



# **AGENDA ITEM**

**9**

## **INVESTMENT BELIEFS**

**FALKIRK COUNCIL**

**Subject: INVESTMENT BELIEFS**  
**Meeting: JOINT MEETING OF PENSION COMMITTEE AND PENSION BOARD**  
**Date: 23 JUNE 2016**  
**Author: DIRECTOR OF CORPORATE AND HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 This report invites the Pensions Committee to consider adopting certain core investment beliefs for inclusion in the Fund's Statement of Investment Principles.
- 1.2 Having a stated set of beliefs can be viewed as a valuable tool in terms of justifying investment decisions. It also demonstrates that the Committee has considered what motivates its decision making process and is therefore evidence of good governance.

**2. BACKGROUND**

- 2.1 The issue of beliefs was considered by the Investment Strategy sub-group. The group was broadly supportive of the proposal to incorporate key beliefs into the Fund's revised strategy and subsequently made this recommendation. The matter was then discussed at the joint meeting of Board and Committee in March 2016 at which time it was decided to defer the final decision until the June Committee.
- 2.2 A draft set of beliefs is attached at Appendix 1. This has been prepared by the Fund's investment adviser Hymans Robertson and based on the discussions and recommendations arising from the sub group meetings.

**3. INVESTMENT BELIEFS**

- 3.1 The changes being made to the Fund's investment strategy currently, including the change to asset allocation, the commitment to making a "Smart Beta" investment and the decision to refrain from any further private equity/debt investments will require to be recorded in the Statement of Investment Principles (SIP). Linking these decisions to specific beliefs and including these, and other beliefs, within the SIP will enable the SIP to be more reflective of Fund strategy and therefore a more credible document.
- 3.2 The Hymans paper indicates that a publicised set of investment beliefs will help:
  - provide clarity over the role and objectives of the various mandates;
  - assist in prioritising competing investment demands;
  - Committee to take the long term view;
  - provide a consistent framework for decision making; and
  - provide an ongoing record of the decision making rationale.

- 3.3 The beliefs highlighted in the Hymans paper include recognising:
- the importance of having clear and well defined strategic objectives;
  - that strategic asset allocation is a key determinant of risk and return;
  - that being a long term investor provides opportunities for enhanced returns;
  - that both active and passive management has a role to play; and
  - the significance of fees and costs.
- 3.4 The Committee may of course wish to consider other potential beliefs (e.g. its attitude to private equity/private debt/currency hedging, regional v global exposure etc.). Any such additional elements could be developed and added into the belief statement over time.

#### **4. CONCLUSION**

- 4.1 The investment decision making process of local authority funds is increasingly under scrutiny from a combination of bodies including pressure groups, lobbyists, auditors and the new governance regime of Pension and Scheme Advisory Boards.
- 4.2 In this environment, it is important for Funds to be able to demonstrate why certain investments have been made and others discarded. The adoption of a series of investment beliefs for inclusion within the Fund's Statement of Investment Principles is likely to make it easier to substantiate existing investments, determine whether to make a particular type of future investment and generally improve the transparency and consistency of the investment decision making process.

#### **5. RECOMMENDATIONS**

- 5.1 The Pensions Committee and Pension Board are asked note the contents of this report and comment as appropriate.
- 5.2 The Pensions Committee is asked to considering adopting the investment beliefs set out in the Hymans Robertson paper at Appendix 1 and any other beliefs it deems appropriate.

**Director of Corporate & Housing Services**

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**Date: 8 June 2016**

**Contact Officer: Alastair McGirr**

# Investment beliefs

## Introduction

This paper is addressed to Pensions Committee (“the Committee”) of the Falkirk Pension Fund (“the Fund”). It discusses investment beliefs and follows on from initial discussions that took place at the March 2016 meeting. This paper should not be released or otherwise disclosed to a third party except as required by law or with our prior written consent, in which case it should be released in its entirety. We accept no liability to any third party unless we have expressly accepted such liability in writing.

## Background

### Good governance

A number of studies have been carried out to help define what makes a good pension fund. Many of these studies have cited clarity of objectives, focus on investment strategy and understanding and managing key risks as being core attributes – all of which we agree with. However, one other feature often cited, but often overlooked by decision makers, is having a well-defined set of investment beliefs in place.

### Investment beliefs

Beliefs are, by definition, unique to each pension committee or trustee body. They reflect the way in which committees (explicitly or implicitly) translate a fund’s objectives into its actual investment arrangements. For example, you can have two funds, with broadly similar characteristics and objectives, but very different investment arrangements e.g. the extent of their use of diversification, active and passive management, regional equity exposures, approach to environmental, social and governance matters etc. all because the committees’ beliefs are very different.

Having a well-defined set of investment beliefs offers a number of advantages, including:

1. **Clarity of why each mandate is held and the role it performs in the Fund’s arrangements** – this clarity is of benefit to committees and the underlying members. It also offers a basis for framing external communication on investment strategy which is of particular relevance where decisions are subject to public scrutiny.
2. **Prioritisation** - having identified which decisions are important, advice can be brought and meetings scheduled around these key priorities.
3. **Long-term thinking** - having stated beliefs, committees are able to stand clear of short-term market noise and “fads”.
4. **Consistency, both of advice and decision-making** – meaning all decisions are reached using the same consistent framework.
5. **Continuity understanding of decision-making** – having a defined decision making framework allows decisions to be contextualised which is particularly valuable if there is regular turnover of committee members, i.e. the committee may not “own” the decision on a certain element of the investment strategy, but as they own the framework, they can better understand why the decision was taken.

There is no right answer when it comes to setting beliefs, with each scheme’s beliefs being unique, depending on their specific circumstances and their trustees’ views. A scheme’s beliefs should be revisited on a regular basis to ensure they remain appropriate. It is also important that these beliefs are reflected in the underlying portfolio of assets and in the scheme’s ways of working. In the remainder of this paper we discuss the Fund’s investment beliefs.

## Fund specific

At the March meeting, we introduced the concept of investment beliefs to the Committee and set out a draft set of beliefs based on our previous discussions with the Strategy Sub-Committee and with reference to the Fund's underlying assets. Taking on board some of the initial comments from that meeting, we have updated the draft investment beliefs. These are set out below:

### Draft beliefs

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

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

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

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

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

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

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

The Committee believes that, over the longer term, equities are expected to outperform other liquid assets, in particular government bonds. The Committee is therefore comfortable that the Fund maintains a significant allocation to equities, with a view to reducing this allocation as the funding position improves.

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

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

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

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

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

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

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

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

**Belief: Choice of benchmark index matters**

The Committee recognises that, for each asset class, there is a range of benchmark indices that they could use. As a result, the Committee focus on the benchmark's underlying characteristics and consider how they may be appropriate for the Fund.

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

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

**Summary**

This paper set out our views on your investment beliefs. At your June meeting, we will gather your thoughts on these beliefs. Taking on board your comments and feedback, we will work with the Officers to prepare a finalised set of beliefs that can then be published on the Fund's website.

We look forward to discussing this paper with the Committee at the forthcoming meeting.

William Marshall, Partner  
Consultant

Simon Jones, Senior Investment

For and on behalf of Hymans Robertson LLP

June 2016

**Risk Warning**

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.