

Somerset County Council Pension Fund

Investment Strategy Statement

1. Introduction

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require administering authorities to formulate and to publish a statement of its investment strategy, in accordance with guidance issued from time to time by the Secretary of State.

The regulations provide a prudential framework, within which administering authorities are responsible for setting their policy on asset allocation, risk and diversity. The Investment Strategy Statement will therefore be an important governance tool for the Somerset Pension Fund as well as providing transparency in relation to how Fund investments are managed.

The Somerset Pension Fund's primary purpose is to provide pension benefits for its members. The Fund's investments will be managed to achieve a return that will ensure the solvency of the Fund and provide for members' benefits in a way that achieves long term cost efficiency and effectively manages risk. The Investment Strategy Statement therefore sets out a strategy that is designed to achieve an investment return consistent with the objectives and assumptions set out in the Fund's Funding Strategy Statement.

The Somerset Pension Fund aims to be a long term investor, it seeks to invest in productive assets that contribute to economic activity, such as equities, bonds and real assets. The Fund diversifies its investments between a variety of different types of assets in order to manage risk.

The Investment Strategy Statement will set out in more detail:

- The Somerset Fund's assessment of the suitability of particular types of investments, and the balance between asset classes.
- The Somerset Fund's approach to risk and how risks will be measured and managed, consistent with achieving the required investment return.
- The Somerset Fund's approach to pooling and its relationship with the Brunel Pension Partnership.
- The Somerset Fund's policy on how social, environmental or corporate governance considerations are taken into account in its investment strategy, including its stewardship responsibilities as a shareholder and asset owner.

Under the previous regulations the Fund was required to comment on how it complied with the Myners Principles. These were developed following a review of institutional investment by Lord Myners in 2000, and were updated following a review by the National Association of Pension Funds in 2008. While a statement on compliance with the Myners Principles is no longer required by regulation, the Somerset Pension Fund considers the Myners Principles to be a standard for Pension Fund investment management. A statement on compliance is included at Annex 1.

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

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

The primary objective of the Somerset Pension Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death before or after retirement for their dependants, in accordance with LGPS Regulations.

In line with the Fund's Funding Strategy Statement, the Pensions Committee has set an objective of the Fund being at or above a 100% funding level, as calculated by the Fund's actuary at the triennial valuation, so that it can meet its current and future liabilities.

In order to meet these overriding objectives, the Somerset Pension Fund maintains an investment strategy so as to:

- Maximise the returns from investments whilst keeping risk within acceptable levels and ensuring liquidity requirements are at all times met;
- Contribute towards achieving and maintaining a future funding level of 100%;
- Enable employer contribution rates to be kept as stable as possible.

The Somerset Pension Fund has the following investment beliefs which help to inform the investment strategy derived from the decision making process.

- Funding, investment strategy and contribution rates are linked.
- The strategic asset allocation is the key factor in determining the risk and return profile of the Fund's investments.
- Investing over the long term provides opportunities to improve returns.
- Diversification across asset classes can help to mitigate against adverse market conditions and assist the Fund to produce a smoother return profile due to returns coming from a range of different sources.
- Managing risk is a multi-dimensional and complex task but the overriding principle is to avoid taking more risk than is necessary to achieve the Fund's objectives.
- Environmental, Social and Governance are important factors for the sustainability of investment returns over the long term. More detail on this is provided in Section 5.
- Value for money from investments is important, not just absolute costs. Asset pooling is expected to help reduce costs over the long-term, whilst providing more choice of investments, and therefore be additive to Fund returns.
- Active management, after all relevant fees and charges, can add value to returns, albeit with higher short-term volatility.

The Pensions Committee annually adopts a target return for the investment funds as a whole. This target return is set with specific reference to the investment return assumed by the actuary as part of the valuation process and therefore explicitly links the Fund's targeted level of return with achieving and maintaining a future funding level of 100%.

In order to translate the above objectives and beliefs into a set of investment mandates for practical management of the investments the Pension Committee have created a customised benchmark for the Fund. The customised benchmark is an amalgamation of specific benchmarks for each investment mandate, which is then given to an investment manager (internal or external) for day to day management.

The customised benchmark sets out the intended long term weighting to various types of investment (or asset classes), such as equities, bonds and property and reflects the Fund's investment strategy. The customised benchmark seeks to balance the affordability of contributions with the risk of different types of investments.

The investment strategy and customised benchmark are reviewed by the Pensions Committee annually to ensure they continue to meet the Fund's investment objectives.

The Actuary considers the Pension Fund's assets in broad terms – growth assets and stabilising assets. The table below splits the customised benchmark between these categories, along with an overview of the role each asset plays:

Asset Class	Strategic Allocation	Role(s) within the strategy	Geography	Currency
Equities				
Global Passive (FTSE Russell Paris Aligned series)	20%	Growth Inflation protection	Diversified	Diversified
UK Active	10%	Growth Inflation protection	UK	GBP
Global High Alpha Active	25%	Growth Inflation protection	Diversified	Diversified
Global Smaller Companies Active	5%	Growth Inflation protection	Diversified	Diversified
Emerging Market Active	5%	Growth Inflation protection	Diversified	Diversified
Total	65%			
Maximum	100%			

Bonds				
UK Gov't Bonds	4%	Stabilising	UK	GBP
UK Gov't Index linked bonds	4%	Stabilising Inflation protection	UK	GBP
Investment Grade corporate bonds	8%	Stabilising	Diversified	GBP
Multi-Asset Credit	3	Stabilising	Diversified	Diversified
Total	19%			
Maximum	100%			
Alternatives				
Property	10%	Growth Inflation protection	UK	GBP
Private equity	5%	Growth	Diversified	Diversified
Total	15%			
Maximum	25%			
Cash				
Cash	1%	Liquidity	UK	GBP
Total	1%			
Maximum	100%			

The Fund's benchmark currently includes a significant holding in 'growth' assets, specifically equities, reflecting its need for higher returns than from government bonds in the long term. These long term returns form part of the Actuary's assumptions and mean that employer contributions can be kept lower.

Actual asset allocation varies over time through the impact of market movements and cash flows. The overall balance is monitored regularly by officers and they have delegated authority to rebalance the assets taking into account market conditions and other relevant factors. The actual asset allocation and the actions taken by officers are reported to the Pensions Committee regularly.

As well as monitoring asset allocation officers also regularly monitor the largest single asset exposures and concentrations to ensure inappropriate exposures do not occur.

As there is a strong internal monitoring mechanism in place it is not deemed necessary to place an upper limit on the exposure of the fund to assets that are readily realisable such as assets listed on a regulated exchange or pooled funds that provide daily dealing. This is reflected in the maximum exposures of 100% quoted in the table above although it is not anticipated that this is likely to occur in anything but the most extreme circumstances. For assets that are illiquid, such as property and private equity funds a limit of 25% of the total value of the fund has been set.

It is anticipated that the majority of assets held will be collective investment funds provided by Brunel Pension Partnership Ltd., the Fund's chosen pool provider. Each Brunel offering is created to meet a specification agreed by Brunel and its Clients. Clients regularly review the portfolios to ensure they continue to meet, and do not deviate from, the agreed specifications.

Whilst it is now anticipated that the majority of holdings will be in collective investment funds the Somerset Pension Fund can invest in the following asset types:

- listed stocks, shares and warrants of companies;
- listed government and corporate bonds;
- futures and options;
- Interest rate and inflation swaps
- spot and forward currency contracts;
- cash deposits with suitable banks and building societies;
- stock-lending arrangements;
- unlisted collective investment schemes such as unit trusts and investment companies;
- limited liability partnerships (LLPs) ; and
- unlisted shares.

3. Risk measurement and management

Successful investment involves taking considered risks, acknowledging that the returns achieved will to a large extent reflect the risks taken. There are short-term risks of loss arising from default by brokers, banks or custodians but the Somerset Pension Fund is careful only to deal with reputable counter-parties to minimise any such risk.

Longer-term investment risk includes the absolute risk of reduction in the value of assets through negative returns (which cannot be totally avoided if all major markets fall). It also includes the risk of under-performing the Fund's performance benchmark (relative risk).

Different types of investment have different risk characteristics and have historically yielded different rewards (returns). Equities (company shares) have produced better long-term returns than fixed interest stocks but they are more volatile and have at times produced negative returns for long periods.

In addition to targeting an acceptable overall level of investment risk, the Pensions Committee seeks to spread risks across a range of different sources, believing that diversification limits the impact of any single risk. The Committee aims to take on those risks for which a reward, in the form of excess returns, is expected over time.

The key investment risks that the Somerset Pension Fund is exposed to are:

- The risk that the Fund's growth assets in particular do not generate the returns expected as part of the funding plan in absolute terms.
- The risk that the Fund's assets do not generate the returns above inflation assumed in the funding plan, i.e. that pay and price inflation are significantly more than anticipated and assets do not keep up.
- That there are insufficient funds to meet liabilities as they fall due.
- That active managers underperform their performance objectives.

At Fund level, these risks are managed through:

- Diversification of investments by individual holding, asset class and by the investment managers appointed on behalf of the Fund by the Brunel Pension Partnership.
- Explicit mandates governing the activity of investment managers.
- The appointment of an Independent Investment Advisor.

The external investment managers can control relative risk to a large extent by using statistical techniques to forecast how volatile their performance is likely to be compared to the benchmark. The Fund can monitor this risk and impose limits.

The Somerset Pension Fund is also exposed to operational risk; this is mitigated through:

- A strong employer covenant.
- The use of a Global Custodian for custody of assets.
- Having formal contractual arrangements with investment managers.
- Comprehensive risk disclosures within the Annual Statement of Accounts.
- Internal and external audit arrangements.

The ultimate risk is that the Fund's assets produce worse returns than assumed by the Actuary, who values the assets and liabilities every three years, and that as a result, the solvency of the Fund deteriorates. To guard against this the Investment Strategy seeks to control risk but not to eliminate it. It is quite possible to take too little risk and thereby to fail to achieve the required performance.

The Somerset Pension Fund also recognises the following (predominantly non-investment) risks:

Longevity risk: this is the risk that the members of the Fund live longer than expected under the Actuarial Valuation assumptions. This risk is captured within the Actuarial Valuation report which is conducted at least triennially and monitored by the Committee, but any increase in longevity will only be realised over the long term.

Sponsor Covenant risk: the financial capacity and willingness of the sponsoring employers to support the Fund is a key consideration of the Committee and is reviewed on a regular basis.

Liquidity risk: the Committee recognises that there is liquidity risk in holding assets that are not readily marketable and realisable. Given the long-term investment horizon, the Committee believes that a degree of liquidity risk is acceptable, given the potential return. The majority of the Fund's assets are realisable at relatively short notice.

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 environments subject to unstable regimes. The Committee will attempt to invest in a manner which seeks to minimise the impact of any such regulatory or political change should such a change occur.

Climate change risk: climate change is a systemic investment risk that may have an impact on investee companies as a result of both the consequences of climate change and the transition to a low carbon economy. The Fund's approach to climate change is included in section 5 of the Investment Strategy Statement, and the Fund will expect Brunel and other fund managers to have policies in place to manage the risk.

Cashflow risk: the Fund's cashflow is currently positive, in that income from contributions currently meet benefit obligations without the need to disinvest from the Fund's investments. Over time, it is likely that the size of pensioner cashflows will increase as the Fund matures and greater consideration will need to be given to raising capital to meet outgoings. The Pensions Committee recognises that this can present additional risks, particularly if there is a requirement to sell assets at inopportune times, and so looks to mitigate this by taking income from investments where possible.

Governance: members of the Pensions Committee and Local Pension Board participate in regular training delivered through a formal programme. Both the Pensions Committee and Local Pension Board are aware that poor governance and in particular high turnover of members may prove detrimental to the investment strategy, fund administration, liability management and corporate governance and seeks to minimise turnover where possible.

The Fund maintains a risk register which is considered by the Pensions Committee regularly and updated as necessary. The risk register considers a number of investment and non-investment risks such as those above.

The Fund's Funding Strategy Statement specifically covers the risks with respect to Funding and how these are managed by the Fund.

4. Approach to asset pooling

The Somerset Pension Fund participates with nine other administering authorities to pool investment assets through the Brunel Pension Partnership. At the centre of the partnership is Brunel Pension Partnership Limited (Brunel), a company established specifically to manage the assets within the pool.

The Somerset Pension Fund, through the Pensions Committee, retains the responsibility for setting the detailed strategic asset allocation for the Fund and allocating investment assets to the portfolios provided by Brunel.

The Brunel Pension Partnership Ltd, established in July 2017, is a company wholly owned by the Administering Authorities (in equal shares) that participate in the pool. The company is authorised by the Financial Conduct Authority (FCA). It is responsible for implementing the detailed strategic asset allocations of the participating funds by investing those funds' assets within defined outcome focused investment portfolios. In particular, it researches and selects the external managers or pooled funds needed to meet the investment objective of each portfolio. Brunel will create collective investment vehicles for quoted assets such as equities and bonds; for private market investments it will create and manage an investment programme with a defined investment cycle for each asset class.

As a client of Brunel, the Somerset Pension 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 Somerset Pension Fund as a client. It includes a duty of care of Brunel to act in its clients' interests.

The governance arrangements for the pool have been established. The Brunel Oversight Board is comprised of representatives from each of the Administering Authorities and two fund member observers, with an agreed constitution and terms of reference. Acting for the Administering Authorities, it has ultimate 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 will consider relevant matters on behalf of the Administering Authorities, but does not have delegated powers to take decisions requiring shareholder approval. These will be 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.

The Oversight Board will be supported by the Client Group, comprised primarily of pension investment officers drawn from each of the Administering Authorities but will also draw on Administering Authorities finance and legal officers from time to time. It has a primary role in reviewing the implementation of pooling by Brunel. It provides a forum for discussing technical and practical matters, confirming priorities, and resolving differences. It is responsible for providing practical support to enable the Oversight Board to fulfil its monitoring and oversight function. The Client Group will monitor Brunel's performance and service delivery for each of the established Brunel portfolios. The Somerset Pensions Committee will receive regular reports covering portfolio and Fund performance and Brunel's service delivery.

The proposed arrangements for asset pooling for the Brunel pool were formulated to meet the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and Government guidance. Regular reports have been made to Government on progress, and the Minister for Local Government has confirmed on a number of occasions that the pool should proceed as set out in the proposals made.

Somerset's Pensions Committee approved the full business case for the Brunel Pension Partnership in 2017. The process of transitioning the Fund's assets to the portfolios managed by Brunel started in April 2018 (the passive equity assets transitioned in July 2018) and was completed (except for legacy private market assets) in July 2021.

Following the completion of the transition plan, virtually all of the Somerset Pension Fund's assets are invested through Brunel portfolios except certain cash holdings. However, the Fund has certain commitments to long term illiquid investment funds 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.

5. Social, environmental and corporate governance policy

The Somerset Pension Fund has a fiduciary duty to seek to obtain the best financial return that it can for its members. This is a fundamental principle, and all other considerations are secondary. However, the Fund is also mindful of its responsibilities as a long term shareholder, and the Pensions Committee regularly considers the extent to which it wishes to take into account social, environmental or ethical issues in its investment policies. The Fund's policy is to support engagement with companies to effect change, rather than disinvestment.

In the light of that overarching approach the following principles have been adopted:

- The Fund seeks to be a long term responsible investor. The Fund believes that in the long term it will generate better financial returns by investing in companies and assets that demonstrate they contribute to the long term sustainable success of the global economy and society.
- Social, environmental and ethical concerns will not inhibit the delivery of the Fund's investment strategy and will not impose any restrictions on the type, nature of companies/assets held within the portfolios that the Fund invests in. However, the identification and management of ESG risks that may be financially material is consistent with our fiduciary duty to members.
- The Fund will seek to engage (through the Brunel Pension Partnership, its asset managers or other resources) with companies to ensure they can deliver sustainable financial returns over the long-term as part of comprehensive risk analysis. Engagement with companies is more likely to be successful if the Fund continues to be a shareholder.
- Although social, environmental and ethical issues rarely arise on the agendas of company Annual General Meetings, where an issue does arise the Fund's investment managers will vote in accordance with the Fund's interest on investment grounds. Some issues may be incorporated into generally accepted Corporate Governance Best Practice (e.g. the inclusion of an Environmental Statement in the Annual Report and Accounts). In this case the Council will instruct its external investment managers to vote against the adoption of the Annual Report, if no such statement is included.

- The Fund recognises the risks associated with social, environmental and governance (ESG) issues, and the potential impact on the financial returns if those risks are not managed effectively. The Fund will work with its partners in the Brunel pool and the Brunel Pension Partnership Limited company to ensure that robust systems are in place for monitoring ESG risk, both at a portfolio and a total fund level, and that the associated risks are effectively managed.
- More broadly the Fund adopts the policies set out in the Brunel Responsible Investment Policy. The Brunel policy can be found at: <https://www.brunelpensionpartnership.org/responsible-investment/responsible-investment-policy/>

Climate Change

The Somerset Pension Fund believes climate change poses significant risks to global financial stability and could thereby create climate-related financial risks to the Fund's investments unless action is taken to mitigate these risks. In recognising the need to address the risks associated with climate change posed to both the Fund's investments and our beneficiaries, we acknowledge that there is an urgent need to accelerate the transition towards global net zero emissions and play our part in helping deliver the goals of the Paris Agreement. The Somerset Pension Fund has therefore pledged that its portfolio of investments will be net-zero by 2040, or sooner if investment products allow. In order to achieve this goal, the Fund has set an initial target of a 7% per annum reduction in the Weighted Average Carbon Intensity (WACI) of the Fund's investments, based on the March 2019 calculation of the WACI, to be reviewed in 2022. This recognises the need for significant progress in the earlier part of the period to 2040, with the intention of achieving at least a 50% reduction by 2030. These targets will also be applied to the Fund's exposure to fossil fuel reserves as a proxy for downstream scope 3 emissions which are not captured within the WACI calculation.

This will be achieved by the following strategy.

(a) We recognise that climate change will have impacts across our portfolios. This means we look to the Brunel Pension Partnership and all our asset managers to identify and manage climate-related financial risks as part of day-to-day fund management. The way those risks and opportunities present themselves varies, particularly in evaluating what a portfolio aligned to the Paris Agreement looks like.

(b) The Somerset Pension Fund wants to play its part in achieving real economy emissions reductions. This means that we are looking for investee companies, irrespective of industry or type, to make significant reductions in their emissions, rather than just shifting our investments from higher emitting companies to lower emitting companies. The Fund does not therefore consider a top-down approach to disinvestment to be an appropriate strategy. By integrating climate change into risk management process, using carbon footprinting, assessing fossil fuel exposure and challenging managers on physical risks, we seek to both reduce climate and carbon risk and achieve real reductions in global emissions. Where investee companies fail to engage with climate change issues, selective disinvestment may be appropriate based on investment risk.

(c) We are committed to working with Brunel to decarbonise our investments in listed portfolios. Decarbonisation is achieved by being selective in the allocation of capital, particularly to carbon intense companies. This process is informed by using a variety of tools in combination with industry and corporate engagement. For example, engagement with electric utility companies about their future strategy on energy sources informs the investment decisions relating to those companies and indeed the relative attractiveness of the sector over time.

(d) The Somerset Pension Fund will collaborate via the Brunel Pension Partnership and the Local Authority Pension Fund Forum (LAPFF) to advocate policy and regulatory reforms aimed at achieving global net zero emissions by 2050 or sooner. This will include engaging with asset managers, credit rating agencies, auditors, stock exchanges, proxy advisers, investment consultants, and data and service providers to ensure that funds, products and services available to investors are consistent with achieving global net zero emissions by 2050 or sooner.

(e) We expect the engagement and voting conducted on behalf of the Fund by LAPFF, Brunel and underlying investment managers to be consistent with an objective for all assets in the portfolio to achieve net zero emissions by 2040 or sooner. The Fund's stewardship and voting policies are set out more fully in section 6 of the Investment Strategy Statement.

(f) Climate change risk and carbon reduction targets will be a consideration in reviews of the Fund's strategic asset allocation. This will be considered ensuring consistency with the Fund's fiduciary duty to achieve the investment returns required to meet its future pension liabilities.

(g) The Somerset Pension Fund adopts the Brunel Pension Partnership's climate change policy, found at the following link:

<https://www.brunelpensionpartnership.org/climate-change/>

(h) Somerset County Council has committed to reduce the carbon emissions from its operations to net-zero by 2030. This will include the operational emissions of the Somerset County Council Investment Team in the oversight of the Somerset Pension Fund's investments, and the administration of benefits by Peninsula Pensions in conjunction with Devon County Council.

(j) We are committed to being transparent about the carbon intensity of our investments through the publication of the Fund's carbon footprint and reserves exposure on an annual basis. This will enable us to measure progress against the targets set out above. The Fund will also report on delivery through the Brunel Annual Climate Action Plan and work towards meeting the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

DRAFT

6. Stewardship Policy

The Somerset Pension Fund is committed to responsible stewardship and believe that through stewardship it can contribute to the care, and ultimately long-term success, of all the assets within our remit.

The Fund supports and applies the UK Stewardship Code 2020 definition of stewardship: "Stewardship is the responsible allocation, management, and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society."

The Somerset Pension Fund works with or through the Brunel Pension Partnership, the Local Authority Pension Fund Forum and/or other partners to pursue activities which are outcomes focused, which prioritise the pursuit and achievement of positive real-world goals, and where there is enhanced collaboration which focuses on collective goals to address systemic issues. From a bottom up perspective, this includes:

- Engaging with companies and holding them to account on material issues.
- Exercising rights and responsibilities, such as voting.
- Integrating environmental, social and governance factors into investment decision making.
- Monitoring assets and service providers.
- Collaborating with others.
- Advancing Policy through advocacy.

The Somerset Pension Fund fully endorses and supports the Brunel Pension Partnership Stewardship Policy, and the Somerset Pension Fund's policy should be seen as fully consistent in all aspects. The full Brunel policy can be found at: https://www.brunelpensionpartnership.org/stewardship_report/

The following section sets out in detail the Somerset Pension Fund's policies on stewardship, including its policy on the exercise of rights, including voting rights, attached to investments.

Governance and Oversight

The Pensions Committee approves and is collectively accountable for the Fund's Policies, which includes the Stewardship Policy. Operational accountability on a day-to-day basis is held by officers in line with the Fund's Scheme of Delegation. The Fund requires the Brunel Pension Partnership to provide a suite of public reports on their stewardship activities, and environmental, social and governance metrics to empower the Somerset Pension Fund's stewardship activities and to enable oversight.

The Somerset Pension Fund believes in the importance of regular and in-depth shareholder and stakeholder engagement. Our Stewardship Policy has been developed in conjunction with that of the Brunel Pension Partnership, which in turn has been developed in collaboration with key stakeholders, including the Brunel Oversight Board, Brunel Client Group, and the Client Responsible Investment (RI) Sub-Group. The RI Sub-Group is made up of members of Brunel's clients and meets monthly, it provides an opportunity for clients to:

- Raise stewardship interests.
- Share best practice with Brunel and amongst partner funds.
- Provide insights on concerns, issues, and member perspectives.
- Shape priorities of Brunel and Equity Ownership Services (EOS) at Federated Hermes.
- Review reporting outputs.
- Knowledge share and receive in-depth reports on topics of interest.
- Access expertise.
- Consult on policy design and development.

Identifying and Prioritising Engagement

The Somerset Pension Fund will expect Brunel to identify engagement objectives in four ways:

- Top down, to identify thematic areas of risk and opportunity.
- Bottom up, to review exposure to individual companies and to specific ESG risks and opportunities. Companies should be identified through asset managers, collaborative engagement forums, external research, and Brunel's own internal ESG risk analysis.
- Reactively to events, for example, after a specific, usually significant, incident. The companies that Brunel actively engage with should be prioritised based on our level of exposure and the probability of successful outcome.
- Brunel should be responsive to client concerns. Where the Fund raises specific issues, which could be as a result of Fund member concerns or points raised by Pension Committee or Pension Board members, Brunel will be expected to engage with companies to address the concerns raised.

The Somerset Pension Fund is a global investor and seeks to apply the principles of good stewardship globally. It is a strong advocate of the benefits of global stewardship codes to improve the quality of stewardship, and when updates are made aims to adopt best practice. As a UK-based investor our key reference points are the UK Stewardship Code 2020 and UK Corporate Governance Code and guidance produced by UK industry bodies, for example, the British Venture Capital Association (BVCA – private equity) RI toolkit.

The Somerset Pension Fund is committed to supporting policy makers, regulators and industry bodies in the development and promotion of the codes and supporting guidance. The Fund publishes an annual review of its stewardship and engagement activities in its Annual Report which is intended to meet the best practice requirements of the UK Stewardship Code 2020 and support the Fund's compliance with the Shareholder Rights Directive II. The Fund is a strong supporter of the UK Corporate Governance Code and the application of the Companies Act S172 (Duty to promote the success of the company). It believes that corporate behaviour in line with the spirit of the Act more broadly is essential to the Fund's objective of contributing to a more sustainable and resilient financial system, which supports sustainable economic growth and a thriving society.

The Somerset Pension Fund encourages companies either to comply with such codes or to fully explain their reasons for noncompliance. However, it is also cognisant that good governance cannot be guaranteed solely by adherence to the provisions of best practice governance codes. Therefore, we urge companies to consider carefully how best to apply the principles and the spirit of such codes to their own circumstances and to clearly communicate to investors the rationale behind their chosen approach.

Transparency and Collaboration

Good stewardship requires a good understanding of the assets that the Fund invests in. This is done in collaboration with Brunel, who do it directly, through EOS at Federated Hermes, their asset managers, and other initiatives. Working closely with company boards is one of the most effective means to achieve this but requires the establishment of mutual trust and, at times, confidentiality. It is also acknowledged that, when working collaboratively with other investors, we must respect other disclosure requirements and restrictions.

The Fund publishes regular updates on its stewardship activities, including quarterly engagement and voting activity analysis presented to the Pension Committee, and the annual review included in the Fund's Annual Report.

The Fund believes that working collaboratively is essential to delivering its objectives as the scope and scale of investments means that we need to draw on the expertise of others, including Brunel, the Local Authority Pension Fund Forum (LAPFF), and not least the asset managers employed by both Brunel and directly by the Fund. In addition to managers and specialist advisors, the Fund supports a number of organisations and initiatives that enable its ability to work collaboratively – for example this includes membership of LAPFF. The Fund's reporting will evidence its activities.

Conflicts of Interest

Somerset County Council has a robust Code of Conduct and Conflicts of Interest policy, which all members of the Pensions Committee (whether Somerset County Councillors or not) are required to adhere to. The policies can be found at:

[Members Code of Conduct](#)

Pensions Committee members are required to make declarations of interest prior to committee meetings in line with the Council's code of conduct and interest rules. This would ensure that if committee members had any personal interests in any company that the Fund invests in that may have an impact on stewardship activity then those interests would be declared and managed.

The management of conflicts is important in building long-term relationships with the companies the Fund invests in and with its partnerships. In particular, the Fund expects Brunel to have a robust approach to conflicts of interest. This includes having comprehensive controls operating at all levels within the business to prevent conflicts of interest from adversely affecting the interests of the Somerset Pension Fund and other clients, including the Fund's members and employers.

The effective management of potential Conflicts of Interest is a key component of Brunel's due diligence on all asset managers and service providers, as well as ongoing contract management. Conflict of interest clauses are included in investment management agreements. Conflicts are also considered when undertaking voting and engagement. Details on how EOS at Federated Hermes, Brunel's appointed engagement voting provider, approach conflicts of interest are available on their website at:

<https://www.hermes-investment.com/ukw/wp-content/uploads/2020/05/stewardship-conflicts-of-interest-policy-2020.pdf>

Data and Information

The Fund recognises that ESG data is a developing discipline and is a strong advocate for improved disclosure from companies and assets in which it invests. The Fund will use a variety of data sources to analyse the ESG risks of its investments and asset allocation strategy. It expects Brunel to use its own analysis and that of its asset managers to inform its stewardship activity and risk ESG management, as well as media and company reports and a variety of third party proprietary and public data sources.

Given the lack of standardisation and transparency across ESG data, differing methodologies can lead to different outputs and biases. On behalf of the Fund and other clients, Brunel use a variety of best in class providers, which leverage the Sustainability Accounting Standards Board's (SASB) materiality framework, to reduce bias, provide greater coverage of our assets, improve awareness of differences in data providers or to aid specific targeted engagement priorities. SASB promotes better quality reporting on material ESG risks, the standards focus on financially material issues. Another framework Brunel endorses is the Task Force on Climate-related financial disclosures (TCFD) which has developed a set of consistent climate-related financial disclosures that can be used by companies. Further detail on the TCFD is located in Brunel's Responsible Investment Policy and Climate Change Policy.

These sources of data are embedded into quarterly reports reviewed by Brunel at quarterly Brunel Investment Risk Committee meetings and are included in the reports provided to the Somerset Pensions Committee.

The Fund recognises that data provision is a continuously evolving area. The Fund supports Brunel's policy of reviewing their use of providers annually and providing feedback where developments could be made. Brunel seek to stimulate market-wide improvements in ESG risk analysis and commit to continue to innovate, adapt and improve to ensure the availability of robust, independent and effective data to work collegiately with external asset managers on the management of the whole spectrum of investment risks.

Voting

Responsibility for the exercise of voting rights has been delegated to the Brunel Pension Partnership. For the Brunel passive portfolios, Brunel have further delegated voting to Legal and General Investment Management but have retained the right to direct split voting on significant issues. The below link provides information on Legal and General Investment Management's approach to active ownership.

<https://www.lgim.com/uk/en/capabilities/corporate-governance/>

Brunel have adopted voting guidelines, following extensive consultation with their client funds, which can be found on their website.

The Somerset Pension Fund requires that Brunel will always seek to exercise its rights as shareholders through voting. This means seeking to vote 100% of available ballots. However, as with any process, errors and issues can occur. If the level of voting drops below 95% this would raise a cause for concern, be investigated and corrective action identified.

Votes should be cast applying the following principles:

Consistency: Brunel should vote consistently on issues, in line with their Voting Policy, applying due care and diligence, allowing for case-by-case assessment of companies and market-specific factors. This should include consideration of engagement with companies when voting.

No abstention: Brunel should aim to always vote either in favour or against a resolution and only to abstain in exceptional circumstances or for technical reasons, such as where a vote is conflicted, a resolution is to be withdrawn, or there is insufficient information upon which to base a decision.

Supportive: Brunel should aim to be knowledgeable about companies with whom they engage and to always be constructive. Brunel should aim to support boards and management where their actions are consistent with protecting long-term shareholder value.

Long-term: Brunel should seek to protect and optimise long-term value for shareholders, stakeholders and society.

Engagement: Brunel should support aligning voting decisions with company engagement and escalate the vote if concerns have been raised and not addressed in the prior year.

Transparency: The Somerset Pension Fund expects Brunel to be transparent and publish voting activity no less than twice per year.

The Somerset Pension Fund expects that companies will conduct themselves as follows:

Accountability: The directors of a company must be accountable to its shareholders and make themselves available for dialogue with shareholders.

Transparency: We expect companies to be transparent and to disclose, in a timely and comprehensible manner, information to enable well-informed investment decisions. This includes environmental and social issues that could have a material impact on the company's long-term performance.

One Share, One Vote: We support one share, one vote. Where a company issues shares with differing rights, they must define these rights transparently and clearly explain why rights are not equal.

Informed votes: We expect companies to make complete materials for general meetings available to shareholders and, where possible, to do so in advance of the legal timeframes for the meeting.

Development: We encourage companies to explore technology to improve the voting process and confirmation, such as blockchain, virtual meetings, electronic voting, and split voting (ownership proportion).

The Somerset Pension Fund is a member of the Local Authority Pension Fund Forum (LAPFF). LAPFF also conducts significant engagement with companies on behalf of their member funds, and where there is a significant issue to be voted on at a company AGM they will issue a voting alert, with a recommendation to member funds on how to vote.

Where a voting alert has been issued by LAPFF, the Somerset Pension Fund expects that Brunel (and Legal and General Investment Management) should give consideration to LAPFF's recommendation when deciding how to vote. Brunel should report back to the Fund on how they have voted and the rationale for their vote, especially where they vote differently to the LAPFF recommendation.

In exceptional circumstances, the Somerset Pension Fund may direct a split vote where the Fund has a specific investment policy commitment. Brunel has made provisions to allow clients, by exception, to direct votes, including the passive pooled funds, as an elective service. Client funds need to submit the request in line with the issuance of the meeting notification, usually not less than 2-3 weeks prior to an AGM/EGM.

The following issues are of particular concern to the Somerset Pension Fund in determining how shares should be voted. The Fund's policies on these issues align with Brunel's voting guidelines, which are not repeated in full here, but more details can be found at:

https://www.brunelpensionpartnership.org/voting_guidelines/

Sustainability: Companies should effectively manage environmental and social factors, in pursuit of enhancing their sustainability. A company's governance, social and environmental practices should meet or exceed the standards of its market regulations and general practices and should take into account relevant factors that may significantly impact the company's long-term value creation. Issuers should recognise constructive engagement as both a right and a responsibility.

Human and Natural Capital: Companies operate interdependently with the economy, society, and the physical environment. The availability and retention of an appropriately skilled workforce will impact company productivity. Similarly, companies impact the environment through their use of natural resources e.g. water, waste and raw materials. The physical environment has an impact too; extreme weather can disrupt supply chains, either directly or indirectly which can impact company productivity. Companies should manage their workforce and natural capital effectively to enhance their productivity and to deliver sustainable returns. Companies should regularly disclose key metrics on their capital requirements and risks. Directors of companies should be accountable to shareholders for the management of material environmental and social risks which, over the long term, will affect value and the ability of companies to achieve long term returns.

Company Boards – Conduct and Culture: Corporate culture and conduct have always been important, but recent evidence from incidents where conduct has fallen below the expected standards has reinforced the need to focus on conduct and culture, as well as highlighting the financial risks linked to low standards on conduct.

Board Composition and Effectiveness: The composition and effectiveness of boards is crucial to determining company performance. Boards should comprise a diverse range of skills, knowledge, and experience, including leadership skills, good group dynamics, relevant technical expertise and sufficient independence and strength of character to challenge executive management and hold it to account.

The Somerset Pension Fund believes that to function and perform optimally, companies and their boards should seek diversity of membership. They should consider the company's long-term strategic direction, business model, employees, customers, suppliers and geographic footprint, and seek to reflect the diversity of society, including across race, gender, skill levels, nationality and background. Robust succession planning at the Board and senior management level is vital to safeguard long-term value for any organisation, including planning for both unanticipated and foreseeable changes.

The board is accountable to shareholders and should maintain ongoing dialogue with its long-term shareholders on matters relating to strategy, performance, governance and risk and opportunities relating to environmental and social issues. This dialogue should support, but not be limited to, informing voting decisions at annual meetings.

Executive Remuneration: Executive remuneration is a critical factor in ensuring management is appropriately incentivised and aligned with the best interests of the long-term owners of the business. Whilst judgement of remuneration is therefore made on a case-by-case basis, we adhere to the following guiding principles:

- **Simplicity:** pay schemes should be clear and understandable for investors as well as executives.
- **Shareholding:** the executive management team should make material investments in the company's shares and become long-term stakeholders in the company's success.
- **Alignment and quantum:** pay should be aligned to the long-term success of the company and the desired corporate culture and is likely to be best achieved through long-term share ownership.
- **Accountability:** remuneration committees should use discretion to ensure that pay properly reflects business performance. Pay should reflect outcomes for long-term investors and take account of any decrease in the value of or drop in the reputation of the company.
- **Stewardship:** companies and investors should regularly discuss strategy, long-term performance and the link to executive remuneration.
- **Behaviour:** the most senior executives should willingly embrace the approach described. If they do not, boards should consider the implications.

Audit: The audit process is vital to ensuring the integrity of company reporting and the presentation of a true and fair view, enabling shareholders to assess the financial health and long-term viability of a company.

Protection of Shareholder and Bondholder Rights: The rights of shareholders and bondholders should be protected, including the right to access information, to receive equal treatment and to propose resolutions and vote at shareholder meetings. We support a single share class structure and generally oppose any measures to increase the complexity of shareholding structures. We will generally require the unbundling of resolutions, giving shareholders the right to vote distinctly on the general, and enhanced authorities to issue shares as separate items on the agenda of shareholder meetings. We also support adherence to the highest possible standards on listed stock exchanges.

Stock Lending and Share Recall

The Fund permits holdings in its segregated portfolios to be lent out to market participants. Stock lending is an important factor in the investment decision, providing opportunities for additional return, but that lending should not undermine governance, our ability to vote or long-term investing. The stock lending programme is managed by Brunel, and the Somerset Pension Fund adopts Brunel's policies on stock lending and share recall.

Voting rights attached to a stock or security reside with the borrower for as long as it is out on loan. Stock will be recalled from stock lending where Brunel considers it in the client's best interest and consistent with our investment principles.

Where there is a perceived trade-off between the economic benefit of stock lending, and Brunel's ability to discharge its obligations as a responsible long-term investor, the latter will have precedence. Securities lending entails operational process risks such as settlement failures or delays in the settlement of instructions. The Fund expects Brunel to undertake a comprehensive review of the potential risks and implemented measures to mitigate and reduce the risk. Controls include, but are not limited to:

- An approved borrowers list.
- Retention of 5% of any one stock.
- On average, stock will be lent no longer than 21 days.
- Restrictions on acceptable collateral.

All measures and service level agreements are regularly monitored. Brunel examines the selection criteria for approved borrows to confirm consistency with Brunel's internal requirements regarding appropriate criteria. The selection criteria and content of the Approved List will be reviewed by Brunel at least annually.

There may be some instances where Brunel decides not to stock lend, for example where they have co-filed a shareholder resolution, but particularly where there are concerns of borrowers deliberately entering transactions to sway the outcome of a shareholder vote.

The decision to stock lend is a collective decision made by Brunel's clients and is supported by the Somerset Pension Fund. Stock lending is applied at portfolio level and reviewed annually as part of the product governance cycle. The policy and relevant SLAs are also reviewed annually. Brunel's approach to responsible stock lending is outlined in further detail in a separate policy.

Fixed Interest

Fixed interest instruments are debt instruments and therefore do not usually confer voting rights. However, the Fund believes that well-governed companies are more likely to make their loan repayments and improve their creditworthiness, enabling better access to funds to support the creation of long-term value for shareholders, other stakeholders, society, and the environment.

Where voting rights are not attached and where opportunity to engage is limited, stewardship focuses on the managers' investment decision-making. The Somerset Pension Fund expects Brunel to integrate Environmental Social and Governance (ESG) considerations into manager selection and ongoing manager monitoring to ensure that ESG is imbedded into the investment process at an issuer, sector, and geographic level.

Where voting rights are attached to fixed income, the Fund, via Brunel, will have the opportunity to vote at company meetings (AGM/EGMs). The Fund would look to Brunel to engage particularly prior to issuance, where the most impact can be made. However, we recognise that there is more work to be done in this asset class.

Private Markets

Stewardship is an intrinsic part of private markets investing due to the degree of influence and control, lack of short-term results pressure on capital markets, and long-term nature of the investments that are made. There are however some natural barriers to stewardship due to the lack of disclosure and often opaque nature of the asset classes and arm's length relationships between general partners (GPs) and limited partners (LPs). As a result, in-depth due diligence is critical, alongside building close relationships and exerting influence where possible.

When assessing potential private market investments, the Somerset Pension Fund would expect Brunel to pay particular attention to ESG and sustainability throughout the selection process. We believe that well governed investments and those with strong ESG and sustainability characteristics will offer better long-term risk-adjusted returns.

Managers should have firm ESG and climate change policies in place, and these should be considered across the value chain, from investment due diligence to ongoing managing, monitoring, and ultimately disposal of the assets. As part of this due diligence Brunel examine case studies to evidence these policies are in place and, crucially, are being actioned. Proof of implementation is critical and supersedes all else. The Fund and Brunel will support managers and encourage best practice, forgiving policies and processes not being formalised so long as the manager commits to action in a reasonable timeframe.

Application of robust stewardship in private markets is very dynamic. Brunel seeks to use the appropriate mechanisms relative to the asset class, size and complexity of the investment, position in the capital structure and the influence that does or does not permit.

Stewardship actions across private markets include:

- Ensuring appropriate governance structures are in place, with particular attention paid where managers have minority positions in assets.
- Assessing the manager's approach to diversity and inclusion and where possible tracking metrics to substantiate claims.
- Assessing the manager's knowledge and commitment to Responsible Investment and climate change mitigation and avoidance.
- Assessing how Responsible Investment is integrated into the investment and asset management processes and fully embedded in the culture of the organisation (both deal teams and operations teams), or whether this is siloed in a separate ESG team.
- Supporting the manager's ongoing development of their Responsible Investment and Stewardship practices, including where appropriate participation in events, workshops as a representative on the Limited Partner Advisory Committee (LPAC)
- Establishing what commitments to Responsible Investment through existing or planned memberships/affiliations with organisations such as Principles for Responsible Investment (PRI), TCFD, GRESB and/or have adopted the SASB framework
- Assessing the awareness, training, capacity and track record on Responsible Investment issues
- Working with managers to improve transparency and quality of the manager's ESG approach and reporting.

Further details of Brunel's approach to private markets are included in the Brunel Stewardship Policy.

Reporting

The Pension Committee will monitor Brunel's engagement with the companies they have invested in, through the regular reporting arrangements in place. Brunel and LGIM's voting records will be reported to Committee on a quarterly basis.

The Somerset Pension Fund Annual Report each year includes a report focusing on stewardship and voting activity. A summary of Brunel's stewardship activities is also included.

7. Advice taken

This Investment Strategy Statement has been put together by Somerset County Council's professional investment officers, supported by the Fund's Independent Investment Advisor.

The Fund has committed to pooling investments through the Brunel Pension Partnership Limited (BPP Ltd.), and advice from both Brunel and the Brunel Client Group has also been taken into account in shaping the Fund's response to the pooling initiative and building an investment strategy that can be implemented via Brunel.

The Brunel Client Officer Group has provided support with regard to the impact on strategy of the investment pooling proposals. The group comprises the investment officers from the Avon Pension Fund (Bath and NE Somerset Council), Buckinghamshire Council, Cornwall Council, Devon CC, Dorset Council, Gloucestershire CC, Oxfordshire CC, Somerset CC, Wiltshire Council and the Environment Agency.

8. Arrangements for reviewing this statement

The guidance requires that the Investment Strategy Statement should be revised at least every three years, and when any significant changes are made to the Fund's investment strategy.

This Investment Strategy Statement will be regularly reviewed by the pensions committee, particularly to ensure it continues to meet all regulatory and statutory requirements. Where there is significant change to the Statement the pensions committee will consult relevant stakeholders, particularly the Pension Board, prior to amending the policy.

**Approved by the Pensions Committee
Somerset County Council Pension Fund
XXXXXXXXXX**

DRAFT

Annex 1

Working in line with Myners

In 2000, the UK Government ordered a review of institutional investment in the UK. The review was carried out by Paul Myners, the chairman of a large fund-management group, and his findings were published in March 2001.

Myners sets out a number of principles of best practice and recommends that pension funds should set out what they are doing to apply these principles. In response to Myners' proposals, the Government issued a set of 10 investment principles in October 2001 that it said it would be taking forward. In November 2008, the Government published a revised set of principles, following on from this CIPFA had produced a set of Myner's principles specifically for Local Government Pension Schemes and guidance on how to compare compliance with the principles. The fund's performance against the CIPFA principles and guidance is set out below.

Principle 1: Effective Decision Making

Administering authority should ensure that:

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

The fund is fully compliant with this principle but must continue to work to ensure that the knowledge base of officers, board members and committee members remains comprehensive and current.

Principle 2: Clear Objectives

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

The fund is fully compliant with this principle. The fund will look to make additional progress by further consideration of the needs of the disparate employers within the fund and how their differing needs are reflected in the objectives of the fund as a whole.

Principle 3: Risk and Liabilities

In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of the liabilities.

These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

The fund is fully compliant with this principle.

Principle 4: Performance Assessment

Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors.

Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision making body and report on this to scheme members.

The fund is fully compliant with this principle with respect of measurement of investment performance and investment managers. The fund needs to consider more formal arrangements for the measurement of performance of other advisors and particularly formal assessment of the pension board and pensions committee's performance.

Principle 5: Responsible Ownership

Administering authorities should:

- **adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholder and agents**
- **include a statement of their policy on responsible ownership in the statement of investment principles**
- **report periodically to scheme members on the discharge of such responsibilities.**

The fund is fully compliant with this principle.

Principle 6: Transparency and Reporting

Administering authorities should:

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

The fund is fully compliant with this principle.