Kent Pension Fund

[DRAFT] Investment Strategy Statement

December 2023

Introduction and purpose

Kent County Council (the "Council") is the administering authority for the Kent Pension Fund (the "Fund"). The Council is required by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the "Regulations") to formulate and publish an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State for Levelling Up, Housing and Communities.

The Fund must invest any fund money that is not needed immediately for the payment of benefits and the purpose of the Investment Strategy Statement (the "ISS") is to document the principles, beliefs and policies by which the administering authority manages the investment assets of the Fund.

Governance

The Council has delegated to the Pension Fund Committee (the "Committee") all the powers and duties of the Council in relation to its functions as an administering authority. The Committee is responsible for setting investment strategy, carrying out regular reviews, and monitoring the Fund's investments.

The role of the Kent Local Pension Board (the "Board") is to assist the Committee to comply with legislative and regulatory requirements, and to ensure the effective and efficient governance and administration of the Local Government Pension Scheme.

The Committee can create non-decision making working groups, constituted from its own membership, to enable the Committee to explore and examine specific themes and subjects in greater technical detail. Two such groups are in operation at the time of writing: the Responsible Investment Working Group and the Risk Management Group. These bodies enhance the Fund's investment governance capacity; they report their findings to the Committee, which remains the sole decision-making authority.

The latest version of the ISS was approved by the Committee on **XX XX XXXX.** The Fund has taken proper advice from the Fund's investment consultant, Mercer (the "Investment Consultant") in formulating its investment strategy.

As set out in the Regulations the ISS is subject to review at least every three years and from time to time depending on any material change in investment policy or other matters as required by law.

Scope

Regulation 7(2) requires that the ISS must address the follow matters:

- a requirement to invest money in a wide range of investments
- the authority's assessment of the suitability of particular investments and types of investments

- the authority's approach to risk, including the ways in which risks are to be measured and managed
- the authority's approach to pooling investments, including the use of collective investment vehicles and shared services
- the authority's policy on how social, environmental, or corporate governance considerations are taken into account in the selection, non-selection, retention, and realisation of investments, and
- the authority's policy on the exercise of rights (including voting rights) attaching to investments.

Links to the Funding Strategy Statement

The Funding Strategy Statement (FSS) aims to establish a clear and transparent strategy that will identify how participating employers' pension liabilities are best met going forward. To determine the value of accrued liabilities and derive future contribution requirements it is necessary to discount the Fund's future cash flows to present day values. The discount rate used in the actuarial valuation is derived by considering the long-term expected return from the Fund's long-term investment strategy, with a deduction applied for prudence. This ensures consistency between the funding strategy and investment strategy.

Accordingly, there is a fundamental link between the FSS and the ISS relating to the discount rate that underlies the funding strategy as set out in the FSS, and the expected rate of investment return which is expected to be achieved by the long-term investment strategy as set out in the in this document.

Investment Objectives

The Fund's primary purpose is to pay pensions, and lump sums and other benefits to Scheme Members as provided for under the Local Government Pension Scheme Regulations 2013. This primary objective is set out in more detail in the FSS.

The investment objective for the Fund is to ensure that over the long term it will have sufficient assets, when taken in conjunction with future contributions, to meet pension liabilities as they fall due. At the present time, the Fund's aim is to achieve at least an investment return in line with that set by the Fund Actuary for the 3-year valuation period, presently 4.5% p.a. based on the 2022 valuation results.

In order to achieve the investment objective the investment strategy seeks to:

- maximise returns for a given level of risk
- ensure liquidity requirements are met at all times
- achieve and maintain 100% funding level
- maintain stable employer contribution rates.

Asset Allocation

The Fund recognises that diversification is key to managing portfolio risks. Assets are invested across different asset classes and distinct investment management styles are combined with the aim of securing sufficient and stable returns and using risk efficiently.

The Fund recognises that the likelihood of achieving the investment objective is heavily influenced by the choice of strategic asset allocation. The Fund reviews its strategic asset allocation via periodic investment strategy reviews and in order to ensure that its asset allocation policy remains appropriate, reviews will normally take place every three years. However, a review may be undertaken sooner if there is a material change in the investment or regulatory environment, or in the circumstances of the Fund itself.

The Investment Consultant supports the Fund in determining its strategic asset allocation through the provision of professional advice.

The Committee reviewed the Fund's investment strategy following the 2022 triennial valuation and approved the Fund's current strategic asset allocation policy (shown in the following table) in September 2023.

Asset Class	Strategic Asset Allocation (%)
Equities	**53**
UK Equities	10
Global Equities	38
Emerging Market Equities	5
Fixed Income	**22**
Credit	15
Risk Management Framework (Index Linked Gilts)[1]	7
Alternatives	**25**
Absolute Return	5
Infrastructure	5
Private Equity	5
Property	10
Total	**100**

Compared to the Fund's previous Strategic Asset Allocation, the current policy has a reduced allocation to UK equities and increased exposure to Global Equities and Emerging Market Equities to better align the strategic asset allocation with their respective weights in global markets. Fixed income also has an enhanced role within the current Strategic Asset Allocation through the introduction of a new allocation to Index Linked Gilts, which also supports the risk management framework of the Fund.[1]

Rebalancing Policy

The actual distribution of the Fund's assets will be affected by a range of factors including market movements, manager performance and cashflows into and out of the Fund. Over time there is therefore the potential for the asset allocation to drift away from the target allocation, potentially changing the agreed risk return characteristics of the Fund's portfolio.

[1] The Risk Management Framework is discussed in further detail under Suitability.

The Fund's current rebalancing policy is based on rebalancing ranges, as established in the following table.

Asset Class	Strategic Asset Allocation (%)	Tolerance Range (%)	Tolerance Band (%)
Equities	**53**	**43 – 63**	**+/- 10**
UK Equities	10	7.5 – 12.5	+/- 2.5
Global Equities	38	33 – 43	+/- 5
Emerging Market Equities	5	2.5 – 7.5	+/- 2.5
Fixed Income	**22**	**17 – 27**	**+/- 5**
Credit	15	10 – 20	+/- 5
RMF	7	-	-
Alternatives	**25**	**15 – 35**	**+/- 10**
Absolute Return	5	-	-
Infrastructure	5	-	-
Private Equity	5	-	-
Property	10	-	-
Cash	**0**	**0 - 5**	**+ 5**
Total	**100**		

Rebalancing is considered quarterly with the decision taken as a standing item at the Committee meeting. Rebalancing is based on the position shown in the latest available month-end valuation data.

The tolerance ranges are set sufficiently wide so that a degree of flexibility remains.
For the purpose of the rebalancing policy, the Fund defines High Level Asset Classes as: Equities, Fixed Income, Alternatives and Cash. The Fund defines Sub-asset Classes as UK Equity, Global Equity, Emerging Markets Equity, Multi Asset Credit, the Risk Management Framework, Property, Private Equity, Infrastructure and Diversified Growth.

Rebalancing is based on both High Level Asset Classes and Sub-asset Classes for Equities (including UK Equity, Global Equity and Emerging Markets Equity) and Fixed Income (including Multi Asset Credit and the Risk Management Framework) and as a High Level Asset Class for Alternatives. Alternatives includes Property, Private Equity, Infrastructure and Absolute Return.

The Risk Management Framework is excluded from the rebalancing framework. Collateral adequacy is more important than the actual allocation to the Risk Management Framework. The Committee reviews collateral adequacy quarterly in order to determine if there was a shortage or surplus of collateral.

For the purposes of reviewing the Fund's position versus the rebalancing ranges, the total synthetic equity exposure from the Total Return Swaps within the Risk Management Framework should added to the Fund's relevant physical sub-asset class equity exposures. The equivalent amount should be deducted from the Risk Management Framework valuation. For clarity, the mark-to-market value (whether positive or negative) of the Fund's equity protection overlay structure should be included as part of the Risk Management Framework's value.

Decisions of where to either invest or disinvest cash within the asset and sub-asset class categories specified will be at the discretion of the Committee and should take into consideration the following: relative weights versus strategy, liquidity and transaction costs, medium term market views, short term sector/geographical outlook, tactical asset allocation considerations and confidence of the Committee in the manager's ability to meet performance targets (taking into account manager ratings).

Regular rebalancing is only made between the Fund's liquid assets. Within alternatives, this means rebalancing could involve adjusting the allocation to Diversified Growth to offset over or underweights to property, private equity and infrastructure. However, the Committee should have a strategy to manage the illiquid assets relative to their strategic allocation. This could involve pacing analysis to determine how much capital to deploy to the illiquid strategies and/or the use of listed alternatives.

Unless there is good reason otherwise, rebalancing is undertaken to bring the over or underweight asset class back to approximately the mid-point between its target allocation and the current position to reduce transaction costs and regret risk (should markets reverse shortly after rebalancing takes place).

The Fund also uses cash flows where possible to maintain the target allocations.

Suitability

The suitability of the Fund's investment assets has been determined in the context of its investment and funding objectives.

In assessing suitability, the Fund evaluates the expected returns and expected volatility of particular asset classes together with the correlations between asset classes and the diversification benefits available from combining different asset classes.

The current Strategic Asset Allocation has been established using the Investment Consultant's long term capital market expectations at the time of the most recent triennial valuation (31 March 2022).

The Fund has a central expectation for the current Strategic Asset Allocation to generate an expected annual return of 5.7% over the long term.

The Fund makes use of illiquid investments (such as infrastructure, private equity and property), recognising that investors are expected to be rewarded over the long term for bearing liquidity risk. In setting and reviewing its strategic asset allocation, the Fund further considers the legality of all investments for compliance with the LGPS.

The investment strategy is implemented via external fund managers (including ACCESS, as set out under Pooling below) and there is no internal investment management other than of cash flow. The Fund has a policy of appointing specialist managers with the necessary skills in managing specific investment strategies which should help the Fund to meet its long-term investment objectives.

The Investment Consultant supports the Fund in the implementation of its Investment Strategy, which includes advice on the suitability and appointment of investment managers. An investment management agreement and/or prospectus is in place for each investment mandate which sets out the relevant investment objectives, asset allocation ranges and restrictions, performance targets and relevant benchmark as determined by the Committee. The list of current investment manager arrangements is set out at Appendix 1.

The Committee monitors the Fund's investment management arrangements on an ongoing basis to ensure their continuing suitability. Monitoring is supported via the provision of in-house performance reporting, together with ongoing reporting from the Investment Consultant on appointed investment managers and the investment strategy (including the Risk Management Framework).

Risk Management Framework

The Fund uses a derivatives overlay (the "Equity Protection Programme") as an effective means of implementing its investment strategy. The equity protection programme enables the Fund to efficiently manage the volatility emanating from its equities allocation while still ensuring the Fund has sufficient upside potential to meet its investment return target. As such equity protection provides the Fund with greater flexibility in establishing its targeted risk exposure.

In order to ensure it has an adequate and sustainable collateral pool available to support the equity protection programme, and that it has sufficient exposure to equity risk premia, the Fund obtains some of its equity exposure via Total Return Swaps (synthetic equity) within the same investment mandate as the Equity Protection Programme.

The Fund's allocation to Index Linked Gilts serves a dual purpose of providing exposure to inflation linked UK sovereign bonds, and acting as a source of collateral for the Equity Protection Programme and the Total Return Swaps. In aggregate, this arrangement is referred to as the Risk Management Framework for investment governance purposes.

The Committee is experienced in overseeing a derivatives overlay programme but recognises that this arrangement necessitates a higher governance outlay. The Committee ensures it has the requisite governance capabilities in place to monitor and manage the Risk Management Framework. Proper advice on the implementation and ongoing monitoring of the Framework is provided by the Investment Consultant while specialist investment management expertise has been obtained via the appointment of investment manager, Insight. The Committee has also maintains a Risk Management Group to support the Committee in maintaining sufficient oversight of the Risk Management Framework.

Approach to Risk

The Fund recognises that risk is an intrinsic feature of investment activity. The Fund has identified several key risks that may impact on its investment strategy and funding position, which are set out below together with appropriate mitigations. The Committee takes proper advice from its Investments Consultants on investment risks.

Risk	Mitigation
Equity risk	The largest risk the Fund is exposed to relates to its equity holding. Equity risk arises from the inherent volatility within equity market returns. Should equity markets deteriorate significantly, this will have a negative impact on the Fund's funding level. The Fund holds equities in order to generate sufficient investment returns so that employer contributions remain affordable. In order to manage equity risk, the Fund invests in managers with a variety of investment styles and has implemented an equity protection programme to limit the impact of falls in global equity markets. It also maintains a disciplined approach to rebalancing to ensure current risk exposures remain within tolerance.
Asset class concentration risk	Asset class concentration risk is a risk that any impact of adverse economic conditions affecting a particular asset class poses an outsized risk to the Fund's funding level and that the risk is not mitigated by investments in other asset classes. The Fund mitigates this risk through the establishment of a diversified investment strategy that pays attention to correlations between asset classes. Frequent and periodic rebalancing protects the Fund from maintain concentrated exposures that are not aligned with its target strategic asset allocation policy.
Active manager risk	Active manager risk is the risk that a fund manager underperforms a pre-established benchmark. The Committee believes that good active managers will add value to the Fund over the long term. The risk is small relative to asset class risk; nevertheless, the Fund addresses the risk through diversification of its exposure to active managers and careful monitoring of their investment performance and process. The Fund evaluates manager performance through regular reporting and through regular meetings with appointed fund managers.
Inflation risk	Inflation risk is the risk that a rise in inflation erodes the value of the investment returns required by the Fund to meet its pension liabilities. The Fund partially mitigates this risk by investing in asset classes that seek to provide returns in excess of inflation, or whose return is a direct function of inflation. Additionally, equities, property and infrastructure investments aim to achieve an indirect linkage to inflation.
Foreign exchange rate risk	The Fund invests in overseas assets. Foreign exchange rate risk is the risk that the value of the Fund's reporting currency, GBP, strengthens in comparison to other currencies (and affects the Fund's ability to realise the stated value of its global investments). The Fund is a long-term investor and can withstand short term currency fluctuations. The Fund monitors its overseas investment currency exposure but has not made

	arrangements to hedge this risk.
Alternative asset classes risk	The Fund invests in a range of alternative assets, which often have higher levels of volatility and higher illiquidity when compared to some traditional asset classes. However, the Committee judges that these assets are suitable where they produce sufficiently high expected returns and diversification benefits that reduce the Fund's overall reliance on equities for capital growth.
Liquidity risk	Liquidity risk is the risk that the Fund will not have sufficient cash to meet its pension and investment liabilities in time and becomes a forced seller of assets at an inopportune time. The Fund actively manages its cash flows over the short and longer term to ensure liquidity. It restricts its investments in illiquid assets to minority portion of the Fund's strategic asset allocation and undertakes paced commitments to private markets investments to reduce cash flow challenges.
Custody risk	Custody risk is the risk that the investments might not be held and transacted securely and efficiently for the benefit for the Fund. The Fund must maintain its beneficial ownership of Fund assets when held in custody or trading and it does this through its global custodian. Counterparty risk is mitigated through a robust selection and legal contracting process. Direct custody risk is reducing as the Fund moves its investments into pooled funds. Indirect custody risk is mitigated by careful selection of funds.
Transition risk	Transition risk is the risk that trading and opportunity costs are higher than anticipated when moving assets between investment managers. The risk of incurring additional costs in relation to the transitioning of assets between external managers is managed through the use of professional advisers and experienced in house staff undertaking establishing transition risk management techniques.
Stock lending risk	Stock lending risk is the risk that assets lent are not recovered in full or partially. The Fund has agreed a stock lending policy for its segregated mandates as well as for its investments in the ACCESS pool. This is a limited programme of stock lending and risk is mitigated by lending to approved counterparties against non-cash collateral mainly comprising of Sovereigns, Treasury Bonds and Treasury Notes.
Regulatory risk	Regulatory risk is the risk that the Fund will be in breach of a regulatory requirement. A significant portion of regulatory risk is transferred to the externally appointed (regulated) investment managers. The Fund ensures internal staff have the requisite knowledge and skills, as well as access to appropriate external advice, to ensure compliance with LGPS Regulations. The ISS is reviewed on a periodic basis (at least every three years and sooner in the event of a significant change in the Fund's circumstances or the regulatory environment).
Investment advice risk	Investment advice risk is the risk that the Fund receives

	inappropriate or poor-quality investment advice. The Fund has engaged Mercer as its Investment Consultant a proper procurement process. Consistent with the CMA Order 2019 and upcoming revised guidance for the LGPS, the Committee has set strategic objectives for the Investment Consultant and regularly considers the effectiveness of the advice given against these objectives.
Unmatched liability risk	Unmatched liability risk is the risk that the growth of the Fund's assets is less than the growth of the Fund's pension liabilities (and therefore the Fund does not have sufficient assets to meet its long-term liabilities). The Fund manages this risk by ensuring its funding and investment strategies are mutually consistent and through periodic reviews of the growth of its liabilities (triennial valuations) and its investment strategy.
ESG Risk	The Fund recognises that environmental, social and governance (ESG) factors pose material financial and non-financial risks to the Fund. The Fund is particularly cognisant of the risks that climate change, and the transition to a low carbon economy, pose to the value of the Fund's assets over the long term.

The Fund assesses risk both qualitatively and quantitatively, with the starting point being the triennial strategy review. Risks are considered, understood, and then prioritised accordingly. Investment risks are not the only risks that impact the Fund's funding level e.g. longevity risk is also a significant component. The Fund maintains a full risk register which is reported to every meeting of the Committee. This covers the full range of risks faced and not just investment risks.

Approach to Pooling

The Fund is part of the ACCESS (A Collaboration of Central, Eastern and Southern Shires) pool which was established in 2015 and now oversees assets totalling £35.4bn (as at 30 June 2023). The ACCESS member authorities retain authority to determine their strategic asset allocation policies in the exercise of their fiduciary responsibility and seek to implement the local strategy through the pool.

Waystone is currently the ACCESS pool's contracted pool operator and is responsible for operating an Authorised Contractual Scheme (ACS) along with the creation of investment sub-funds to meet the collective needs of the ACCESS member authorities.

The Fund has made a commitment to pool its investments other than its direct property holdings but will rigorously apply the value for money test before moving assets into the pool. There are various challenges and complications in pooling directly held properties, including transition (re-registration) costs, lack of liquidity, and determining fair transfer values that make it unviable to pool direct property.

As at 30 June 2023 the total value of the Kent Fund's investments in the ACCESS pool was £3.4bn, being 44% of the total assets of the Fund. ACCESS now has a range of sub funds for equity and fixed income asset classes and the Fund will continue to look for opportunities to pool their remaining liquid assets within the existing sub funds where suitable as well as collaborate for the development of further pooled solutions.

The Fund will also participate in the pooling of alternative assets (other than direct property) through the structures being developed in the ACCESS pool.

On 22 November 2023, the Government published the outcome of the *Local Government Pension Scheme (England and Wales): Next Steps on Investments* consultation, which details the Government's proposals for the future of asset pooling within the scheme. The Fund expects to update its ISS once associated regulation and statutory guidance is made available to ensure its investment arrangements remain compliant, and make optimal use of the regulatory context in which the Fund invests on behalf of its beneficiaries.

Environmental, Governance and Social Considerations

The Fund has an overriding fiduciary duty to maximise investment returns for the benefit of the Fund's beneficiaries. The Fund recognises that it is consistent with its fiduciary duty to manage Environmental, Social and Governance (ESG) issues including climate risk, that may be financially material. It also understands that in seeking to deliver long-term returns, taking a sustainable investment view is more likely to create and preserve and enhance capital over the long term.

The Fund is committed to being a responsible investor and a good long-term steward of the assets in which it invests. The Fund's Responsible Investment Policy sets out the Fund's approach to responsible investment and details the actions the Fund and its external providers take on its behalf, to protect the Fund and its assets from ESG and reputational risk. The Committee expects those responsible for managing the Fund's investments to comply with the Fund's policy.

The Fund is a signatory to the PRI and is a member of collaborative investor networks including the IIGCC, LAPFF and Pensions for Purpose to benefit from a collective approach to engagement as well as ensuring it can access expertise and best practice in the field of responsible investment.

The Committee has established the Responsible Investment Working Group to support the implementation of the Fund's Responsible Investment Policy and to further develop the Fund's approach in this area.

Exercise of Voting Rights

The ACCESS pool has agreed voting guidelines that it expects each of the underlying investment managers managing sub funds on its behalf to comply with or, when this is not the case, to provide an explanation.

The Fund has instructed its other investment managers to vote in accordance with their in-house policies and practices and expects them to apply these policies responsibly and in the best interest of the Fund. It also seeks to inform the managers' voting activity with alerts from the LAPFF and require them to provide rationale for any divergence with the alerts.

The Fund supports the UK Stewardship Code and expects the investment managers who hold shares on its behalf to be signatories of the UK Stewardship Code 2020 and to fully participate in voting at company annual general meetings. It expects its investment managers to carry out all voting decisions on behalf of the Fund and to provide feedback information on voting decisions on a quarterly basis. The majority of the Fund's investment managers are signatories to the UK Stewardship Code.

Stock lending

The Fund has agreed a programme of stock lending with the custodians of its segregated investments. With regard to the Fund's pooled investments stock lending is undertaken at the discretion of the pooled fund manager. The Fund also participates in the ACCESS stock lending programme for investments under ACCESS Pool governance.

Kent Pension Fund

APPENDIX 1 – CURRENT INVESTMENT MANAGEMENT ARRANGEMENTS

Asset Class / Mandate	Performance Target	Description
UK Equities		
Waystone/ACCESS (Schroders)	Customised UK equity + 1.5%	Active equity
Insight	FTSE All Share	Synthetic passive equity
Global Equities		
Waystone/ACCESS (Baillie Gifford)	Customised regional equity + 1.5%	Fixed regional weight growth equity
Sarasin	MSCI AC World + 2.5%	Thematic
Waystone/ACCESS (M&G)	MSCI AC World + 3%	Dividend growth
Waystone/ACCESS (Schroders)	MSCI AC World + 3-4%	Quantitative value
Impax	MSCI AC World + 2%	Environmental themed
Insight	MSCI World	Synthetic passive equity
Insight	Blended index returns	Equity options structure
Fixed Income		
Schroders	ICE BOFA STG 3 Month Govt Bill	Active strategic bond fund
Goldman Sachs	+3.5-6%	Target return, buy and hold
CQS	SONIA+4%	Multi asset credit
M&G	SONIA+4%	Multi asset credit
Insight	SONIA + 2%	Asset backed securities and cash (collateral manager)
Absolute Return		
Pyrford	RPI + 5%	Diversified growth fund
Waystone/ACCESS (Ruffer)	RPI	Diversified growth fund
Infrastructure		
Partners Group	SONIA	Global infrastructure fund of funds
Private Equity		
HarbourVest	SONIA	Global private equity fund of funds
YFM	SONIA	UK growth and buyout
Property		
DTZ	MSCI Customised Pension Fund Index	Direct UK property
DTZ	MSCI UK PF All Balanced Property Fund Index	Pooled UK property fund close ended
Fidelity	MSCI UK PF All Balanced Property Fund Index	Pooled UK property fund open ended
M&G	MSCI UK PF All Balanced Property Fund Index	Pooled UK residential property fund open ended