise the impact of any such regulatory or political change should such a change occur.

Exchange rate risk: this risk arises from unhedged investment overseas. The Fund has a currency hedging policy in place, hedging between 50% and 100% of its exposure to currency risk on passive equity holdings. For other asset classes, currency hedging is reviewed on a case-by-case basis.

Cashflow risk: the Fund is cashflow negative, in that income and disinvestments are required from the Fund's investments to meet benefit outgoes. Over time, it is expected that the size of pensioner cashflows will increase as the Fund matures and greater consideration will need to be given to raising capital to meet outgoings. The Committee recognises that this can present additional risks, particularly if there is a requirement to sell assets at inopportune times, and so looks to mitigate this by taking income from investments where possible.

Governance: members of the Committee and Local Pension Board participate in regular training delivered through a formal programme. Both the Committee and Local Pension Board are aware that poor governance and in particular high turnover of members may prove detrimental to the investment strategy, fund administration, liability management and corporate governance and seeks to minimise turnover where possible.

4. Approach to asset pooling

The Devon Pension Fund is working with nine other administering authorities to pool investment assets through the Brunel Pension Partnership Ltd. (BPP Ltd). This is currently work in progress with the intention of meeting the Government's requirement for the pool to become operational and for the first assets to transition to the pool from April 2018.

Once the Brunel Pension Partnership Ltd. is established the Devon Pension Fund, through the Pension Committee, will retain the responsibility for setting the detailed Strategic Asset Allocation for the Fund and allocating investment assets to the portfolios provided by BPP Ltd.

The Brunel Pension Partnership Ltd will be a new company which will be wholly owned by the Administering Authorities. The company will seek authorisation from the Financial Conduct Authority (FCA) to act as the operator of an unregulated Collective Investment Scheme. It will be responsible for implementing the detailed Strategic Asset Allocations of the participating funds by investing Funds assets within defined outcome focused investment portfolios. In particular it will research and select the Manager Operated Funds needed to meet the requirements of the detailed Strategic Asset Allocations. These Manager Operated Funds will be operated by professional external investment managers. The Devon fund will be a client of BPP Ltd and as a client will have the right to expect certain standards and quality of service. A detailed service agreement is being drafted which will set out the duties and responsibilities of BPP Ltd, and the rights of Devon Fund as a client. It includes a duty of care of BPP to act in its clients' interests.

An Oversight Board will be established. This will be comprised of representatives from each of the Administering Authorities. It will be set up by them according to an agreed constitution and terms of reference. Acting for the Administering Authorities, it will have ultimate responsibility for ensuring that BPP Ltd delivers the services required to achieve investment pooling. It will therefore have a monitoring and oversight function. Subject to its terms of reference it will be able to consider relevant matters on behalf of the Administering Authorities, but will not have delegated powers to take decisions requiring shareholder approval. These will be remitted back to each Administering Authority individually.

The Oversight Board will be supported by the Client Group, comprised primarily of pension investment officers drawn from each of the Administering Authorities but will also draw on Administering Authorities finance and legal officers from time to time. It will have a primary role in reviewing the implementation of pooling by BPP Ltd, and provide a forum for discussing technical and practical matters, confirming priorities, and resolving differences. It will be responsible for providing practical support to enable the Oversight Board to fulfil its monitoring and oversight function.

The proposed arrangements for asset pooling for the Brunel pool have been formulated to meet the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and Government guidance. Regular reports have been made to Government on progress towards the pooling of investment assets, and the Minister for Local Government has confirmed that the pool should proceed as set out in the proposals made.

Devon County Council has approved the full business case for the Brunel Pension Partnership. It is anticipated that investment assets will be transitioned across from the Devon Pension Fund's existing investment managers to the portfolios managed by BPP Ltd between April 2018 and March 2020 in accordance with a timetable that will be agreed with BPP Ltd. Until such time as transitions take place, the Devon Pension Fund will continue to maintain the relationship with its current investment managers and oversee their investment performance, working in partnership with BPP Ltd. where appropriate.

Following the completion of the transition plan outlined above, it is envisaged that all of the Devon Pension Fund's assets will be invested through BPP Ltd. However, the Fund has certain commitments to long term illiquid investment funds which will take longer to transition across to the new portfolios to be set up by BPP Ltd. These assets will be managed in partnership with BPP Ltd. until such time as they are liquidated, and capital is returned.

5. Social, environmental and corporate governance policy

The Devon Pension Fund has a fiduciary duty to seek to obtain the best financial return that it can for its members. This is a fundamental principle, and all other considerations are secondary. However, the Devon Pension Fund is also mindful of its responsibilities as a long term shareholder, and the Investment and Pension Fund Committee has considered the extent to which it wishes to take into account social, environmental or ethical issues in its investment policies. The Devon Fund's policy is to support engagement with companies to effect change, rather than disinvestment.

In the light of that overarching approach the following principles have been adopted:-

(a) The Devon Fund seeks to be a long term responsible investor. The Fund believes that in the long term it will generate better financial returns by investing in companies and assets that demonstrate they contribute to the long term sustainable success of the global economy and society.

(b) Social, environmental and ethical concerns will not inhibit the delivery of the Devon Fund's investment strategy and will not impose any restrictions on the type, nature of companies/assets held within the portfolios that the Devon Fund invests in.

(c) It is recognised, however, that the interests of investors on social etc. grounds may coincide with those solely on investment grounds in which case there will be no conflict of interest. Indeed, the Committee believes that in the long run, socially responsible and fiduciary investment will tend to come together since adverse performance on social, environmental or ethical issues will ultimately be reflected in share prices.

(d) The Devon Pension Fund will seek to engage (through the Brunel Pension Partnership, its asset managers or other resources) with companies to ensure they can deliver sustainable financial returns over the long-term as part of comprehensive risk analysis. In the example of fossil fuels, this will mean engaging with oil companies on how they are assessing their business strategy and capital expenditure plans to adapt to changes in cost base and regulation that will ensure the continued delivery of shareholder returns in the medium to long term. Engagement with companies is more likely to be successful if the Fund continues to be a shareholder.

(e) Although social, environmental and ethical issues rarely arise on the agendas of company Annual General Meetings, where an issue does arise the Council's external investment managers will only vote if it is in the Fund's interest on investment grounds. Some issues may be incorporated into generally accepted Corporate Governance Best Practice (e.g. the inclusion of an Environmental Statement in the Annual Report and Accounts). In this case the Council will instruct its external investment managers to vote against the adoption of the Annual Report, if no such statement is included.

(f) The Devon Pension Fund recognises the risks associated with social, environmental and governance (ESG) issues, and the potential impact on the financial returns if those risks are not managed effectively. The Fund therefore expects its external fund managers to monitor and manage the associated risks. As the Devon Fund moves towards the new arrangements for the pooling of investments it will work with its partners in the Brunel pool and the Brunel Pension Partnership Limited company to ensure that robust systems are in place for monitoring ESG risk, both at a portfolio and a total fund level, and that the associated risks are effectively managed.

(g) The Pension Board regularly reviews all the Fund's statutory statements. Their views will be taken into account in setting the Devon Fund's environmental, social and governance policies. The Fund also holds an annual consultative meeting with fund members which provides the opportunity for discussion of investment strategy and consideration of non-financial factors.

6. Policy of the exercise of rights (including voting rights) attaching to investments

The Devon Pension Fund is fully supportive of the UK Stewardship Code, published in July 2010, and the Committee accepts the rights and responsibilities that attach to being a shareholder and will play an active role in overseeing the management of the companies in which it invests. During 2018 we will develop this further by seeking to become tier 1 signatories to the code. As part of the Brunel Pension Partnership (BPP) we are actively exploring opportunities to enhance our stewardship activities. More information is on the BPP website:

https://www.brunelpensionpartnership.org/

The following section sets out the Fund's policy in relation to the seven principles of the UK Stewardship Code, including its policy on the exercise of rights, including voting rights, attached to investments:

(a) Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

The Devon Pension Fund aims to be a supportive, long term shareholder. It believes that by discharging stewardship responsibilities it can enhance and protect the value of the Fund in the best interests of pension fund members and other stakeholders.

The Committee will support the latest widely accepted standards of Best Practice in Corporate Governance and will expect the companies in which it invests to comply therewith. It will use its influence as a shareholder to persuade the Directors of any companies that do not already comply to adopt Best Practice.

The Devon Fund appoints external managers to manage its investments. In the future it will make its investments via the Brunel Pension Partnership. As a result the Fund's policy is to apply the Stewardship Code through its arrangements with its asset managers and through membership of the Local Authority Pension Fund Forum (LAPFF).

The Fund will expect its external investment managers to:

(i) Vote at all UK company meetings and all overseas company meetings where practical to do so.
(ii) Seek to develop a long-term relationship and an understanding of mutual objectives and concerns with the companies in which we invest.
(iii) Meet regularly with those companies to discuss corporate strategy and objectives, and to make an assessment of management performance.
(iv) Have processes in place to ensure access to accurate information regarding companies in which we invest, including the approach to corporate governance adopted by the company.
(v) Intervene when a company fails to meet expectations in terms of traditional governance inputs (such as board structures) but also the outputs of governance such as acquisitions and operational performance.

The Fund's external investment managers will judge whether to support a company by subscribing to a rights issue, accepting a take-over bid or other similar events purely on investment grounds.

The Fund will actively monitor how each of its external investment managers is carrying out stewardship responsibilities over the Fund's assets. This will include:

(i) Quarterly reporting from each of the Fund's equity managers on their stewardship activity, including details of the votes cast at company meetings, and where they have voted against company recommendations.
(ii) Meetings between Fund representatives and the external managers to review performance, including stewardship activity.
(iii) Quarterly reporting to the Investment and Pension Fund Committee on external investment managers' stewardship activity.
(iv) Raising of issues of concern with external investment managers, for example where committee members have a clear view on an issue being proposed at a company meeting, or where LAPFF notify the fund of a significant proposal at a company meeting. The Fund may encourage the external investment manager to vote in a particular way, and will require the external investment manager to report back on how it intends to vote or has voted.

Seven of the Fund's eight main external investment managers as at 31 December 2017 are Tier 1 signatories to the UK Stewardship Code, the other is a Tier 2 signatory. In addition, the fund has smaller investments in four funds managed by other external investment managers, of whom two are Tier 1 signatories, one is a Tier 2 signatory and one is not a signatory to the UK Stewardship Code.

(b) Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

Devon County Council has a robust Code of Conduct and Conflicts of Interest policy, which all members of the Investment and Pension Fund Committee (whether Devon County Councillors or not) are required to adhere to. The policies can be found at:

http://democracy.devon.gov.uk/ieListDocuments.aspx?CId=416&MId=2487&Ver=4&info=1

Investment and Pension Fund Committee members are required to make declarations of interest prior to committee meetings in line with the Council's code of conduct and interest rules. This would ensure that if committee members had any personal interests in any company that the Fund invests in that may have an impact on stewardship activity then those interests would be declared and managed.

External investment managers will be expected to act in the Fund's interests when considering matters such as engagement and voting. The Fund will expect its fund managers to:

(i) Put in place and maintain a policy for managing conflicts of interest.
(ii) Ensure that any significant conflicts of interest are disclosed.

The Fund has reviewed the position of all the external investment managers who manage equity holdings on its behalf. Each has an appropriate conflicts of interest policy in place. The Fund will regularly review the position of its external investment managers and the Brunel Pension Partnership to make sure that their conflicts of interest policies are kept up-to-date.

(c) Institutional investors should monitor their investee companies.

Day-to-day responsibility for managing the Fund's assets is delegated to external investment managers, and the Fund expects them to monitor the companies they invest in, intervene where necessary, and report back regularly on activity undertaken.

The Fund will expect its external investment managers to

(i) Satisfy themselves, to the extent possible, that the investee company's board and committee structures are effective, and that independent directors provide adequate oversight, including by meeting the chairman and, where appropriate, other board members.
(ii) Maintain comprehensive records of governance engagements, votes cast and the reasons for voting against management or abstaining.
(iii) Attend General Meetings selectively when they consider it is of value to our investment to do so.

The Fund will engage with its investment managers at regular quarterly meetings, and via phone calls and email correspondence. Each of the Fund's main investment managers is expected to provide a summary of their stewardship activity for inclusion in the Fund's Annual Report. Once the Brunel Pension Partnership becomes operational the Fund will expect Brunel to assess the effectiveness of engagement via an external benchmarking service.

In addition the Fund receives an 'Alerts service' from LAPFF which highlights corporate governance issues of concern at investee companies. These alerts are shared with the relevant asset managers, who are then expected to report back on how they intend to vote / have voted. The Fund reviews Quarterly engagement reports provided by LAPFF at Pension Committee meetings.

(d) Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

As highlighted above, responsibility for day-to-day interaction with companies is delegated to the Fund's asset managers, including the escalation of engagement when necessary. The Fund will expect its external investment managers to escalate activities if a company fails to meet expectations. The most important issues for us are:

- Strategy - including acquisitions and the deployment of capital
- Operational performance
- Quality of the Board
- Succession planning
- Management of environmental / climate change risk
- Health & Safety
- Risk management
- Remuneration
- Corporate social responsibility

The Fund will expect its external investment managers to engage with the board in order to better understand what is behind such concerns. Engagement should be regularly reviewed and its success assessed.

Escalation by the Fund's managers may include:

(i) Additional meetings with management.
(ii) Intervening jointly with other institutions – e.g. Fund managers have shown support for LAPFF alerts by publishing their voting intention online prior to AGMs.
(iii) Writing a letter to the board or meeting the board.
(iv) Submitting resolutions at general meetings and actively attending to vote.

Actions by managers are considered and undertaken on the basis of protecting and enhancing client value. Individual manager guidelines for such activities are disclosed in their own statement of adherence to the Stewardship Code. Each of the Fund's external investment managers provide a summary of their engagement activity, including examples of where they have intervened, that is published in the Devon Pension Fund's Annual Report.

On occasion, the Fund may itself choose to escalate activity, principally through engagement activity coordinated by the Local Authority Pension Fund Forum.

(e) Institutional investors should be willing to act collectively with other investors where appropriate.

As a general rule we believe the effectiveness of engagement is considerably increased when we find common ground with other shareholders. The Fund will therefore encourage its fund managers to work with collective bodies or collaborate with other shareholders if they believe this will increase the chance of success.

The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), an association of local authority pension funds who act collectively with a view to achieving the highest standard of corporate governance and corporate social responsibility amongst the companies in which they invest.

Representatives of the Committee and Fund officers are able to attend LAPFF's quarterly management meetings and the Annual Conference, which provides them with the opportunity to input to the priority areas for LAPFF to engage with companies on. Details of the Fund's holdings are provided to LAPFF on a regular basis, which enables LAPFF to assess the quantum of member funds' holdings when they are seeking to engage with companies.

LAPFF focuses its collaborative engagement on the following areas:

(i) Leadership on key campaigns, such as Board diversity.
(ii) Promotion of good governance.
(iii) Management of environmental risk.
(iv) Social and reputational risks such as employment standards.

As part of the LGPS pooling initiative, the Fund will also expect the Brunel Pension Partnership to foster collaboration with its client LGPS Funds on voting and engagement which should improve transparency of voting and embed best practice.

(f) Institutional investors should have a clear policy on voting and disclosure of voting activity.

Responsibility for the exercise of voting rights has been delegated to the Fund's appointed investment managers who adopt their own voting guidelines. The Fund requires its managers to exercise all votes attached to its UK equity holdings, and to seek to vote where practical in overseas markets. This includes consideration of company explanations of compliance with the Corporate Governance Code. The Fund believes that the investment managers are best placed and have the necessary insight to vote in the best interests of its clients and align voting to the investment decision. Regular reports are received from asset managers on how votes have been cast.

While it is not practical to publish each individual vote on every stock held, the Fund will publish summary information, and will monitor activity on key governance themes, and how the external investment managers have cast their votes in comparison to other shareholders and LAPFF recommendations.

Information on voting policies and voting records can also be found on the extermal investment managers' websites.

Details of Managers' voting policies and vote reporting:

Manager	Link
State Street	https://www.ssga.com/content/ssga/softlinks/global/en/about-us/asset-stewardship.html/
UBS	https://www.ubs.com/global/en/asset-management/investing/responsible-investment.html
Aberdeen Asset Management	http://aboutus.aberdeen-asset.com/en/aboutus/expertise/equities/stewardship/delivery
Montanaro	http://www.montanaro.co.uk/about-us/ethical-and-esg-investing
Other Specialist Fund Managers (RWC / BMO / Fabian Pictet)	Voting records are not published on their websites, but details of votes cast and engagement undertaken are made available to the Devon Fund

The Fund permits holdings in its segregated portfolios to be lent out to market participants. The Fund retains the right to recall loaned stock or block stock from being loaned from its segregated portfolios should the Fund wish to not lend the stock for any reason. The stock lending policy on pooled Funds is determined by the individual investment managers.

(g) Institutional investors should report periodically on their stewardship and voting activities.

The Investment and Pension Fund Committee will monitor the fund managers' engagement with the companies they have invested in, through the regular reporting arrangements in place. The managers' voting records will be reported to Committee on a quarterly basis. The engagement activity undertaken by LAPFF will also be reported to Committee on a quarterly basis, together with a record of voting alerts issued by LAPFF, how the Fund's investment managers have voted on the proposals concerned and the outcome of the votes.

The external investment managers produce an annual summary of their engagement activity for inclusion within the Devon Pension Fund Annual Report. From 2017/18 the Annual Report will include a report focusing on stewardship and voting activity. This will include details of investment manager activity, voting analysis, LAPFF alert analysis, engagement, case studies and collaboration

As part of its annual review of the Internal Control Reports of its managers, the Fund has identified the voting process as an area which is tested within the controls environment. All of the Fund's managers are independently verified by an external auditor, details of which are found in their ISAE 3402 made available by request or publicly on their websites. Where there are exceptions the Fund seeks clarification from managers.

7. Advice Taken

This Investment Strategy Statement has been put together by Devon County Council's professional investment officers, supported by the Fund's Independent Investment Advisor, and with advice from Mercer LLC investment advisors, who have conducted a review of the Fund's investment strategy and asset allocation. Mercer were selected to undertake the investment review following a procurement exercise through the South West LGPS Framework for the Supply of Actuarial, Benefits and Investment Advisory Services, administered by the Environment Agency.

The Devon Fund has committed to pooling investments through the Brunel Pension Partnership Limited (BPP Ltd.), and advice from the Brunel Client Officer Group project team has also been taken into account in shaping the Devon response to the pooling initiative and building an investment strategy that can be implemented via BPP Ltd. once it becomes operational.

The key people who have been consulted and who have provided advice in drawing up the Investment Strategy Statement are:

The Investment and Pension Fund Committee

This County Council Committee, which includes Unitary and District Council and other employer representatives and those of the contributors and the pensioners (non-voting), carries out the role of the Administering Authority. It has full delegated authority to make decisions on Pension Fund matters. In particular it:

- decides the Investment Principles;
- determines the fund management structure;
- reviews investment performance;

The Devon Pension Board

While not a decision making body, the Pension Board has been set up to assist the Administering Authority in securing compliance with legislation and regulation and the effective and efficient governance of the Fund. Members of the Pension Board were included in a consultation workshop on the investment strategy, and regularly review the Fund's statutory statements.

County Treasurer: Mary Davis BA (Hons), CPFA

The County Treasurer advises the Committee and ensures that it is informed of regulatory changes and new developments in the investment field and implements the Committee's decisions. Mary Davis is a CIPFA qualified accountant and has been the County Treasurer and Section 151 Officer for Devon County Council since 2008. Mary has responsibility for Devon County Council's finances, including responsibility for the Devon Pension Fund. Mary has a BA (Hons) degree in Economics.

Assistant County Treasurer Investments: Mark Gayler ACMA, IMC

Mark Gayler has been Assistant County Treasurer, Investments and Treasury Management at Devon County Council since 2013. Mark heads up the investment team responsible for overseeing the Devon Pension Fund, as well as undertaking treasury management for the council. Mark is a CIMA qualified accountant and holds the CFA Level 4 Certificate in Investment Management. Mark has 28 years of experience within local government, and first moved to the Investment Team in 2010, initially as Deputy Investment Manager.

Investment Manager: Daniel Harris BSc (Hons) IMC

Daniel Harris has been an Investment Manager in the Investment Team since 2013, acting as the deputy to the Assistant County Treasurer. Dan has worked within finance for Devon County Council since 2006. Prior to joining Devon County Council he worked for a Private Banking Company, managing investment portfolios for high wealth clients. Dan has a BSc (Hons) degree in Pure Mathematics and holds the Investment Management Certificate.

Independent Investment Advisor: Steve Tyson BSc (Hons), Chartered FCSI, Allenbridge Epic

Steve is the independent adviser to the LGPS for Devon County Council and Gloucestershire County Council Pension Funds. He has over 35 years' investment experience and holds a portfolio of trustee and advisory positions. Formerly Steve was a public member of Network Rail and a NED of Manulife Asset Management. His last full-time role was as Chief Investment Officer and CEO of Manulife Asset Management from 2004-2012, responsible for £4 billion of assets under management and advice in a variety of asset allocation and equity strategies. During his career, Steve managed a wide range of DB and DC pension funds and has specialised in strategic and tactical asset allocation strategies. Steve is a Chartered Fellow of the Chartered Institute for Securities and Investment

Mercer LLC Investment Consultants:

Tessa Page, Principal

Tess is a Senior Principal at Mercer and an LGPS strategy specialist, with close to 15 years' pensions and investments experience. Tess joined Mercer in 2011, having previously worked at JLT (formerly HSBC Actuaries and Consultants). She has a Masters in Biochemistry from the University of Oxford and is a Fellow of the Institute and Faculty of Actuaries.

James Giles, Senior Associate

James is a Senior Associate within Mercer's investment consulting practice, with over 10 years' experience advising public and private sector pension schemes on all aspects of investment strategy, implementation and monitoring. James has a BA (Hons) in Politics, Philosophy and Economics from the University of Manchester, and is a Fellow of the Institute and Faculty of Actuaries.

Brunel Client Officer Group

The Brunel Client Officer Group has provided support with regard to the impact on strategy of the investment pooling proposals. The group comprises the investment officers from the Avon Pension Fund (Bath and NE Somerset Council), Buckinghamshire CC, Cornwall Council, Devon CC, Dorset CC, Gloucestershire CC, Oxfordshire CC, Somerset CC, Wiltshire Council and the Environment Agency.

Annex 1 – Compliance with the Myners Principles

The Committee has considered the 6 Myners Principles and is of the view that the Fund currently complies with the spirit of these recommendations. Further details are given below on each of the 6 principles.

1. Effective Decision Making

The County Council has a designated Committee whose terms of reference are to discharge the duties of the Council as the Administering Authority. There is a training programme for Committee members. They also have external and internal advisers and are supported by an experienced in-house team to oversee the day to day running of the Fund. Representatives of the Fund's contributors and pensioners, although not voting members, advise the Committee on the views of their members. The Administering Authority is supported by a Pension Board, whose role is to assist them in securing compliance with legislation and regulation and the effective and efficient governance of the Fund.

2. Clear Objectives

This document sets out clear objectives in relation to the split of assets between Equities and Bonds, investment in Diversified Growth Funds, and other assets such as Property.

The Committee is aware of the Fund's current deficit and its investment policy is designed to gradually improve solvency whilst keeping employers' contribution rates as constant as possible. A key objective of the Fund's strategy is to manage the fund to ensure a healthy cash-flow for the foreseeable future.

3. Risk and Liabilities

The Committee has considered the mix of assets that it should adopt and the level of risk (volatility of returns) it is prepared to accept. This document sets out current policy, which is designed to improve the Fund's solvency while only accepting moderate risk.

The Committee will regularly review the benefits of using the full range of asset classes.

4. Performance Assessment

In the award of mandates to individual investment managers the Investment and Pension Fund Committee has set benchmarks for each asset class, as set out in Annex 2. The total fund is measured against a bespoke benchmark based on the Fund's strategic asset allocation.

The Fund uses the services of its custodian bank to provide an independent measurement of investment returns. These are used for comparison purposes against specific and peer group benchmarks.

The Investment and Pension Fund Committee receive quarterly performance reports and are therefore able to consider the performance of all asset classes and managers on a regular basis, focusing on the longer term. These considerations form the basis of decision making.

5. Responsible Ownership

Section 6 of this document, on the Policy of the exercise of rights (including voting rights) attaching to investments, sets out the Fund's commitment to responsible ownership. The management agreements with the Fund's investment managers include provision for them to engage with companies in compliance with the terms of the Combined Code and the Council's voting policy as set out in this document. The Fund is also a member of the Local Authority

Pension Fund Forum (LAPFF).The Fund has investments in specialist pooled funds that are specifically designed to be activist. This document sets out the Council's policy on voting.

6. Transparency and Reporting

This Investment Strategy Statement is available to any interested party on request. The latest version is available on the Peninsula Pensions website.

In accordance with LGPS (Administration) Regulations 2008, the Devon Pension Fund has published a Communications Policy Statement, which can be viewed at: https://www.peninsulapensions.org.uk/wp-content/uploads/2013/08/Devon-Pension-Fund-Communications-Policy.pdf,

which describes the Fund's policy on:

- Providing information to members, employers and representatives,
- The format, frequency and method of distributing such information,
- The promotion of the Fund to prospective members and their employing bodies.

The Fund will continue to develop the Peninsula Pensions website, which it considers to be its primary communications channel.

Annex 2 – Current Managers and Mandates

Manager	**Mandate**	**Target**
Aberdeen Asset Managers Ltd	Global Equity	Outperform FTSE World Index by 3% per annum over rolling 3 and 5 year periods
Aberdeen Asset Managers Ltd	Global Emerging	Outperform MSCI Emerging Markets Index by 2-4% per annum over rolling 3 year periods
State Street Global Advisors Ltd	Passive Equities	Performance in line with FTSE World market specific indices
UBS Global Asset Management (UK) Ltd	Passive Equities	Performance in line with FTSE All Share Index
UBS Global Asset Management (UK) Ltd	Passive Equities (Alternative Indexation)	Performance in line with FTSE RAFI / MSCI World Quality / MSCI World Minimum Volatility Indices
Lazard Asset Management LLC	Global Fixed Interest	Outperform Barclays Capital Global Aggregate Bond Index by 1% per annum
Wellington Management International Ltd	Global Fixed Interest	Outperform Barclays Capital Global Aggregate Bond Index by 1% per annum
Wellington Management International Ltd	Multi Sector Credit	Outperform composite of 1/3 Bank of America Merrill Lynch Global High Yield Constrained Index, 1/3 JP Morgan Emerging Markets Bond Index Plus, and 1/3 CS Leveraged Loan Index
Baillie Gifford and Co.	Diversified Growth Fund	Outperform Bank of England Base Rate by 3.5% per annum net of fees
Barings Asset Management Ltd	Diversified Growth Fund	Outperform LIBOR by 4% per annum
Aviva Investors Global Services Ltd	Property	Outperform the IPD UK PPF All Balanced Funds Index
DCC Investment Team	Specialist Equity Funds	Outperform FTSE World Index
DCC Investment Team	Infrastructure Funds	Outperform GBP 7 Day LIBID
DCC Investment Team	Cash	Outperform GBP 7 Day LIBID