Bath & North East Somerset Council

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AVON PENSION FUND

Avon Pension Fund

Investment Strategy Statement

July 2020

Avon Pension Fund - Investment Strategy Statement 2020

1. Introduction

1.1 Local Government Pension Scheme (LGPS) regulations require administering authorities to prepare and maintain an Investment Strategy Statement ('ISS'). This ISS has been prepared by the Avon Pension Fund (the Fund) in accordance with regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the 'Regulations') and associated guidance. This statement updates and replaces the December 2018 ISS and incorporates changes arising from the 2019/20 strategic investment review.

1.2 The purpose of the ISS is:

- To set out the Fund's investment objectives
- To define the fund's To set out the governance arrangements for investment
- investment beliefs
- How the Fund will manage investment -related risks
- How the Fund incorporates responsible investment
- To set out the strategic asset allocation benchmark and ranges to provide flexibility

1.3 As stated above, the ISS outlines the Fund's approach to Responsible Investment (RI), how RI is integrated into the investment decision making process and how the Fund fulfils its role as a responsible steward of its assets. Particular attention is given to the Fund's immediate and long-term ambitions around climate change. The strategy acknowledges there is a need to address the impact of climate change on its investment assets and capture new sources of return that will arise from the transition to a low carbon economy. However, it also acknowledges that the investment products required are not yet fully developed. In addition, the policy supports the Just Transition, seeking to manage the societal and economic impacts of the transition to a lower carbon world. It therefore has set clear objectives with milestones that will be delivered through its relationship with Brunel Pension Partnership to ensure that the investment portfolio is aligned with the Paris Agreement within a realistic timeframe.

1.4 The ISS is supported by the Funding Strategy Statement (FSS) as well as a broader framework of policies in investments, most notably those relating to Risk Management and Responsible Investment. An integrated approach ensures the investment strategy supports the Fund in meeting its regulatory requirements.

1.5 The ISS is subject to a review at least every three years and from time to time on any material changes to any aspects of the Fund which are judged to have a bearing on the stated investment strategy. Ongoing quarterly and annual monitoring of the strategy enables the Committee to take advice as to whether a review is needed at any time.

1.6 In preparing the ISS, the Committee has taken advice from Fund Officers, the Fund's appointed investment consultant and the Client Officer Group at the Brunel Pension Partnership. The Fund's Pension Board reviews the Investment Strategy Statement before it is approved by Committee.

Investment Governance Framework

1.7 The Avon Pension Fund (the Fund) is administered by Bath & North East Somerset Council, which is legally responsible for the Fund. The Council delegates its responsibility for administering the Fund to the **Avon Pension Fund Committee** (the Committee), which is its formal decision-making body. Members of the Committee represent a cross section of the Fund's stakeholders and therefore a range of views are taken into account when agreeing policy and strategy.

1.8 The Committee is supported by a sub-committee, the **Investment Panel** (the Panel), which considers matters relating to the management and investment of the assets of the Fund in greater detail. Although the Panel has delegated powers to take decisions on specific issues and makes recommendations to the Committee, setting the strategic asset allocation is the responsibility of the Committee. Operational implementation of strategy is delegated to Officers.

1.9 In addition, the **Local Pension Board** has an oversight and scrutiny role to ensure good governance through monitoring of the Fund's performance, activity of the Committee and compliance with regulations and statutory duties. The Board's role is to assist the administering authority to ensure the management of the pension fund is effective and efficient.

1.10 Both the Committee and the Pensions Board have members and other stakeholder representatives who actively engage with stakeholders to ensure the Fund is aware and can respond effectively to stakeholder concerns.

2. Approach to Pooling

2.1 The Fund participates with nine other administering authorities to pool its investment assets through the Brunel Pension Partnership. Brunel Pension Partnership Limited (Brunel) authorised by the Financial Conduct Authority (FCA) has been established specifically to manage the assets within the pool. Brunel is owned by the ten administering authorities (in equal shares) that participate in the pool. These pooling arrangements meet the requirements of the Regulations and Government guidance.

2.2 The Avon Pension Fund retains responsibility for setting the strategic asset allocation for the Fund and allocating assets to the portfolios provided by Brunel. Brunel is responsible for implementing the asset allocations of the participating funds (the 'clients') by investing the clients' assets within defined outcome focused investment portfolios. In particular, it selects the external managers or pooled funds required to meet the investment objective of each portfolio. Brunel creates collective investment vehicles for quoted assets such as equities and bonds; for private market investments it creates and manages an investment programme with a defined investment cycle for each asset class.

2.3 As a client of Brunel, the Fund has the right to expect certain standards and quality of service. The Service Agreement between Brunel and its clients sets out in detail the duties and responsibilities of Brunel and the rights of the Avon Pension Fund as a client. It includes a duty of care of Brunel to act in its clients' interests.

2.4 The pool has established governance arrangements. The Brunel Oversight Board is comprised of representatives from each of the administering authorities and two member observers with agreed constitution and terms of reference. Acting for the administering authorities, it has responsibility for ensuring that Brunel delivers the services required to achieve investment pooling and deliver each Fund's investment strategy. Therefore, it has a monitoring and oversight function. Subject to its terms of reference it considers relevant matters on behalf of the administering authorities but does not have delegated powers to take decisions requiring shareholder approval. These are remitted back to each administering authority individually. As shareholders of Brunel, the administering authorities' shareholder rights are set out in the Shareholders Agreement and other constitutional documents.

2.5 Brunel Oversight Board is supported by the Client Group, comprised investment officers drawn from each of the administering authorities but also draws on finance and legal officers as required. It has a primary role in managing the relationship with Brunel, reviewing the transition of assets to the portfolios, providing practical support to the Brunel Oversight Board so it can fulfil its monitoring and oversight function and monitoring Brunel's performance and service delivery. The Committee and Investment Panel receive regular reports covering portfolio and Fund performance and Brunel's service delivery.

2.6 Bath & North East Somerset Council approved the full business case for the Brunel Pension Partnership in 2017. The transitioning the Fund's assets to Brunel's management is expected to be completed (except for legacy private market assets) during 2021/22. The transition timetable agreed between the clients and Brunel is regularly monitored by the Client Group. Until such time as assets transition, the Fund will maintain its relationship with existing investment managers and oversee their investment performance, working in partnership with Brunel where appropriate.

2.7 Following the completion of the transition plan, it is intended that all of the Avon Pension Fund's assets will be invested through Brunel portfolios. However, the Fund has certain commitments to long term illiquid private market and fund of fund investments which will take longer to transition across to the Brunel portfolios. These assets will be managed in partnership with Brunel until such time as they are liquidated and capital is returned. The formulation, implementation and

ongoing monitoring of the Fund's risk management strategies (e.g. Liability Driven Investing and Equity Protection) remain the responsibility of the Fund and its specialist advisors. Brunel acts as facilitator working with the manager, under a broad commercial agreement covering the manager's key terms.

3. Investment Beliefs

3.1 The Fund has the following investment beliefs which underpin the investment strategy and guide decision making around investment of the Fund's assets.

- **The Funding Strategy and the Investment Strategy, and thus the employer contribution rates, are inherently linked.** A material change to one cannot be effected without due regard for the others.
- **Strategic asset allocation** is the key factor in determining the risk and return profile of the Fund's investments.
- **Investment governance is key to effective decision making.** The Fund has a governance framework in place that ensures effective decision making regarding the investment of its assets.
- **Long term approach to investing.** The strength of the employer covenant[1] and funding strategy, which allows for any deficit to be recovered over time, enables the Fund to take a long-term view of investment strategy.
- **Environmental, Social and Governance factors** are important drivers of the sustainability of investment returns over the long term and they can have a material financial impact if not managed appropriately.
- **Climate change.** The Fund believes climate change creates both risks and opportunities to the Fund's investments and has used an evidence-based approach to develop a set of objectives with the aim of delivering a portfolio aligned with the goals of the Paris Agreement. Key milestones that review the progress made over time ensure the Fund continues to work towards its medium-term and long-term objectives.
- **Diversification of assets is an important element of the risk management framework.**
- **Active management can add value to returns, albeit with higher short-term volatility.**
- **Value for money from investments** is important, in terms of net returns. Asset pooling is expected to help reduce costs over the long term, whilst providing more choice of investments, and therefore have the potential to enhance Fund returns.

4. Investment Objective

4.1 The Fund's investment objective is to achieve a return on assets consistent with an acceptable level of risk that will enable the Fund to meet its pension liabilities over time, that is, to achieve 100% funding in line with the Funding Strategy. The investment strategy must therefore generate returns that will help stabilise and minimise employer contribution rates in the long-term, as well as reflect the balance between generating returns consistent with an appropriate level of risk, protecting asset values from market falls and matching liabilities.

4.2 An assessment by the Fund's investment consultant generates a best estimate average expected return of CPI+2.5% per annum based on the current investment strategy. When setting the funding strategy a margin for prudence is taken on this return expectation; implementation of the risk management strategies (see Section 7) to reduce the volatility of returns within the investment strategy supports a lower margin for prudence. To achieve 100% funding for the 2019 valuation, a minimum return of CPI+1.75% per annum (the discount rate) over 13 years was assumed in the Funding Strategy. For future benefit accruals an investment return of CPI+2.25% per annum is assumed.

[1] The Employer covenant is the employer's financial ability to support its legal obligations arising from its defined benefit pension scheme now and in the future

4.3 The Fund adopts a more prudent lower risk investment strategy for those liabilities where the employer has ceased to participate in the Fund or for certain admission bodies where there is no guarantee underpinning the liabilities. These assets are invested in a portfolio that is designed to better match the risk profile of the employer's liabilities and reduce volatility in employer contributions.

5. Investment strategy

5.1 The investment strategy was reviewed in 2019/20 and the review considered:

- An analysis of the medium- and long-term risks facing the Fund, including consideration of different economic and market scenarios.
- A cashflow budgeting exercise designed to assess the level of 'illiquidity premium' the Fund could reasonably be expected to capture.
- Evidence-based climate change modelling designed to inform long term objectives and targets relating to climate change and the direction of travel for investment in alternative energy and low carbon solutions.

5.2 Following this review, a number of strategic changes were agreed as follows:

a) To address the climate emergency:

- Setting clear targets to ensure that the portfolios are aligned with the Paris Agreement ambition to limit global warming to below 2°C
- Increase the target allocation to renewable infrastructure by 2.5% to 5% of assets
- Increase the allocation to sustainable equities to 10% of assets

b) To better meet future cashflow requirements through asset income and further diversify the sources of growth in the portfolio:

- Increase the target allocation to Secured income by 2.5% to 10% of assets
- Allocate 5% of assets to Private Debt

5.3 The proposed changes were reassessed in April 2020 given the Coronavirus pandemic and the ensuing market volatility, which concluded that the revised long-term strategy and asset allocation remained appropriate. The longer-term impact arising from the pandemic will be kept under review. In order to manage any potential cash flow pressures as a direct result of the market volatility the allocations to private markets strategies will be phased in over the medium-term to mitigate liquidity risk.

5.4 Currently 37.5% of assets are allocated to equities of which 20% is targeted to be invested in sustainable and low carbon equities. Sustainable equity portfolios seek to maximise exposure to companies that are responding positively to the challenges of climate change, environmental sustainability or social well-being, whilst maintaining financial returns. The Fund's longer-term ambition is to invest all equity assets in sustainable and low carbon equities; however further analysis is required to assess the overall viability of making such a change and the impact on risk and return it is likely to have on the portfolio.

5.5 The investment cycle for private market assets means that commitments are drawn down over an extended timeframe. As a result, progress in reaching the target allocation for the private market assets and the consequent decrease in the existing allocations to liquid growth strategies will depend upon Brunel in identifying suitable investments, and on the pace of the subsequent draw down of capital.

5.6 The strategic framework includes a target allocation against which strategic performance is monitored by Committee. In addition, there are ranges for each asset category that allow limited deviation within the framework. The ranges enable the Fund to reflect changes in the market outlook and provide greater flexibility to manage cash flow. The ability to periodically rebalance asset holdings enables the Fund to effectively implement risk management strategies such as liability-driven investments, equity protection strategies and currency hedging which require collateral to be posted in order to maintain the desired level of risk reduction.

5.7 The Fund's long-term asset allocation following the 2019/20 review, along with an overview of the role each asset plays, is set out in Appendix 1.

6. Suitability of Investments

6.1 The Fund invests across a diversified portfolio of assets including quoted equity, government and non-government bonds and less liquid private market assets such as infrastructure, property and private debt. Derivatives are used for the purpose of efficient portfolio management and to hedge specific risks. The Fund implements these strategies using a combination of passive and active investment managers.

6.2 The allocations to secure income, renewable infrastructure and private debt exploit alternative sources of return and generate more income to improve cash flow to provide greater stability in contribution rates. Secure Income and some infrastructure assets benefit directly from contractual, inflation-linked income with fixed uplifts, which make them an ideal tool for cash flow management purposes.

6.3 Climate change scenario modelling indicates that allocating to sustainable and low carbon equities can capture a low carbon transition 'premium' under various climate change scenarios and displays no materially greater level of downside risk versus broader equity allocations.

6.4 The most recent investment strategy review analysed the reduction in carbon emission and reserves across the spectrum of investment approaches from fully invested to fossil free portfolios. The Fund concluded that low carbon strategies that significantly reduce exposure to fossil fuel reserves and carbon emissions across all companies, combined with robust engagement with companies regarding their climate strategies, is currently a more effective approach to meeting the Fund's climate objectives.

6.5 The portfolios offered by Brunel will typically consist of a number of underlying managers that will have complementary investment styles and approaches to investing. This results in highly diverse portfolios, carefully structured to manage stock specific risk as well as underlying manager, investment style and other financial risks.

6.6 Currently Brunel directly manages 30% of the Fund's assets across its Low Carbon passive equity portfolio, its actively managed UK, Emerging Market and High Alpha equity portfolios and private markets portfolios. A further 20% of assets relating to the Fund's risk management strategies are governed by Brunel legal agreements.

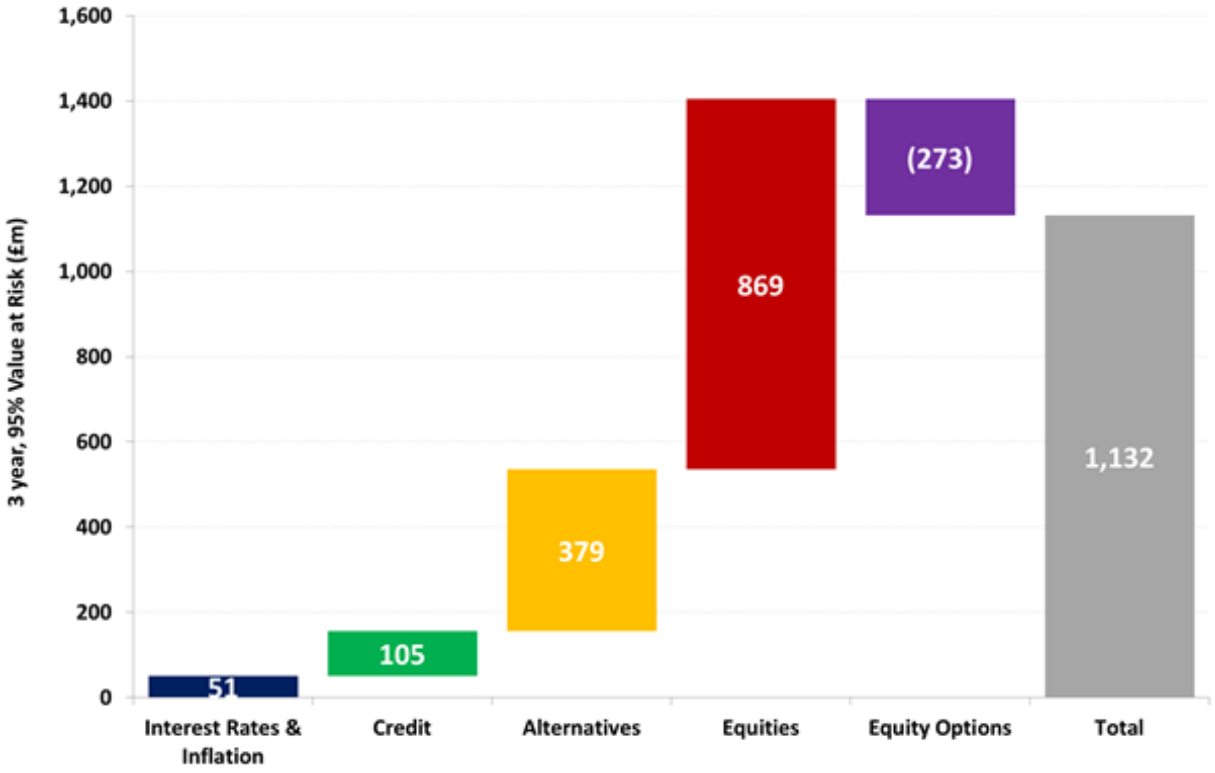
6.7 Consideration of each asset class or investment approach includes modelling of risk adjusted return expectations and an assessment of the extent to which the investment manager's approach is consistent with the Fund's Responsible Investment (RI) Policy including an assessment of the Environmental, Social and Governance (ESG) risks and opportunities identified for each asset class. Product structure and management costs will also be a factor.

Details of the current investment management structure can be found in Appendix 2.

7. Risk Measurement and Management

7.1 The primary risk to the Fund is that its assets are insufficient to meet its liabilities, as determined by the Funding Strategy Statement. The main risk to the employers is the volatility of the contribution rates, and affordability.

7.2 The graph below provides an indication of the main sources of investment risk to the funding position, as measured using three-year Value-at-Risk (VaR) based on the funding position and asset allocation as at 31 March 2020. This estimates how much the funding deficit could increase over a three-year period with a 1-in-20 probability.



Source: Mercer

7.3 The graph shows that if a 1-in-20 downside event occurred, in three years' time the deficit would be expected to increase by at least an additional £1,132m on top of the expected deficit at that time. The changes to the long-term investment strategy that were agreed following the 2019/20 review are expected to reduce the 3-year VaR by £25-30m. The reduction in risk is achieved with no impact on the average expected return of CPI+2.5% per annum.

7.4 Equities remain the largest source of risk. The Fund's equity protection strategy (discussed later in this section) reduces the three-year VaR number by approximately 25% (estimated by Mercer).

7.5 Evaluation of risks that may impact the investment strategy and expected future returns is crucial in determining the appropriate measures to mitigate those risks. The principal risks affecting the Fund and the actions to mitigate those risks are set out below.

Financial Risks	Management / Control
Investment Risk - Assets do not deliver the return required to meet the cost of benefits payable by the Fund; potential drivers: • Investment market performance/volatility • Manager underperformance • Possibility the actual return generated fails to meet the Fund's discount rate, due to inflation increasing more than expected or assets failing to deliver as expected	• Diversification - A diverse range of asset classes and approaches to investing is designed to achieve returns in a variety of market environments. By holding a range of assets that are not overly concentrated in any one area, the Fund expects to reduce the level of risk it is exposed to, whilst increasing the potential to generate attractive risk-adjusted returns • Scenario testing - carried out as part of the strategic investment review to set strategic benchmarks. Allocation 'ranges' enable tactical positions to be implemented to reflect shorter-term market outlook • Regular monitoring of manager performance - Each manager is monitored against a three-year performance target designed to highlight any inappropriate risk-taking behaviour and address factors that may impact the ability of that manager to achieve their performance target. A number of risk metrics are monitored at the portfolio level including tracking error and active risk positions • Mitigates inflation risk by implementing a diversified investment strategy, through the alignment of the investment strategy with funding requirements through regular reviews and through regular monitoring. At the Fund level Value at Risk and correlation between asset returns are monitored. Management of strategic risks such as inflation and equity market volatility are addressed through a dedicated risk management framework. See Section 7 for further information.
Asset Risk - • Liquidity risk: The inherent risk of holding illiquid/less liquid assets that cannot be easily converted into cash • Exchange Rate risk: Foreign currency exposure is expected to be an unrewarded risk over the longer term • Collateral Management risk: Collateral - often cash - is required to support specific components of the investment strategy and protects all parties to a transaction from the risk of default	• Investing across a range of liquid assets recognises the Fund's need for some access to liquidity in the short term. A tactical liquidity strategy that seeks to replicate the Fund's strategic benchmark offers immediate access to cash to negate the risk of selling assets when it might be inopportune to do so • Liquidity budgeting informs how much the Fund can reasonably afford to invest in illiquid holdings in order to benefit from the 'illiquidity premium', without compromising future outgo requirements. Following the extreme market volatility as a direct result of the Coronavirus pandemic, the Fund prioritised short-term cash flow requirements over private markets commitments, opting to phase in its commitments over the medium-term rather than commit the full long-term target amount at outset. • Foreign exchange hedging protects the sterling value of overseas investments and serves to reduce the volatility that arises from movements in exchange rates. The programme consists of a 50% passive hedge of the US Dollar, Yen and Euro currency exposure for the Fund's developed equity holdings and a 100% hedge of

	currency risk for infrastructure, global property and hedge fund investments. In periods of sterling weakness the investment return will be lower than if the assets were unhedged • A robust and pro-active collateral monitoring process with prescribed minimum thresholds protect the fund from becoming a forced seller of assets in the event a large adverse move in market prices triggers a collateral call
Responsible Investment - • Environmental, Social & Governance (ESG) issues may have a material financial impact on the Fund if not given due consideration • Climate change	• Actively addresses ESG risks through implementation of its Responsible Investment Policy • Considers ESG risks as part of Strategic Investment Reviews • Quantifies the risk climate change presents to Fund assets and seeks to reduce this risk by allocating capital accordingly • Is compliant with the UK Stewardship code for Institutional Investors Details of the Fund's approach to managing ESG risks are set out in Section 8 of this document.
Longevity Risk - the risk Members of the Fund live longer than assumed in the actuarial valuation model	• Captured within the funding strategy which is monitored by the Committee on at least a three-yearly cycle. Any improvement or deterioration in longevity will only be realised over the long term

Operational /Other Risks	Management / Control
Investment Pooling - • Expected benefits and cost savings do not emerge over the long-term • Transition risks - unexpected costs or losses arising from transition of assets	• The Service Agreement sets out the duties and responsibilities of the Pool and the rights of the Fund as a client • A robust governance framework with agreed constitution and terms of reference ensures the objectives of pooling are met • Ongoing monitoring of performance, service delivery, costs and savings arising from pooling Details of the Fund’s Pooling arrangement are set out in Section 2 of this document.
Employer Covenant Risk - Employers within the Fund lack the financial capacity to make good their outstanding liabilities	• Addressed through a covenant assessment monitoring process, which annually assess the financial standing of all Employers in the Fund and the analysis is considered when setting the Funding Strategy • A lower risk investment strategy is adopted for certain admission bodies and orphan liabilities where there is no guarantee underpinning the liabilities

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 markets subject to political uncertainty	• Ongoing horizon scanning and consideration on the Fund Risk Register • Review and response to consultations on changes to the LGPS regulations and guidance which may impact scheme funding or investment strategy • Ongoing review of the investment strategy and specific investment portfolios
Governance Risk - Committee Members do not have sufficient expertise to evaluate and challenge the advice they receive. Committee members are to possess an appropriate level of knowledge, skill and understanding to discharge their fiduciary duty	• Periodic Member self-assessment • Training framework based on Chartered Institute of Public Finance and Accounting (CIPFA) Knowledge and Skills Framework for LGPS funds • Expert advice commissioned to support strategic and implementation decisions
Cash Flow Risk - Payments to pensioner members exceed contributions	• Investment strategy structured to generate investment income to help manage negative cash flow profile • Monitoring cash flow critical to the internal monitoring and rebalancing process and is an important consideration when setting investment strategy
Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded	• Use of global custodian with negotiated service level agreement and internal reconciliation of accounting records
Counterparty risk - The possibility of default of a counterparty in meeting its obligations	• Counterparty exposure restrictions as relates to the risk management framework • Internal controls reporting and compliance monitoring

Risk Management Strategy

7.6 The Risk Management Framework encompasses three bespoke risk management strategies and a passive equity fund for collateral management purposes. The Liability Driven Investment (LDI) Strategy and the ‘Lower Risk’ strategy (which includes a Buy-and-Maintain Corporate Bond Portfolio) are designed to hedge interest rate and inflation risks arising from the liabilities, whereas the Equity Protection Strategy (EPS) protects the Fund from a large drawdown in the value of its equity investments. These strategies are linked to the funding strategy and de-risk the Fund by placing less reliance on growth assets to fund future pension benefits and to simultaneously protect the funding position.

7.7 The strategies are reviewed annually to assess whether a material change in market conditions requires an adjustment to any of the strategies to ensure they still meet the strategic objectives.

This review also considers the ongoing collateral requirements. Quarterly monitoring of the risk management strategies is delegated to the Investment Panel which considers collateral adequacy, the performance of the strategies and performance of the fund manager.

Liability Driven Investment Strategy (LDI)

7.8 The Fund is not in a position to reduce its exposure to higher return growth assets (e.g. equities) and use the proceeds to purchase lower return, 'liability matching' assets (e.g. Index-Linked Gilts), as the expected future return on the assets held would fall short of the assumptions built into the funding plan. The LDI strategy, therefore, allows the Fund to retain its allocation to growth assets and simultaneously increase its exposure to 'matching' assets through the use of repurchase agreements (a form of borrowing in capital markets) and/or derivatives, such as interest rate and inflation swaps[2].

7.9 In order to meet the assumed investment return in the funding strategy, the LDI strategy includes predetermined 'real yield' triggers, where exposure to 'matching' assets is only increased when they pay a sufficiently high yield to meet the Fund's requirements. The 'real yield' triggers are a combination of triggers on nominal interest rates, that is the risk-free interest rate attached to conventional Government bonds (gilts), plus triggers on the market expectation for future inflation rates.

Lower Risk Investment Strategy

7.10 The liabilities relating to this strategy are valued using the discount rate linked to the yields on the corporate bonds held within the portfolio. The strategy benefits from the inflation hedging undertaken within the LDI portfolio, resulting in greater stability of any funding deficit and therefore contributions for employers.

Equity Protection Strategy (EPS)

7.11 The EPS is underpinned by the funding level and protects against significant falls in developed and emerging equity markets. In order to structure the downside protection efficiently in terms of absolute protection levels and minimise transaction costs, equity gains are capped at c.9% (plus dividend income over the period the protection is in place) from the absolute market levels at which the protection strategy was struck.

Role of Collateral in Risk Management Framework

7.12 The risk management strategies are held in a Qualified Investor Fund (QIF), bespoke to the Fund, enabling collateral management to be delegated to the investment manager. The LDI and EPS both use derivative instruments that require collateral (often in the form of cash) to be posted on a daily basis. This protects all parties to a transaction against the risk that one defaults and is unable to fulfil the terms of the financial contract.

7.13 To reduce the risk of the Fund having to sell assets at short notice if more collateral is required, a passively managed pooled equity fund is held within the QIF. The manager of the QIF will sell units in this equity fund and purchase eligible collateral (gilts or cash) to meet collateral obligations when they arise. When the investment manager sells assets to meet collateral requirements, derivatives will be used to replicate the lost physical equity exposure so that the strategic allocation to equities is maintained.

[2] An inflation swap is a contract used to transfer inflation risk from one party to another through an exchange of cashflows. An interest rate swap is a contract to exchange a fixed interest rate for a floating rate, or vice versa, to reduce or increase exposure to fluctuations in interest rates.

Risk Management Strategy under Pooling

7.14 The Fund retains responsibility for strategic and operational aspects attached to its risk management strategies and seeks advice from its investment advisors on the suitability of the risk management strategies. The pooling arrangement allows the Fund to determine a bespoke strategy for LDI, EPS and the low risk investment portfolio to meet its risk management objectives. Brunel does not advise on the suitability of investments made for the express purposes of efficient portfolio risk management.

7.15 Brunel contracts with the investment manager to set out the basis on which the manager will offer its services to client funds within the pool. This enables Brunel to access information so they can monitor the manager and delivery of services to clients. Clients also benefit from increased economies of scale and negotiated fee structures arising from the Brunel agreement.

8. Responsible Investment (RI)

RI Principles

8.1 The Fund has a Responsible Investing (RI) Policy where it defines RI as the integration of Environmental, Social and Corporate Governance (ESG) issues into its investment processes and ownership practices in the belief this can positively impact financial performance. The RI Policy supports the wider investment strategy and seeks to understand and manage ESG and reputational risks to which the Fund is exposed. The full policy is available at the following link:

https://www.avonpensionfund.org.uk/sites/default/files/RIP2016.pdf

8.2 The Fund's approach to Responsible investing is based on its RI Principles as follows:

- As a long term investor it seeks to deliver long term sustainable returns
- Management of ESG risks is consistent with the Fund's fiduciary duty to members
- That Climate Change poses a long-term financial risk to the Fund
- ESG issues are integrated at all stages of the investment decision-making process
- Strategies and policies must be evidence–based
- The Fund has a duty to exercise its stewardship responsibilities as an owner
- The Fund aims to be transparent and accountable

8.3 The Fund's policy is to integrate RI across its investment decision-making process for the entire portfolio. When setting the investment strategy and objectives the analysis includes the impact of ESG issues on each asset class, the materiality of ESG risks within those asset classes and whether there are any strategic ESG-related opportunities that would generate value.

8.4 The Fund does not have an exclusion policy to divest from specific assets but manages such risks by analysing ESG factors identified as potentially financially material in its strategic reviews. The Fund expects its managers to engage with company management on ESG issues they have identified as being a risk to the investment case; it is the Fund's belief that engagement and responsible stewardship will influence corporate behaviour more effectively than divestment. Managers are required to report to the Fund on their engagement activities and other ESG initiatives regularly.

8.5 The RI Policy allows the Fund to consider non-financial factors alongside financial considerations provided that doing so will not involve significant risk of financial detriment to the Fund and where it can reasonably conclude that members would support the decision.

Climate Change

8.6 The Fund recognises that Climate change presents an immediate systemic and material financial risk to the Fund, as well as society more broadly. It is a strategic investment priority for the Fund and as well as developing proprietary climate change objectives, the Fund has supported Brunel in the development of its comprehensive and market leading Climate Change Policy, which sets out how they manage these risks across all of their activities. The full policy is available at the following link: https://www.brunelpensionpartnership.org/climate-change/

8.7 The Fund has set targets to ensure that the portfolios are aligned with the Paris Agreement ambition to limit global warming to below 2°C by 2050, specifically:

(1) Implement a <2^{0}C aligned portfolio by committing to net zero emissions by 2050 or earlier. This will be achieved by working with Brunel using the results of the industry wide project being undertaken to assess what each 2^{0}C asset portfolio will look like. Expect to review the findings in line with the global stocktake timeline in 2022/23.

(2) Reduce the carbon intensity of the equity portfolio over time with the aim of being 30% less carbon intensive than the benchmark by 2022.

(3) Invest sustainably to support a 'just transition[3]' to the low carbon economy with the aim of investing at least 30% of the total assets in sustainable and low carbon investments by 2025.

(4) Use the Fund's power as a shareholder to encourage change. Financial markets and companies urgently need to adapt their activities to support the transition to a low carbon economy. Collaboration as part of Brunel Pension Partnership makes our influence more powerful as they manage a £30bn pool of assets. In addition, the Fund will independently support investor led initiatives such as ClimateAction100+ and Institutional Investors Group on Climate Change to increase pressure on companies and governments to align with the Paris goals. If engagement does not work ahead of the Paris Stocktake in 2023, we will consider selective divestment from laggard companies

8.8 The Fund monitors its carbon exposure annually to inform strategic decisions relating to climate change and to chart its progress towards its long-term climate change objectives.

RI and Pooling

8.9 One of the principal benefits of pooling, achieved through scale and resources arising from pooling, is the improved implementation of responsible investment and stewardship across all the Fund's assets. Brunel's Investment Principles articulate clearly its commitment and that of each client in the pool, to be responsible investors and as such recognises that ESG considerations are an integral part of portfolio construction, the selection, non-selection, retention and realisation of assets. Every Brunel portfolio explicitly includes responsible investment and an assessment of how social, environment and corporate governance considerations may present financial risks to the delivery of the portfolio objectives. The approach undertaken will vary to be the most

[3] A 'just transition' for workers and communities as the world's economy responds to climate change was included as part of the 2015 Paris Agreement. The concept builds on well-established global frameworks in terms of climate change, human rights, labour standards and inclusive growth. It focuses attention on the need to anticipate and manage the social and economic implications of the shift to a low-carbon economy and the increasing physical impacts of climate change.

effective in mitigating risks and enhancing shareholder value in relation to each portfolio and its objectives.

8.10 Brunel is tasked with the development of investment portfolios and the appointment of managers for the portfolios that are consistent with and accommodate the Fund's wider RI objectives and long-term asset allocation decisions. Proprietary Brunel policies covering ESG factors such as climate change, voting and stewardship have been developed in conjunction with its clients to ensure the needs of the respective client funds are adequately met in respect of RI. The Fund monitors the portfolios managed by Brunel to ensure they continue to deliver against strategy.

8.11 Brunel is a signatory to the UN backed Principles of Responsible Investment and has published a comprehensive Responsible Investment Policy. Under its policy framework Brunel publishes position statements, engagement plans, voting records and an Annual Responsible Investment and Outcomes Report. More information can be found on the Brunel website here: https://www.brunelpensionpartnership.org/responsible-investment/

Policy of the exercise of rights (including voting rights)

8.12 The FRC UK Stewardship Code (the Code) explains that "stewardship aims to promote the long-term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole." The Fund is a signatory to the Code and has outlined its approach to stewardship, including voting and engagement in its Statement of Commitment to the Code and will work with Brunel to ensure it maintains its signatory status under the Stewardship Code 2020.

8.13 The Fund believes that voting is an integral part of the RI and stewardship process. Under the current arrangements voting is delegated to its investment managers including Brunel. The Fund monitors how its investment managers undertake voting and engagement activities in comparison to relevant codes of practice. Where practicable, managers are required to vote in all markets and vote at all company meetings on behalf of the Fund. For legacy assets the Fund retains the right to recall stock that has been lent out under its securities lending programme to enable voting.

8.14 Brunel has a single voting policy for all assets under its management held in segregated accounts. In addition, Brunel will actively attend and vote at company meetings (AGM/ EGMs). Brunel has the right to recall stock that has been lent out in its portfolios to enable voting.

8.15 Brunel's voting and engagement service provider, Federated Hermes EOS, enables the Fund to gain access to specialist expertise and participate in a broad range of engagement themes.

8.16 Brunel will publish its voting policy and provide online voting records no less than twice a year.

8.17 The Fund recognises the importance of collaboration with other investors in order to achieve wider and more effective outcomes. In this respect, the Fund is a member of the Local Authority Pension Fund Forum (LAPFF), a membership group of LGPS funds that focuses on corporate governance issues, and the promotion of high standards of corporate governance and responsibility.

8.18 The Fund publishes a Responsible Investment Report annually which includes analysis of the voting and engagement activity of its investment managers.

Social Investments

8.19 Investments that deliver social impact as well as a financial return are often described as "social investments" which cover a wide spectrum of investment opportunities. The Fund applies risk and return criteria consistently when evaluating all investment opportunities including those that

address societal challenges as well as generate competitive financial returns with an acceptable risk / return profile in line with the investment strategy. Currently the Fund does not allocate directly to social investments.

Appendix 1 – Long-Term Asset Allocation

Asset Class	Target %	Permitted Range	Role within Strategy
Equity Portfolio	**37.5%**	**+/-5%**	
Global Equity	12.0%	7.0-17.0%	Possess characteristics e.g., highly developed capital markets, high liquidity, bond 'proxies' / income seeking, large and small market capitalisation. Given the globalisation of sectors and companies, the strategic policy is to allocate to global markets. As a result there is not a specific allocation to UK equities or other regional markets
Global Sustainable Equity	10.0%	5.0-15.0%	Seeks to maximise exposure to positive pursuit companies which provide solutions to sustainability whilst maintaining financial return. Sustainable equity portfolios comprise long-term forward-looking investment approaches which integrate ESG metrics throughout the investment process and for this reason comply with the Fund's climate change objectives and wider RI policy
Global Low Carbon Equity	10.0%	5.0-15.0%	Manages risks associated with the transition to a low carbon economy by tracking the returns of an index that assigns larger weights to companies with low carbon emissions. The index reflects a lower carbon exposure than that of the broad market and represents an approach consistent with the Fund's climate change objectives
Emerging Markets Equity	5.5%	3.0-9.0%	Possess characteristics such as rapid growth, illiquidity premium and potential for large capital growth
Liquid Growth Assets	**16.0%**	**+/-5%**	
Diversified Growth Funds	10.0%	5.0-15.0%	Builds exposure to alternative sources of return including dynamic tactical allocation and alternative risk premia derived from factors such as value, momentum, size and quality. Provides a degree of downside protection from equity risk by actively adjusting equity market beta
Multi Asset Credit	6.0%	3.0-9.0%	Provides exposure to a diversified range of credit opportunities such as high yield, leveraged and emerging market debt with limited exposure to interest rate risk
Illiquid Growth & Income Assets	**32.5%**	**n/a**	
Core Property	7.5%	5.0-10%	Provides further diversification within the Growth portfolio. Includes both UK and overseas real estate as well as private markets exposure where returns are less correlated with listed markets, and where the Fund is expected to receive a higher return. Property is expected to provide a hedge against inflation in the medium- to long-term
Secured Income	10.0%	0.0-15%	Backed by long maturity assets, Secured Income assets include long lease property, operational infrastructure assets and residential housing. These assets generate contractually secure income streams that provide greater stability of returns, explicit inflation linkage and generate cash flows over time
Core Infrastructure	5.0%	2.5-7.5%	Investments in UK and global infrastructure assets seek to invest in assets with strong market positions, predictable regulatory environments and high barriers to entry. Infrastructure is expected to provide a hedge against inflation in the medium to longer term.

			Some development risk will be considered
Renewable Infrastructure	5.0%	0.0-7.5%	Provides a source of contractual income from an opportunity set that benefits from the drive toward alternative energy sources. Displays lower levels of correlation with traditional assets than other infrastructure sub-sectors. Allocation consistent with the Fund's climate change objectives
Private Debt	5.0%	0.0-7.5%	Provides a source of contractual income with minimal interest rate sensitivity, high return potential through active management and diversification away from listed public market performance. Credit risk is managed via a well-diversified portfolio with a high number of individual credits
Protection Strategies	**14.0%**	**n/a**	
Corporate Bonds	2.0%	No set range	Expected to generate returns commensurate with credit risk. Held to broadly match a specific portion of the liabilities
LDI	12.0%	No set range	A risk reduction tool designed to provide more certainty of real investment returns vs inflation with the ultimate aim of stabilising employer contribution rates. The primary 'matching' instruments used in this strategy include physical instruments such as fixed interest and index-linked Government bonds (financed through "repurchase" agreements) and derivative instruments such as interest-rate and inflation swaps
Equity Protection	Overlay on 100% of equity portfolio		Protects against potential falls in the equity markets via the use of derivatives. The aim of the protection is to provide further stability in employer deficit contributions in the event of a significant equity market fall
Currency Hedging	Overlay on 50% overseas equities and 100% of alternatives		Currency hedging is employed on assets that are traded in overseas markets, in order to reduce the risk of adverse currency movements eroding returns. Asset classes where a significant portion of the return is linked to currency (e.g. emerging markets) are not hedged
Cash	**0.0%**	**0.0-5.0%**	Cash is exposed to credit risk and is generally a very low yielding asset. The Fund aims to be fully invested where possible. To efficiently manage cash the Fund uses a combination of money market funds with daily liquidity and a basket of highly liquid ETFs that are structured to replicate the return of the Fund's benchmark asset allocation
Total	**100%**		

Appendix 2 – Investment Manager Structure as at 31 March 2020

Manager	Mandate	Passive / Active	Performance Objective	% of Fund	Inception Date
Brunel Pension Partnership	Low Carbon Global Equities	Passive	MSCI World Low Carbon Target	11.10%	Jul-18
Brunel Pension Partnership	UK Equities	Active	FTSE All Share +2% p.a.	3.30%	Nov-18
Brunel Pension Partnership	Emerging Market Equities	Active	MSCI EM +2-3% p.a.	4.40%	Nov-19
Brunel Pension Partnership	Global Equities	Active	MSCI World +2-3% p.a.	8.40%	Dec-19
Brunel Pension Partnership	Secured Income	Active	CPI+2% p.a.	1.50%	Apr-18
Brunel Pension Partnership	Renewable Infrastructure	Active	CPI+4% p.a.	0.50%	Apr-18
BlackRock	Corporate Bonds	Bespoke	In line with customised benchmark	2.50%	Apr-19
BlackRock	Liability Driven Investments	Bespoke	In line with customised benchmark	6.40%	Jul-17
BlackRock	Equity Protection Strategy & Global Equities	Passive	MSCI World (for Global Equity Fund)	11.90%	Nov-17
BlackRock	Liquidity Management Strategy	Passive	In line with customised benchmark	0.90%	Feb-19
Jupiter Asset Management	UK Equities (Socially Responsible Investing)	Active	FTSE All Share +2% p.a.	3.60%	Apr-01
Jupiter Asset Management	Global Sustainable Equities	Active	MSCI ACWI +2-4%	0.30%	Jun-18
Pyrford International	Diversified Growth Funds	Active	RPI +5% p.a.	4.80%	Nov-13
Ruffer	Diversified Growth Funds	Active	Cash +5% p.a.	8.70%	Sep-17
JP Morgan Asset Management	Fund of Hedge Funds	Active	Higher of Cash+3%, or 6% p.a.	5.80%	Jul-15
Schroders Investment Management	UK Property	Active	IPD UK Pooled Property Fund Index +1% p.a.	5.10%	Feb-09
Partners Group	Overseas Property	Active	IPD Global Property Index +2% p.a.	4.70%	Sep-09
IFM	Infrastructure	Active	Gilts +2.5% p.a.	7.40%	Sep-14
Loomis	Multi Asset Credit	Active	In line with customised benchmark	6.50%	Sep-17
Record Currency Management	Currency hedge (equity exposure)	Passive	N/A	0.50%	Jul-11
Cash (Internal)	Cash	Passive	N/A	2.10%	N/A