PENSIONS COMMITTEE

SUPPLEMENTARY PAPERS 2

Wednesday 14 June 2023
at 6.30 pm Council Chamber, Hackney Town Hall, Mare Street, London E8 1EA

Pensions Committee
Wednesday 14 June 2023
Agenda

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The London Borough of Hackney

Investment Strategy Statement

1. Introduction

The London Borough of Hackney is the Administering Authority for the London Borough of Hackney Pension Fund. The Pensions Committee ("the Committee") is the body with delegated powers to administer the Fund. The Committee's members are elected representatives of Hackney Council alongside a co-opted scheme member representative and co-opted employer representative. The members recognise that they have fiduciary duties and responsibilities towards beneficiaries, employers and local taxpayers that are analogous to those holding the office of Trustee in the private sector. The Committee takes expert professional financial advice to assist it with managing the Fund.

This Investment Strategy Statement (ISS) has been prepared after taking advice from the Fund's investment adviser, Redington Ltd

The ISS, which was approved by the Committee on 14 June 2023, is subject to periodic review at least every three years and without delay after any significant change in investment policy. In preparing and reviewing its Investment Strategy Statement, the Fund will consult with interested stakeholders including but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with.

The Committee seeks to invest in accordance with the ISS any Fund money that is not needed immediately to make payments from the Fund. The ISS should be read in conjunction with the Fund's Funding Strategy Statement (in force from 1st April 2020).

2. Background to the Fund

2.1 The Legal Requirements

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require pension fund administering authorities to formulate an Investment Strategy Statement, in accordance with guidance issued by the Secretary of State.

The Statement must include:

a) a requirement to invest fund money in a wide variety of investments;
b) the authority's assessment of the suitability of particular investments and types of investments;
c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;

d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

2.2 The Fund

The Pension Fund for the London Borough of Hackney is a Career Average Revalued Earnings (CARE) defined benefit scheme. Benefits are determined by a range of statutory provisions. The main regulations governing the operation of the scheme are the Local Government Pension Scheme Regulations 2013.

The Local Government Pension Scheme (LGPS) Regulations 2013 set out in clear terms the benefits that are payable to Scheme members. The benefits offered to those members are therefore guaranteed by law; members are not reliant on investment performance for their pensions in retirement. The contributions payable by Fund members are also defined in the Regulations. Employing Authorities are required to pay contributions into the Fund to meet the cost of funding employee benefits and are required to meet any shortfall in funding the pension liabilities of Fund members. If, therefore, the Pension Fund's investments do not perform as well as expected, any shortfall must be met from Council Tax, other public funds and by other employers participating in the Fund, and not by reducing the amount of pension benefits paid or by increasing employees' contributions.

Pension benefits for individuals are increased each year in line with movements in the Consumer Prices Index (CPI).

3. The suitability of particular investments and types of investments

3.1 Fund Objectives

The primary objective of the 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, on a defined benefit basis.

The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing. The funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund. This benchmark is consistent with the Committee's views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund's liabilities.

It is intended that the Fund's investment strategy will be reviewed at least every three years following actuarial valuations of the Fund. The Fund has sought advice from Redington, its investment consultant, to assist it in setting its most recent investment strategy.

The Fund considers the impact of investment strategy changes through the Pensions Risk Management Framework (PRMF). The framework considers the impact on the Fund's return objectives and risk budget, in addition to the effects on cashflow and the Fund's ESG targets. The proportion of the portfolio invested in pooled assets and the proportion of local or "levelling up" investments are also considered, although not directly rated. The PRMF will also be used to monitor the Fund's investment strategy on an ongoing basis.

4. Investment of money in a wide variety of investments

4.1 Asset Classes

The Fund may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds, cash, property and commodities either directly or through pooled funds. The Fund may also make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products for the purpose of efficient portfolio management or to hedge specific risks.

The Committee reviews the nature of Fund investments on a regular basis, with particular reference to suitability and diversification. The Committee seeks and considers written advice from a suitably qualified person in undertaking such a review. If, at any time, investment in a security or product not previously known to the Committee is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.

The Fund's target investment strategy is set out below in table 4.2.1. In line with the Regulations, the authority's investment strategy does not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007.

The Fund has committed to investment in a number of less liquid asset classes, including private debt, renewable infrastructure, nature-based solutions and impact property. These investments are expected to take a number of years to be fully invested. Table 4.2.1 reflects the target position once fully invested.

4.2.1 Target Fund Allocation

Asset class	Target allocation %
Private Debt	10.0%
Senior Loans	10.0%
Natural Capital	5.0%
Impact Property	5.0%
Property	10.0%
Renewables	5.0%
Government Bonds	10.0%
Multi-class Credit	5.0%
Global & Emerging Market Equities	40.0%
Total	**100%**

4.3 Managers

The Committee has appointed a number of investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Committee, after seeking appropriate investment advice, has agreed specific benchmarks with each manager so that, in aggregate they are consistent with the overall asset allocation for the Fund. The Fund's investment managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market and asset class, the managers will maintain diversified portfolios through direct investment or pooled vehicles. The manager of the passive funds in which the Fund invests holds a mix of investments within each pooled fund that reflects that of their respective benchmark indices

5. Restrictions on investment

The Regulations have removed the previous restrictions that applied under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The Fund has agreed a number of its own restrictions as set out in the table below.

All other investment restrictions will be negotiated with fund managers or the London CIV, subject to the Fund receiving appropriate investment and/or legal advice.

5.1 Investment Restrictions

Type of investment	Maximum investment by the Fund % of assets
3. Cash deposits	10%

4. Investment with any single manager strategy either directly or via the London CIV (excluding investments in passive index tracking strategies)	20%

6. The approach to risk, including the ways in which risks are to be measured and managed

The Committee is aware that the Fund has a need to take risk (e.g. investing in growth assets) to help it achieve its funding objectives. It has an active risk management programme in place that aims to help it identify the risks being taken and put in place processes to manage, measure, monitor and (where possible) mitigate the risks being taken. One of the Committee's overarching beliefs is to only to take as much investment risk as is necessary.

The principal risks affecting the Fund are set out below, we also discuss the Fund's approach to managing these risks and the contingency plans that are in place:

6.1 Funding risks

- Financial mismatch – The risk that Fund assets fail to grow in line with the developing cost of meeting the liabilities.
- Inflation risk – The risk that price and pay inflation is significantly more than anticipated, increasing the value of pension benefits accrued by active and deferred members of the Fund as well as increasing the value of pensions in payment.
- Changing demographics –The risk that longevity improves and other demographic factors change, increasing the cost of Fund benefits.
- Systemic risk – The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Fund's liabilities.

The Committee measures and manages financial mismatch in two ways. As indicated above, the Committee has set a strategic asset allocation benchmark for the Fund. This benchmark was set taking into account asset liability modelling which focused on probability of success and level of downside risk. This analysis will be formally revisited as part of the 2022 valuation process, but may be repeated prior to that date if required.

The Committee assesses risk relative to the strategic benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. The Committee also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

A detailed schedule of the funding risks to which the Fund is exposed is set out in the Funding Strategy Statement.

6.2 Asset risks

- Concentration - The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Fund's assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Environmental, social and governance ("ESG") – The risk that ESG related factors reduce the Fund's ability to generate long-term returns.
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

The Committee measures and manages asset risks as follows.

The Fund's strategic asset allocation benchmark invests in a diversified range of asset classes. The Committee has put in place rebalancing arrangements to ensure the Fund's "actual allocation" does not deviate substantially from its target. The Fund invests in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, help reduce the Fund's asset concentration risk.

Illiquidity risk is managed by investing across a range of assets, including liquid quoted equities and bonds, as well as property. The majority of the Fund's assets are realisable at short notice. Whilst the Fund does have an allocation to less liquid assets, the degree of liquidity risk within the portfolio is acceptable given the Fund's long term investment horizon.

The Fund invests in a range of overseas markets which provides a diversified approach to currency markets. The Fund is due to review its approach to currency hedging as part of its current investment strategy review.

Details of the Fund's approach to managing ESG risks is set out later in this document.

The Committee has considered the risk of underperformance by any single investment manager and have attempted to reduce this risk by appointing more than one manager and having a proportion of the Scheme's assets managed on a passive basis. The Committee assesses the Fund's managers' performance on a regular basis, and will take steps, including potentially replacing one or more of their managers, if underperformance persists.

6.3 Other provider risk

- Transition risk – The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee seeks suitable professional advice.
- Custody risk – The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default – The possibility of default of a counterparty in meeting its obligations.
- Stock-lending – The possibility of default and loss of economic rights to Fund assets. The Fund does not currently engage in stock-lending but may consider doing so in the future.

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations they conduct for the Fund, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). The Committee has the power to replace a provider should serious concerns exist.

The Committee also monitors some of the strategic risks faced by the Fund through the Pensions Risk Management Framework (PRMF). The framework considers the impact of strategy changes on the Fund's return objectives and risk budget, in addition to the effects on cashflow and the Fund's ESG targets. The proportion of the portfolio invested in pooled assets and the proportion of local or "levelling up" investments are also considered, although not directly rated.

7. The approach to pooling investments, including the use of collective investment vehicles and shared services

The Fund is a participating scheme in the London Collective Investment Vehicle (London CIV). The London CIV has been operational for some time and has opened a range of sub-funds covering both liquid and less liquid asset classes.

7.1 Assets to be invested in the Pool

The Fund is transitioning assets into the London CIV as suitable investment strategies that meet the asset allocation and investment strategy become available on the London CIV platform. The Fund made its first investments of assets in June 2018 with further investments in September and October 2021. The key criteria for assessment of Pool solutions is as follows:

- That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund.

● That there is a clear financial benefit to the Fund in investing in the solution offered by the Pool, should a change of provider be necessary.

At the time of preparing this statement the Fund has 46.8% (£862.8m) of assets invested through mandates directly facilitated by the Pool. The Fund currently holds 19.1% (£351.4m) of its assets in BlackRock pooled equity funds which were facilitated by London CIV and therefore are pooled assets. The Fund agrees for the London CIV to monitor the BlackRock funds as part of the broader Pool.

At the time of writing, the Fund holds 16.6% (£306.6m) of the Fund in illiquid assets that will remain outside of the London CIV pool. The cost of exiting these strategies early would have a negative financial impact on the Fund. These will be held as legacy assets until such time as they mature and proceeds re-invest through the Pool assuming it has appropriate strategies available or until the Fund changes asset allocation and makes a decision to disinvest.

At the time of preparing this statement the Fund holds the following assets outside of the London CIV:

Asset class	Manager	% of Fund assets	Benchmark and performance objectives	Reason for not investing via the London CIV
Property	Threadneedle – Low Carbon Workplace Fund	0.9% (£17.3m)	IPD Quarterly index total return – office sector. Targets outperformance of the benchmark by 1% over rolling 3 year periods.	Illiquid assets - Units do not become redeemable until 5 years from the date of issue. Investment is via Jersey unit trust – whilst it could be held within an ACS structure, the transfer of the property assets could incur significant stamp duty. The Fund has invested in the LCW fund in 2 tranches (May 2016 and October 2016).
Property	Threadneedle - TPEN	7.8% (£143.4m)	IPD Quarterly index total return Targets outperformance of the benchmark by 1% over rolling 3-year periods.	Investment is via a unit linked life vehicle which cannot at present be transferred to the ACS structure. No suitable alternative currently exists through the London CIV,and the Fund wishes to maintain its strategic allocation to property.
Fixed Income	Threadneedle	11.1% (£204.7m)	Outperform a customised benchmark (37.5 FTA Govt All Stocks; 37.5% ML £ Non-Gilt All Stocks Index; 25% FTA Govt IL >5yrs) by 1% over a rolling 3yr period	Fund wished to retain strategic allocation and no suitable alternative existed on CIV at initial review – to be reviewed at next review.
Private Debt	Permira	4.5% (£83.4m)	Target net return 6% - 8%	Illiquid assets– assets held via a Lux Special Partnership and early exit would have a negative financial impact.

Private Debt	Churchill	3.4% (£61.8m)	US Credit Suisse Leveraged Loan Index. Target net return 5.5% - 7%	Illiquid assets– assets held via a Lux Special Partnership and early exit would have a negative financial impact.

Any assets not currently invested in the Pool will be reviewed at least every three years to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money. At the time of writing, the Fund was carrying out its 2023 investment strategy review, with the next review due no later than 2026.

7.2 Structure and governance of the London CIV

The July 2016 submission to Government of the London CIV provided a statement addressing the structure and governance of the Pool, the mechanisms by which the Fund can hold the Pool to account and the services that will be shared or jointly procured.

Since July 2016, the London CIV has made changes to its governance structure, which now operates as follows:

London LGPS CIV Limited ("London CIV") is fully authorised by the FCA as an Alternative Investment Fund Manager (AIFM) with permission to operate a UK based Authorised Contractual Scheme fund (ACS Fund). FCA firm registered as London LGPS CIV Ltd, Reference Number 710618.

Approval for the structure has been signed off by the 32 participating London Authorities

The governance structure of the CIV has been designed to ensure that there are both formal and informal routes to engage with all the Authorities as both shareholders and investors. This is achieved through:

- The Shareholder Committee, which acts on behalf of the Shareholders as a consultative body, including on the Company's business plans and financial performance, and topics such as Responsible Investment. It comprises 12 Committee Members made up of 8 Local Authority Pension Committee Chairs (or Leaders of London Local Authorities) and 4 Local Authority Treasurers. The Chair of the Board of London CIV is also a member of the Committee. A trade union representative sits as an observer.

- The client services framework, which is informed by shareholder consultation and includes a programme of events for clients collectively.

At the company level for London CIV, it is the Board of Directors that is responsible for decision making within the company, which will include the decisions to appoint and remove investment managers.

8. How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments

Responsible Investment is a key part of the Fund's approach to fulfilling its fiduciary duty. ESG issues can create financially material risks and opportunities; the Fund aims to manage these risks and generate sustainable, long term investment returns.

The management of ESG considerations is therefore a fundamental part of the Fund's overarching investment strategy. The Fund has developed an investment beliefs statement as part of its overarching strategy; the statement includes the following beliefs in relation to ESG and Responsible Investment issues:

- Environmental, social and corporate governance ('ESG') issues can have a material impact on the long-term performance of investments
- The UN Sustainable Development Goals highlight investment risks and potential opportunities as well as areas in which asset owners can have a positive impact
- Engagement with managers, and through them with investee companies, can have a material impact on progress towards the chosen goals as well as on investment performance
- Responsible investing is relevant to the performance of the entire Fund across asset classes

The Fund therefore requires its investment managers to integrate all material financial factors, including ESG considerations, into their investment analysis and decision making for all fund investments.

The Fund's Investment Managers (and specifically the London Collective Investment Vehicle through which the Fund will increasingly invest) are also expected to undertake appropriate monitoring of current investments with regard to their policies and practices on all issues which could present a material financial risk to the long-term performance of the fund, including ESG factors. The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

Where appropriate, the Committee considers how it wishes to approach specific ESG factors in the context of its role in asset allocation and investment strategy setting. The Fund recognises that climate change represents a systemic risk that will have an impact on investment portfolios. It brings significant risks, including both transition and physical risks, but also opportunities to contribute to the transition to a net zero economy. The inevitable impact of climate change on investment portfolios means that it is vital to integrate it into investment decision making.

The Fund's ambition is to reach net zero emissions by 2040. To assist it in achieving this ambition, it has set a series of interim targets as follows:

- Achieve a 50% reduction in carbon footprint (scope 1&2) by 2030 compared to 2023 carbon footprint as the baseline.
- Target a 2C portfolio by 2030 with a 1.5C goal for 2040.
- Allocate no less than 10% of Fund assets to climate solutions in line with the Strategic Asset Allocation (SAA) changes and in line with Fund's fiduciary duties.

These targets will be monitored on an annual basis.

The Fund takes non-financial factors into account when selecting, retaining, or realising its investments only where this will not result not result in significant financial detriment to the Fund and the Fund has reason to believe that scheme members would share its view. The Committee reviews its approach to non-financial factors periodically, taking into account relevant legislation and the Law Commission's guidance on when such factors may be considered. Additionally, the Committee monitors legislative and other developments with regards to this subject and will review its approach in the event of material changes.

The Fund does not at the time of preparing this statement hold any assets which it deems to be social investments; however, this ISS places no specific restrictions on the Fund in respect of such investments beyond those of suitability within the Investment Strategy as a whole and compatibility with the Committee's fiduciary duties. In considering any such investment in the future, the Committee will have regard to the Guidance issued by the Secretary of State and to the Law Commission's guidance on financial and non-financial factors.

9. The exercise of rights (including voting rights) attaching to investments

The Fund is committed to being a long-term steward of the assets in which it invests and aims to promote the highest standards of governance and corporate responsibility in the companies in which it invests. It expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills. In addition, the Pensions Committee undertakes training on a regular basis, including training and information sessions on matters of social, environmental and corporate governance.

The Fund has a commitment to actively exercising the ownership rights attached to its investments reflecting the Fund's conviction that responsible asset owners should maintain oversight of the companies in which they ultimately invest. It recognises that the companies' activities impact upon not only their customers and clients, but more widely upon their employees and other stakeholders and also wider society. It therefore expects its managers to follow good practice and use their influence as major institutional investors and long-term stewards of capital to promote good practice in the investee companies and markets to which the Fund is exposed.

Effective monitoring and identification of ESG issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, leading to greater influence and improved outcomes for shareholders and more broadly, the Fund expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

The Fund through its participation in the London CIV will work closely with other LGPS Funds in London to enhance the level of engagement both with external managers and the underlying companies in which it invests. Additionally, the Fund is a member of the Local Authority Pension Fund Forum (LAPFF), through which it joins with other LGPS Funds to magnify its voice and maximise the influence of investors as asset owners.

The Fund is not currently a signatory to the FRC's revised Stewardship Code; however, it fully endorses the principles of the Code and plans to make a Stewardship Code submission at the next available opportunity. The Fund expects its external investment managers to be signatories of the Stewardship Code.

The Fund has delegated responsibility for voting rights to the Fund's external investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value.

Investments through the London CIV are covered by the voting policy of the CIV which has been agreed by the Shareholder Committee. London CIV has appointed Hermes EOS to consolidate its voting activities for the segregated funds, whilst for pooled funds the underlying managers remain responsible for providing voting services on London CIV's behalf. In executing votes, both Hermes EOS and sub-fund managers are expected to vote in accordance with voting alerts issued by the Local Authority Pension Fund Forum as far as practically possible to do so.

The Fund will incorporate a report of voting activity as part of its Pension Fund Annual report which is published on the Pension Fund website.