SOUTH YORKSHIRE PENSIONS AUTHORITY

SOUTH YORKSHIRE PENSION FUND

INVESTMENT STRATEGY STATEMENT (ISS)

March 2017

1. Introduction

1.1 The Local Government Pension Scheme (LGPS) is established and governed by statute and its purpose is to provide death and retirement benefits for all eligible employees. It is a nationwide contributory, defined benefit occupational pension scheme administered at a local level by a number of administering authorities. The South Yorkshire Pension Fund ("the Fund), which is administered by the South Yorkshire Pensions Authority (the Administering Authority), is required to maintain an Investment Strategy Statement (ISS) in accordance with Regulation 7 of the Local Government Pension Fund (Management and Investment of Funds) Regulations 2016.

1.2 The ISS is a living document and will be an important governance tool for the Fund as well as providing transparency in relation to how Fund investments are managed. The Regulations establish the range of matters that the Authority must consider when carrying out its responsibilities. In addition, the Authority is required to manage the Fund in the best financial interests of its members and beneficiaries at all times.

1.3 In preparing this statement officers have taken advice from an investment management consultant, the Fund's actuary and from our three retained independent advisors. The Statement will be reviewed annually and without delay after any significant change in investment policy. Consultation will also take place with the Local Pension Board. The Fund is also required to maintain a Funding Strategy Statement (FSS) which will be revised following the triennial valuation and be reported to the Authority on 16 March 2017. The ISS should be read in conjunction with that.

1.4 The Fund has statements of compliance with the Myners Principles and the Stewardship Code. The latter references a suite of policies addressing responsible investment and stewardship.

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

2.1 The main investment objective of the Fund is to ensure that over the long term it will have sufficient assets to meet all of its pension liabilities as they fall due. This objective is more fully explained in the Authority's Funding Strategy Statement [FSS] derived from the triennial actuarial valuations of the Fund. The crux of the FSS is the need to achieve a future funding level of 100% or better whilst maintaining employer contribution rates to be kept as low and reasonably stable and affordable as possible. Accordingly, the Authority manages the Fund from a long term viewpoint and endeavours to maximise its returns but, at the same time, operates within a closely controlled range of acceptable risks.

2.2 The Authority has formed a Board to manage the Fund's investments on its behalf and has granted it all the powers it needs to do so: it has also delegated its day to day management responsibilities to its senior officer, the Clerk, who in turn delegates her duties and responsibilities to colleagues. The Scheme of Delegation to Officers is formally approved by the Authority. The Board comprises seven councillors drawn from the Authority and selected in accordance with the Authority's Constitution and meets not less than four times per year. The Authority also liaises with the Local Pension Board which includes representatives of employers and stakeholders (including the trades unions).

2.3 The Authority's Board is responsible for setting the strategic asset allocation of the Fund but the ultimate responsibility for investment strategy rests with the Authority. As well as obtaining advice from Authority officers it has also appointed independent investment advisors to advise it on investment matters and an actuary for the production of actuarial valuations and for advice on liability issues. For other work it appoints consultants when required. The Authority is authorised and regulated by the Financial Conduct Authority.

2.4 Investment Beliefs.

The Fund has a set of Investment Beliefs that will be used as a framework when making decisions and agreeing investment strategy:

- Clear goals are crucial to success; it is important that each part of our strategy has a clear role in achieving our goals.

- The Fund's liabilities must influence asset allocation, and it is asset allocation that has the greatest impact on overall risk and return.

- A long term approach to investing is appropriate; moreover a long term time horizon is an advantage.

- Managing risk is a multi-dimensional and complex task.
    - Risks must be understood and prioritised
    - Risk must be taken in the pursuit of return, but no more risk than is deemed necessary will be taken
    - Diversification is key principle in managing risk.

- Costs matter but net of fees returns are the priority and internal management of traditional asset classes is an efficient way of achieving this.

- External managers can add value, assuming that due consideration is given to philosophy and approach in order that confidence is gained in relation to meeting the agreed objectives.

- It takes its stewardship responsibilities seriously and believes that good environmental, social and governance (ESG) practices lead to well-managed, sustainable companies.

- In making decisions on investment matters, no one voice should dominate and diversity of opinion is important.

2.5 In order to ensure as far as possible that the investment strategy is appropriate for the Fund's liabilities the Authority has created its own bespoke or customised benchmark. This benchmark acts as a framework and is adopted only after analysing the Fund's liability structure in detail. It is reviewed at least every three years and always after the statutory actuarial valuation. Changing circumstances can often, but not always, warrant a formal review and one is conducted whenever necessary.

2.6 The investment strategy is developed by reference initially to the valuation of liabilities measured on a risk free basis but then adjusted to make allowance for the Authority's appetite for risk. The investment strategy is determined based on the expected return on asset classes (for equities, bonds, property etc.) within the appetite for risk as measured by the dispersion (likely range) of these returns. The Authority is satisfied that the investment strategy has a sufficient probability of meeting its return targets over the long-term and it is expected that the Fund's long term investment returns will be at least in line with these assumptions and those published in the FSS.

2.7 The Regulations define the types of investments the Fund can hold and places limits on the proportion of the Fund that can be invested in them. Although the Authority has adopted the maximum headroom limits on partnerships, unit trusts, unquoted companies, collective investment vehicles and similar entities permitted under the Regulations it does not necessarily utilise the full allocation. The Authority participates in stock lending to the limit permitted and the programme is managed by the custodian bank in accordance with best market practice. The Fund's securities are held by the custodian bank or its agents or directly by the Authority.

2.8 In line with the regulations, the authority's investment strategy does not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007.

2.9 The asset allocation was previously reviewed and approved in September 2016. An investment strategy review has now been conducted by an external consultant and reviewed by officers and advisers. This has resulted in proposed changes below at Table 1. below. There will be a need to move to new positions over the medium term.

2.10 The asset allocation review (2017) considered the key risks that the Fund is exposed to. It was felt that a change in overall strategy was not required. However some refinements were recommended; some that looked to take into account the Fund's long term investor status (e.g. an increase in illiquid assets) and some that looked to build the level of inflation protection (e.g. the construction of a real assets portfolio). The intention was to evolve the portfolio to be more resilient in stressed scenarios. It is important to note that there is a long term implementation plan in terms of moving to the revised strategy; in addition to taking account of any practical considerations related to asset pooling. The Investment Board is clear that new investments will not be made at any price.

2.11 As at the 31 March 2016 (to be consistent with the actuarial valuation date), the expected return from the Fund's strategy at Table 1. below has a total (best estimate) expected return of around 5.3% p.a. (or CPI plus 3.1% p.a.). This uses a 10 year return projection, whereas the numbers quoted in the FSS (CPI plus 3.4%) use a 20 year projection. Both returns compare favourably to the prudent return assumed by the Fund actuary which sits at CPI plus 2%. The expected volatility of return is 17.0% p.a. for the current allocation, reducing slightly to 16.5% for the proposed allocation strategy.

Table 1: Benchmark asset allocation: All figures quoted as % of Fund market value.

		Current Allocation %		Proposed Allocation %	Tolerance %
Bonds		**23.00**		**23.00**	
UK Index Linked		12.00		12.00	+/- 3.00
UK Buy and Maintain		5.00		5.00	+/- 2.00
Emerging Market[1]		3.00		}	
High Return[1]		3.00		} 6.00	} +/- 5.00
Floating Rate[1]		_		}	
Quoted Equities		**60.00**		**50**	
UK		20.00		15.00	+/- 5.00
Overseas[2]		40.00		35.00	+/- 5.00
	N America		11.50	11.50	+/- 5.00
	Europe		9.50	9.50	+/- 5.00
	Japan		3.75	3.75	+/- 5.00
	Pacific		8.50	8.50	+/- 5.00
	Em Mkts		6.75	6.75	+/- 5.00
			40.00	35.00	
Illiquid Premium					
Private Equity		**3.50**		**7.00**	+/- 5.00
Private Debt		**2.00**		**3.50**	+/- 5.00
Real Assets[3]		**–**		**5.00**	+/- 5.00
Property		**10.00**		**10.00**	+/- 3.00
Cash		**1.50**		**1.50**	+/- 8.50
		100.00		**100.00**	

Table notes:

1. No change in allocation but proposed evolution of approach towards ‘floating rate’ bonds. (From fixed rate bonds).
2. Proposed allocation of overseas equities subject to review with external Advisers.
3. Transition from equities to illiquid / real assets will be managed over a medium timescale.

Table 2: For each asset class the Fund has set a benchmark against which performance will be measured.

Asset Class	Benchmark
BONDS	
UK Index-Linked	FTA ILG over 15 yr Index
UK Buy and Maintain	iBoxx Sterling Non-Gilt Index
Emerging Market	Composite of 1/3 JPM Euro EMBI Global Diversified Index- hedged GBP 2/3 JPM EMBI Global Diversified Index –hedged GBP
High Return	iBoxx Sterling Non-Gilt Index
QUOTED EQUITIES	
UK Equities	75% FTSE 100 Index 25% FTSE 250 Index
Overseas equities	
North America	S&P 500 Index
Europe	FTSE Developed Europe ex-UK Index
Japan	FTSE Japan
Pacific-ex-Japan	FTSE All World Pacific ex-Japan Index
Emerging Markets	Composite 23.75% FTSE Emerging Asia 43.75% FTSE Emerging Latin America 32.50% FTSE Emerging EMEA
ALTERNATIVES	
Private Equity	UK CPI +3%
Illiquid Premium	UK CPI +3%
Property	IPD Balanced Monthly & Quarterly Index
Cash	LIBID 7 Day rate

2.12 In order to measure the performance of each asset class against its benchmark index (Table 2) and monitor the investment objective, the Authority requires detailed performance measurement figures. These are provided by Portfolio Evaluation and are presented to the Investment Board on a quarterly basis.

3 Risk measurement and management

3.1 The Fund's main long-term risk is that assets do not match liabilities, and that funding objectives are not achieved. There are many different types of risk involved in capital stewardship and the Authority notes that without taking "risks" it will be difficult for the Fund to achieve the performance it needs if it is to meet its objectives. The Authority recognises that risk is inherent in any investment or operational activity and seeks to control risk rather than try to eliminate it. The approach aims to mitigate risk without compromising returns. In order to generate the required investment returns necessary to match the growth in liabilities this implies that the Fund will continue to take an active risk relative to its liability profile.

The key risks inherent in the Pension Fund, and how these risks are mitigated, are below:

Risk	Description	Mitigants
Counter Party	Counterparty risk in every transaction in which the Authority takes part.	Use reputable service providers who operate effective controls. Independent investment advisors appointed to assist in the scrutiny of the internal investment management activity.
Funding strategy risk	There is a risk that the value of Fund assets will not match the increase in its liabilities which could result in a deteriorating financial position.	The effect can be reduced by diversifying the Fund's portfolios across a broad spectrum of assets and markets, taking into account these differences and the correlations between them and by granting the Fund's managers sufficient freedom to meet their targets but setting range constraints.
Performance	The Fund's investment managers fail to deliver returns in line with the underlying asset classes.	Analysis of market performance and investment managers' performance relative to their index benchmark on a quarterly basis. Internal and external manager performance is also reviewed regularly with support from external advisers.
Demographic	Demographic factors including the uncertainty around longevity/mortality projections (e.g. longer life expectancies) can also contribute to funding risk.	Demographic assumptions are conservative, regularly monitored, and reviewed on a triennial basis.
Liquidity	Liquidity or market risk associated with the volatility of prices in certain assets and under certain market conditions.	Part of the Fund is held in securities that can be realised quickly in normal market conditions. Management of Authority cash flows to ensure future payments can be met.
Inflation & Interest rates	Different classes of asset have different risk and return characteristics and sensitivities to changes in financial factors, in particular to inflation and interest rates.	It is important that the Fund's strategy takes into account these differences and the correlation between them. The Fund regularly monitors its exposure to interest rates.
Foreign exchange	Investing overseas exposes the Fund to fluctuations in exchange rates.	The Fund's customised benchmark regulates such exposure: part of that approach involves the Authority passively hedging its overseas property portfolio's currency risk.
ESG	**ESG risks have the ability to impact a company's profitability and the Fund's investment performance.**	The Fund has a suite of RI policies, acts as a responsible share owner and factors ESG into investment decision making. These are also referenced elsewhere in the report.

Risk	Description	Mitigants
Employers	The financial capacity and willingness of sponsoring employers to support the Fund.	This is regularly reviewed by the Authority.
Governance	The risk of poor governance and the potential issue of Committee member turnover.	Ensure that Members are well informed by officers and independent advisers. A Member training programme is in operation. The Local Pension Board and external and internal audit also support the scrutiny and governance process.

4. Approach to asset pooling

4.1 In order to satisfy the requirements of the "Local Government Pension Scheme: Investment Reform and Guidance" issued by the Department for Communities and Local Government ("DCLG") in November 2015 the Pension Fund has elected to become a shareholder in Border to Coast Pensions Partnership (BCPP) Limited. BCPP Limited will be an FCA-regulated Operator and Alternative Investment Fund Manager ("AIFM").

4.2 South Yorkshire Pensions Authority elected to join the Border to Coast Pension Partnership Pool (BCPP) on behalf of the South Yorkshire Pension Fund and South Yorkshire Passenger Transport Pension Fund.

BCPP is a partnership of the following 12 administering authorities and thirteen funds (allowing for the South Yorkshire Passenger Transport Pension Fund):

Bedfordshire Pension Fund, Cumbria Pension Fund, Durham Pension Fund, East Riding Pension Fund, Lincolnshire Pension Fund, North Yorkshire Pension Fund, Northumberland Pension Fund, South Yorkshire Pension Fund (including South Yorkshire Passenger Transport Pension Fund), Surrey Pension Fund, Teesside Pension Fund, Tyne and Wear Pension Fund, Warwickshire Pension Fund.

On 15th July 2016 the partner Funds submitted their proposal to Government and have received written confirmation from the Minister to confirm that the proposal meets the criteria laid down in the guidance issued in November 2015**.**

4.3 The core beliefs of the Border to Coast Pension Partnership (BCPP) are as follows:

a) One Partner Fund, one vote for all participating funds from time to time regardless of Fund size.

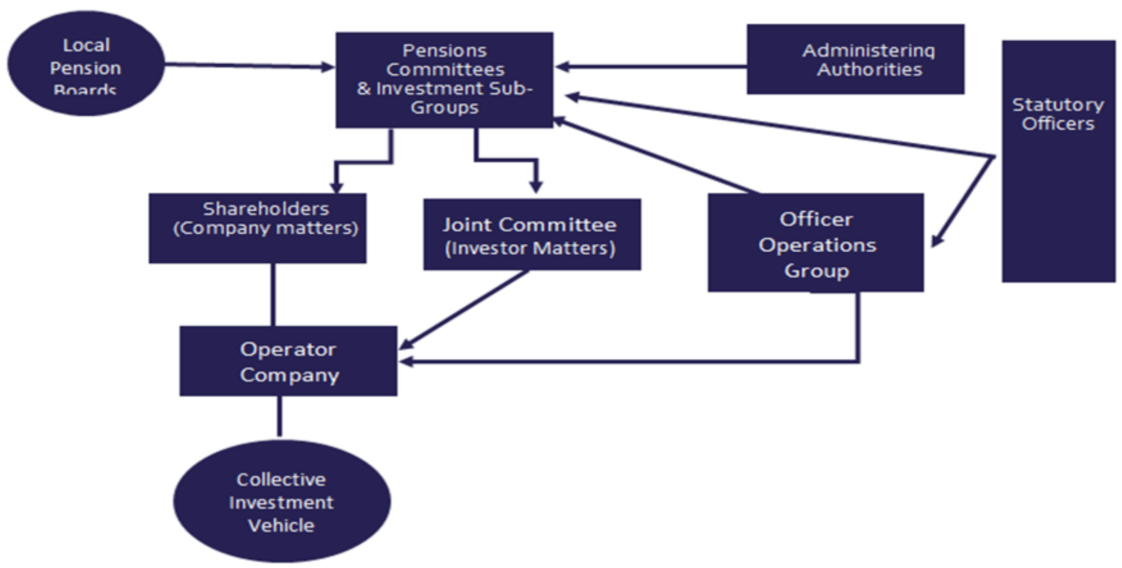
b) Asset allocation strategy remains a decision for each Partner Fund. This is necessary to enable Partner Funds to demonstrate that they are exercising their democratic and fiduciary duty. For practical reasons, the Parties will work together to establish a single Responsible Investor I/ESG policy and a policy for the exercise of rights attaching to investments, based on best practice, with the intention that it will be adopted by each Partner Fund. The adoption of such a policy will be a matter for individual determination by each Partner Fund.

c) The BCPP Pool's role is to independently and professionally deliver Partner Funds asset allocation choices. It will make decisions relating to and monitor the investment managers (including employees of the BCPP Pool) who manage the administering authorities' "fund money" with the aim of maximising the long-term net of fees investment returns attributable to each of the Parties. All Partner Funds accept that if savings are to be achieved, changes will be required through the rationalisation and standardisation of processes. There will be clear segregation between duties undertaken by the Parties and duties undertaken by the BCPP Pool, including during the period after the BCPP Pool has been established but assets have not yet been transferred when staff secondment arrangements will be entered into for certain employees of the BCPP Pool. This will ensure both that the fiduciary duty and democratic responsibility of the Partner Funds can be maintained, whilst achieving the cost benefits and expanded professionalisation of the investment functions through scale.

d) The BCPP Pool should have a strong corporate governance philosophy, focused on the delivery of long term value through active corporate engagement, the rationale being that this aligns directly with ensuring the Partner Funds exercise their fiduciary duty in the best interests of their members and employers.

e) The Parties acknowledge that there may be occasions where the BCPP Pool is unable to implement all asset allocation strategy decisions made because it would not be cost effective to do so, but the Parties and the BCPP Pool will work together to avoid this situation.

The proposed governance structure of BCPP is as follows:



The Fund will hold BCPP to account through the following mechanisms:

- A representative on the Shareholder Board, with equal voting rights, who will provide oversight and control of the corporate operations of BCPP Limited.

- A representative on the Joint Committee who will monitor and oversee the investment operations of BCPP Limited.

- Officer support to the above representatives from the Officer Operations Group and the Statutory Officer Group.

The Pension Fund will retain the decision making powers regarding asset allocation and will delegate the investment management function to BCPP Limited.

It is anticipated that a significant proportion of the Fund's investments will be made through BCPP Limited. Where it is not practical or cost effective for assets to be transferred into the pool they will continue to be managed at the Fund level. This is expected to predominantly include unquoted investments such as limited partnerships. Whilst these assets are unlikely to be transferred it is expected that once these investments mature the proceeds will be reinvested into BCPP. At the current time it is estimated that approximately 75% of the Fund's assets will be invested in BCPP subject to it having suitable management arrangements in place.

The Fund will perform an annual review of assets that are determined to be held outside to ensure that it continues to demonstrate value for money. Following this review it will submit a report on the progress of asset transfers to the Scheme Advisory Board, in line with the guidance.

5. Social, environmental and corporate governance policy

5.1 The Authority is fully committed to responsible investment and good stewardship of its investments. It acts at all times in the best long-term interests of all its members and looks to protect and enhance the economic value of the companies in which it invests on their behalf. It believes that well governed companies produce sustainable and superior returns. Responsible investment is fundamental to the Authority as it is in accordance with trustee's fiduciary duty.

5.2 It takes its responsibilities as a long-term investor seriously integrating environmental, social and govern factors into the investment process. Environmental risks include climate change; the Authority believes that the associated risks and opportunities may have a material impact on the financial performance of the Fund and has therefore published a Climate Change policy statement which can be found on the Authority's website. The Authority will take non-financial considerations into account when making investments but only where it would not involve significant risk of financial detriment.

5.3 The Authority believes that the pursuit of standards of best practice aligns the interest of Fund members with those of fellow shareholders and with society as a whole and, therefore, will not actively invest in or disinvest from companies solely or largely for social or ethical or environmental reasons. The Authority recognises that it is unable to use its policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government. The Authority has published a separate Responsible Investment policy statement available to view on its website.

5.4 The Authority invests in sustainable and impact funds which have positive social and environmental impacts. It does so only when returns are considered to be commercial and will not forego financial return in order to generate social impact.

5.5 The Authority recognises that it is not always possible for it to conduct constructive engagement alone: therefore, it will enter into collaboration with other like-minded investors when the occasion warrants doing so. It is an active member of the Local Authority Pension Fund Forum and will join other collaborative pressure or lobbying groups if it feels it is appropriate to do so. The Authority is a member of the IIGCC which is a forum for collaboration on climate change for European investors. The Authority believes that risks and opportunities associated with climate change may have a material impact on the financial performance of the Fund and, therefore, supports the Group's objective to catalyse greater investment in a low-carbon economy by bringing investors together to use their collective influence with companies, policymakers and investors.

5.6 Under Regulations issued in 2009 administering authorities of the LGPS are required to report their compliance against the Myners' Principles. The six Principles are intended to guide institutional investors on matters such as investment, scheme governance, disclosure and consultation. The Authority publishes a separate statement outlining its full compliance with the Principles, attached at appendix 1.

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

6.1 The Authority regards its voting rights as an asset and uses them carefully. It exercises its votes on its UK, European and North American listed equity investments whenever possible. It has appointed a contractor to ensure that its votes are effectively executed. The Authority has published its own bespoke UK voting policy which is informed through the interpretation of best practice guidelines in consultation with the proxy advisor, and is reviewed annually. This can be viewed on the Authority's website. Voting decisions, nonetheless, are made on a case-by-case basis bearing in mind a company's circumstances. Voting decisions are published on the Fund's website quarterly. The Authority responds to company requests on voting rationale and will, where possible, engage with companies prior to votes being cast. Constructive shareholder engagement, with the aim of promoting and supporting good corporate governance principles and practice, will be pursued whenever it is deemed appropriate to do so. The Authority's Shareholder Engagement Statement sets out the broad approach to its responsibilities as a shareholder. These broad principles provide the framework within which the more detailed voting guidelines are administered.

March 2017