

INVESTMENT STRATEGY STATEMENT ('ISS')

ISLE OF WIGHT COUNCIL PENSION FUND – MARCH 2017

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.

This ISS has been designed to be a living document and is an important governance tool for the Fund. This document sets out the investment strategy of the Fund, provides transparency in relation to how the Fund investments are managed, acts as a risk register, and has been designed to be informative but reader focused. This document replaces the Fund's Statement of Investment Principles.

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

2. Investment Beliefs and Objectives

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
- Risk mitigation will be prioritised according to size of potential impact and risks will only be taken where they are expected to be rewarded
- Environmental, Social and Governance considerations are important factors for the sustainability of investment returns over the long term
- Value for money from investments is important, not just absolute costs. Asset pooling will help reduce costs whilst providing more choice of investments and will therefore be additive to Fund returns.
- High conviction active management can add value to returns

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, in accordance with the Local Government Pension Scheme ("LGPS") regulations and statutory provisions.

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.

3. Investment strategy and the process for ensuring suitability of investments.

As noted above, the Fund's objective is to pay benefits as they fall due and this requires the build-up of sufficient reserves in advance. The Fund is currently assessed to have a deficit in terms of the reserves needed and so the asset strategy is focused on achieving returns in excess of gilts, without taking undue risk. Having a thorough understanding of the risks facing the Fund is crucial and these are covered later in this statement.

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

Asset class	Allocation %	Allowable ranges %	Role (s) within the strategy
Equity	55.0	+/-6%	Long term growth in excess of inflation expected
Diversified Growth Fund	15.0	+/-4%	Diversification and Tactical Asset Allocation
Fixed Income	22.0	+/-4%	Diversified source of return from a range of sources. Not specifically income generating
Property	8.0	+/-4%	Diversification. Generates investment income; Returns expected to be inflation-sensitive Exposure to Illiquidity premium

The Pensions Committee is responsible for the Fund's asset allocation which is determined via a triennial strategy review as part of the valuation process, but is kept under constant review; noting that strategic changes are an evolutionary process.

The triennial review looks at both qualitative and quantitative analysis, covering:

- The required level of return that will mean the Fund can meet its future benefit obligations as they fall due
- The level of risk that the Fund can tolerate in absolute terms, and in relation to its funding level and deficit
- An analysis of the order of magnitude of the various risks facing the Fund is established in order that a priority order for mitigation can be determined

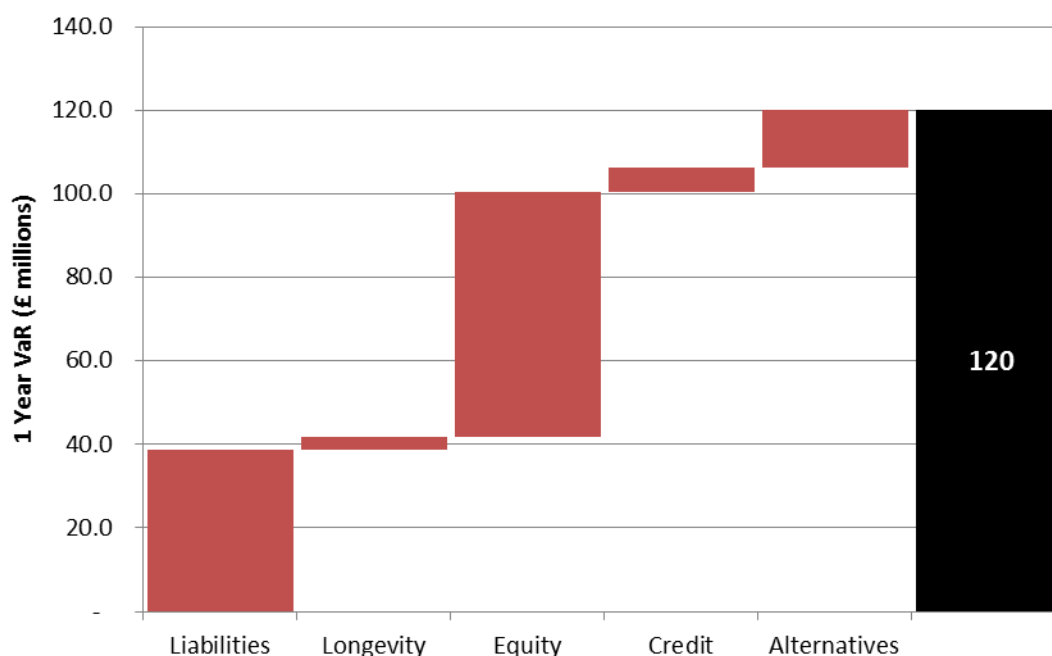
- The desire for diversification across asset class, region, sector, and type of security

4. Risk measurement and management

The Committee assesses risks both qualitatively and quantitatively, with the starting point being the triennial strategy review. Risks are considered, understood and then prioritised accordingly.

A Investment Risks

The Committee uses Risk Attribution Analysis to determine the order of magnitude of the main investment risks the Fund is facing. The chart below shows the VaR (Value at Risk, essentially the losses that would occur in a 1-in-20 event) facing the Fund, split into major risk categories.



As an additional illustration of risk, the table below shows how a range of events could impact the Fund:

Event	Event movement	Impact on Deficit
Fall in equity markets	20% fall in equities	£56m
Rise in Inflation	1% increase in inflation	£75m
Fall in interest rates	1% fall in interest rates	£75m
Active Manager underperformance	3% underperformance from all active managers	£14m

As shown in both the Value-at-Risk attribution chart and the table above, the most significant risk that the Fund is running is in relation to equities. Whilst not immaterial the risks being run by the use of active management is far smaller.

Equities – One of the largest risks that the Fund is running is in relation to its equity holdings. Should equity market conditions deteriorate significantly this will have a negative impact on the funding level. The Fund holds equities in order to provide the necessary returns to ensure that the Fund remains affordable. The Committee believes that the extra returns that are expected to be generated by equities compensates the level of risk equities bring to the Fund, but does believe in diversification, and looks to mitigate equity risk by investing significantly in bonds and alternatives. The Fund is a long term investor but does require income over and above contributions received in order to pay pensions. A strategy is therefore being developed that would seek income from alternative assets and bonds, rather than from equities, in order to avoid being a forced seller at a low point in the market.

Liabilities – The other major risk the Fund is running is in relation to its unhedged liabilities which are impacted by changes in real gilt yields. The Fund's liabilities are sensitive to inflation as future pensions are linked to inflation and the cashflow out of the Fund will increase as inflation increases. The liabilities are sensitive to changes in gilt yields as these are used to place a current value on the future payments, as this yield falls the present value of the liabilities increases.

Alternatives – The Fund has a significant amount of assets allocated to a range of alternatives, with allocations to property and diversified growth. The risks that these investments bring at an individual level is not insignificant however the Committee believe that over the long term alternatives will provide returns that compensate for the risks being run. Additionally the level of diversification the assets provide helps to reduce the Funds reliance on returns from equities. Illiquid assets such as property are also a valuable source of income.

Active Manager Risk – Investment Managers are appointed to manage the Fund's investments on its behalf. This risk is small relative to other risks; however the Fund still addresses this risk. Extensive due diligence is used before managers are selected, with a number of different managers chosen to prevent concentration risk. The investment managers are also monitored regularly by the Committee, Officers and by the Fund's Advisors.

The Fund's portfolio is well diversified across asset classes, geography and asset managers. As different asset classes have varying correlations with other asset classes, the Fund by investing in a range of different investments can minimise the level of risk run to a degree.

B Demographic Risks

The Fund is subject to a range of demographic risks, but with particular reference to investment strategy, the Committee is aware of the potential for the Fund to mature over time as the pensioner liability increases. A mature pension fund is likely to take less investment risk over time and this is considered at each strategy review. The more

mature a pension fund, the more likely it is that disinvestments would need to be made to pay benefits. The Fund is not in that situation at present as income from contributions and investments are greater than benefit payments. However, this situation is monitored regularly and formally as part of the actuarial valuation and strategy review.

C Cashflow Management Risks

As noted above, the Fund is marginally cash flow positive after taking investment income into account. However, this position will be reviewed regularly and is a factor that is incorporated into the Fund's investment strategy reviews in order that a portfolio of income generating assets is built up over time.

D Governance Risks

The Fund believes that there is a benefit to the Fund to be gained from good governance in the form of either or both of an increased return and/or decreased risk. Poor governance can lead to opportunities and risks being missed, and have a detrimental effect on the funding level and deficit.

Details of the Fund's governance structure can be found in the Governance Compliance Statement in the Fund's annual report and accounts.

E Environmental, Social & Governance ('ESG') Risks

The committee recognises that social, environmental and ethical considerations are among the factors which investment managers will take into account, where relevant, when selecting investments for purchase, retention or sale. Each of the Fund Managers has produced a statement setting out its policy in this regard. The managers have been delegated by the committee to act accordingly.

4. Approach to asset pooling

Isle of Wight is a member of the ACCESS pool along with the following 10 other pension funds:

- East Sussex
- Essex
- Hampshire
- Hertfordshire
- Cambridgeshire
- Kent
- Norfolk
- Northamptonshire
- Suffolk
- 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 (this will be updated for the proposed Inter Authority Agreement, once concluded). ACCESS is working to a project plan in order to create the appropriate means to pool investments. The first investments to be pooled in 2017 will be passively managed investments.

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

All 11 ACCESS funds are working in the expectation that all investments will be pooled apart from a minority of investments where there is a no value for money benefit to pooling a specific investment as identified and agreed by an individual fund.

5. Voting Rights

The Committee has delegated the exercise of voting rights to the investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the managers have produced written guidelines of their process and practice in this regard. Copies of the Fund Managers' latest corporate governance reports are available from the Technical Finance Manager. The managers are encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies.

6. Environmental, Social and Corporate Governance policy and policy of the exercise of rights (including voting rights) attaching to investments

The Pension Fund Committee must act with the best financial interests of the beneficiaries, present and future, in mind. The Pension Fund Committee believes that companies should be aware of the potential risks associated with adopting practices that are socially, environmentally or ethically unacceptable. As part of the investment decision-making process, Investment Managers are required to consider such practices and assess the extent to which this will detract from company performance and returns to shareholders.

Investment Managers are required to exercise voting rights on behalf of the Pension Fund when it is in the best interests of the Pension Fund. The quarterly report from investment managers should include details of voting activity.

The 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. The Fund actively engages with companies through its investment managers.

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.

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

Myners Principles

Although not specifically referenced in the Regulations, the Committee feels that assessment of compliance with the Myners Principles is a valuable governance tool. A copy of the Fund's Myners Compliance Statement can be found in the appendix.

Advice Taken

In creating this statement, the Fund has taken advice from its Investment Consultant. Also, in relation to each of the constituent parts, such as the asset allocation and risk mitigation, the Fund has taken advice from its Investment Consultant, Mercer, and the Scheme Actuary, Hymans Robertson. In providing investment advice, Mercer is regulated by the Financial Conduct Authority.

Appendix A – Myners Principles

Principle 1 Effective Decision Making:

Administering authorities should ensure:

- That decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and
- That those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Principle 2 Clear objectives:

An overall investment objective should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.

Principle 3 Risk and liabilities:

- In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.
- These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

Response on Adherence Compliant

Decisions are taken by the Committee which is responsible for the management of the Fund.

The Committee has support from council officers with sufficient experience to assist them. The Committee also seeks advice from professional actuarial and investment advisers to ensure it can be familiar with the issues concerned when making decisions. A training needs analysis was undertaken by the Committee in January 2012, resulting in a training plan being developed and delivered for the financial year 2012-2013.

The training needs analysis was refreshed to inform a new training delivery plan for 2013-14 and beyond. The Committee hold a one hour training session before every Committee meeting.

The Committee is able to make robust challenges to advice and is aware of where potential conflicts of interest may reside within the Committee and in relation to service providers.

Compliant

The Committee has established objectives for the Fund which takes account of the nature of fund liabilities and the contribution strategy. This involved discussions with the actuary to enable the Committee to set the overall risk budget for the Fund. This is reflected in the investment mandates awarded to the asset managers.

There is dialogue with admitted bodies within the fund in relation to the contributions they pay, their capacity to pay these contributions and the level of guarantees they can provide.

Compliant

The investment strategy is considered in the light of the nature of the fund liabilities, the timescale over which benefits will be paid, and financial and demographic factors affecting the liabilities, such as inflation and improving longevity.

The Committee and council officers have discussed the contribution strategy with the actuary taking account of the strength of covenant of the council and its long term horizon. Discussions have also taken place with admitted bodies in relation to the affordability of contributions and the strengths of their covenants.

Principle

Principle 4 Performance assessment:

- Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.
- Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.

Principle 5 Responsible Ownership:

Administering authorities should

- Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee (ISC) Statement of Principles on the responsibilities of shareholders and agents.
- Include a statement of their policy on responsible ownership in the Statement of Investment Principles.
- Report periodically to scheme members on the discharge of such responsibilities.

Principle 6 Transparency and Reporting:

Administering authorities should

- Act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives.
- Should provide regular communication to scheme members in the form they consider most appropriate.

**Response on Adherence
Partially Compliant**

The performance of the Fund and its individual managers are monitored on a regular basis. The quality of advisers is assessed on a qualitative basis but is not formally measured. Advisers are subject to periodic re-tender. The Committee is developing formal processes to measure its own effectiveness.

Partially Compliant

The Committee encourages its Investment Managers to adopt the ISC Statement of Principles on the responsibilities of shareholders and agents on the Fund's behalf. This Statement of Investment Principles includes a statement on the fund's policy on responsible ownership. The Committee needs to consider the implications of the UK Stewardship Code (issued in September 2012) to ensure it is fully compliant with the new requirements.

Compliant

The Committee maintains minutes of meetings which are available on the council website. The Committee holds a formal annual meeting for members and also meets periodically with sponsoring employer bodies. An Admitted Bodies representative and a Member representative attend Committee meetings. The Statement of Investment Principles is published on the council website and is available to members on request. Other information on the scheme is available to members on the council website.