

# London Borough of Hackney Pension Fund

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## Investment Strategy Statement



 **Hackney**

# Investment Strategy Statement (Published 01/04/2017)

## 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, comprised of elected representatives of Hackney Council and a non-voting scheme member representative, 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.

The Investment Strategy Statement (ISS) has been prepared by the Committee having taken advice from the Fund’s investment adviser, Hymans Robertson LLP.

The ISS, which was approved by the Committee on 29th March 2017 is subject to periodic review at least every three years and without delay after any significant change in investment policy. The Fund in preparing and reviewing its Investment Strategy Statement 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 2017).

## 2. Background to the Fund

### 2.1 The Legal Requirements

The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) 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 Scheme**

The Pension Scheme 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 Scheme members are also defined in the Regulations. Employing Authorities are required to pay contributions into the Scheme to meet the cost of funding employee benefits and are required to meet any shortfall in funding the pension liabilities of Scheme 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. This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

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. For employee members, benefits will be based on service completed but will take account of future salary and/or inflation increases.

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 used asset liability modelling (ALM) carried out by Hymans Robertson to help set an investment strategy.

The ALM approach projects forward the potential future development of asset and liability values, using stochastic modelling to model over 5000 different scenarios. This gives a distribution of outcomes which is then used to assess the probability of meeting the funding objective over a given time horizon for a number of different investment strategies. The tail risks of each strategy are assessed by considering the worst 5% of funding outcomes associated with each.

This approach helps to ensure that the investment strategy takes due account of the maturity profile of the Fund (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit (relative to the funding bases used).

In addition, the Committee monitors investment strategy on an ongoing basis, focusing on factors including, but not limited to:

- Suitability given the Fund's level of funding and liability profile
- The level of expected risk
- Outlook for asset returns
- The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation

## **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 investment strategy as reflected in its holdings at 1<sup>st</sup> April 2017 is set out below in table 4.2.1. The table also includes the maximum percentage of total Fund value that it will invest in these asset classes. 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's target investment strategy is set out in table 4.2.2. The Fund intends to implement its target strategy gradually and aims to do so in collaboration with the London CIV.

#### 4.2.1 Current Fund Allocation

Asset class	Target allocation %	Control Range %
UK equities	25%	23% - 27%
Global equities	31%	28% - 34%
Global Emerging Market equities	4.5%	3.5% - 5.5%
Total equities	60.5%	54.5% - 66.5%
Property	10%	9% - 11%
Multi-asset	12.5%	10% - 15%
Bonds	17%	15% - 19%
Total	100	

#### 4.2.2 Target Fund Allocation (following 2016 Investment Strategy Review)

Asset class	Target allocation %
UK equities	10%
Global equities	36%
Global Emerging Market equities	4.5%
Total equities	50.5%
Property	10%
Multi-asset	12.5%
Bonds	17%
Multi asset credit	10%
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
1. Contributions invested in any single partnership	5%
2. Contributions invested in partnerships	30%
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)	15%
5. Total investment in illiquid assets	30%

## 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 2019 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 a small 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 currently maintains a 50% hedge to USD, EUR and JPY exposures within its active global equity mandates. This has been reviewed as part of the recent strategy review but no change is currently planned.

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 assess 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.

## **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 is in the process of opening a range of sub-funds covering liquid asset classes, with less liquid asset classes to follow. The proposed structure and basis on which the London CIV will operate was set out in the July 2016 submission to Government.

### **7.1 Assets to be invested in the Pool**

The Fund will transition liquid assets into the London CIV when there are suitable investment strategies that meet the asset allocation and investment strategy available on the London CIV platform. An indicative timetable for investing through the Pool was set out in the July 2016 submission to Government; the Fund anticipates being able to transition some of the liquid assets across in advance of April 2018. The key criteria for assessment of Pool solutions will be 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 no assets invested through the Pool

The Fund currently holds 23.4% (£297.6m) of its assets in life funds and intends to retain these outside of the London CIV in accordance with government guidance on the retention of life funds outside pools for the time being. The Fund agrees for the London CIV to monitor the passive funds as part of the broader pool

At the time of writing, the Fund holds 1.53% (£19.5m) of the Fund in illiquid assets and these 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 has therefore elected not to invest the following assets via the London CIV:

Asset class	Manager	% of Fund assets	Benchmark and performance objectives	Reason for not investing via the XYZ Pool
Property	Threadneedle – Low Carbon Workplace Fund	1.53% (£19.5m)	IPD Quarterly index total return – office sector. Targets outperformance of the benchmark by 1% over rolling 3 year periods.	Units do not become redeemable until 5 years from the date of issue; the LCW fund is a unit trust and cannot at present be transferred to an ACS structure. The Fund has invested in the LCW fund in 2 tranches (May 2016 and October 2016).
Property	Threadneedle - TPEN	8.41% (£106.8m)	IPD Quarterly index total return Targets outperformance of the benchmark by 1% over rolling 3 year periods.	Investment is via a jersey domiciled property unit trust. No suitable alternative currently exists through the London CIV, and the Fund wishes to maintain its strategic allocation to property.
UK equities	UBS	23.4% (£297.6m)	Index fund tracking the FTSE All share	Passively managed via a life fund and therefore covered by Government guidance on the retention of Life funds outside the pool for the

				present.
Fixed Income	BMO	17.6% (£224.0m)	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	No suitable alternative currently available through the London CIV; the Fund wishes to maintain its strategic allocation to fixed income.

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. The next such review will take place no later than 2019

## 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.

The submission to Government set out the structure and governance of the Pool 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 a combination of the London Councils' Sectoral Joint Committee ("LCSJC"), comprising nominated Member representatives from the London Local Authorities (in most cases the Pensions Committee Chair), and the Investment Advisory Committee ("IAC") formed from nominated borough officers, which includes both London Local Authority Treasurers and Pension Officers from a number of Authorities. At the time of writing, the Fund is represented within the governance structure of the CIV by its Chair of Committee on the LCSJC and by the Authority's Treasurer and a Pension Officer on the IAC.

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**

The Fund invests on the basis of financial risk and return, having considered a full range of factors, including environmental, social, and corporate governance (ESG) factors where these present financial risks to the delivery of portfolio objectives and therefore impact on the sustainability of the Fund's returns.

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. Taking into account the ratification in October 2016 of the Paris Agreement, the Committee considers that significant exposure to fossil fuel reserves within the Fund's portfolio could pose a material financial risk. In summer 2016, Trucost were commissioned to produce a Carbon Risk Audit for the Fund, quantifying the Fund's exposure through its equity portfolio to fossil fuel reserves and power generation and where the greatest risks lie.

Having taken into account the risks associated with exposure to fossil fuel reserves, the Committee has approved a target to:

- Reduce the Fund's relative exposure to future emissions from fossil fuel reserves (measured in MtCO<sub>2</sub>e – million tonnes of CO<sub>2</sub> emissions) by 50% over 2 valuation cycles (6 years)
- Measure the reduction relative to the Fund's position as at July 2016 (7.11MtCO<sub>2</sub>e) and adjusted for Assets Under Management (£AUM)

The target will be periodically reviewed to ensure that it remains consistent with the risks associated with investment in carbon assets and with the Committee's fiduciary duties.

The Committee considers exposure to carbon risk in the context of its role in asset allocation and investment strategy setting. Consideration has therefore been given in setting the Fund's Investment Strategy to how this objective can be achieved within a pooled investment structure and the Committee, having taken professional advice, will work with the London CIV to ensure that suitable strategies are made available.

Where necessary, the Fund will also engage with its Investment Managers or the London CIV to address specific areas of carbon risk. The Fund expects its investment managers to integrate financially material ESG factors into their investment analysis and decision making and may engage with managers and the London CIV to ensure that the strategies it invests in remain appropriate for its needs. However, the Fund

does not at this time operate a blanket exclusion policy in respect of specific sectors or companies.

At the present time the Committee does not take into account non-financial factors when selecting, retaining, or realising its investments. 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 exclude investments in order to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

The 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 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 Committee has formally agreed to adhere to the Stewardship Code as published by the Financial Reporting Council. The Committee expects both the London CIV and any directly appointed fund managers to also comply with the Stewardship Code and this is monitored on an annual basis. A copy of the Fund's statement of compliance with the Stewardship code can be found on the Fund's website. At the FRC's most recent review, the fund was rated as a Tier 2; however, the Fund is currently making improvements to its approach and intends to re-submit its statement for review by the FRC in the hope of achieving a Tier 1.

As part of its compliance with the Stewardship Code the Fund has adopted a set of Voting Intention Guidelines. The Fund has delegated responsibility for voting rights to the Fund's external investment managers and expects them to vote in accordance with these guidelines, which can be found on the Fund's website.

Future investments through the London CIV will be covered by the voting policy of the CIV which has been agreed by the Pensions Sectoral Joint Committee. Voting for investments on the CIV will therefore be delegated to the external managers and monitored on a quarterly basis. The CIV will arrange for managers to vote in accordance with voting alerts issued by the Local Authority Pension Fund Forum as far as practically possible to do so and will hold managers to account where they have not voted in accordance with the LAPFF directions.

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