# INVESTMENT STRATEGY STATEMENT (‘ISS’)

**LONDON BOROUGH OF WALTHAM FOREST PENSION FUND – MARCH 2020**

***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.

This ISS has been designed to be a living document and is an important governance tool for the Fund. This document sets out the investment strategy of the Fund, provides transparency in relation to how the Fund investments are managed, acts as a risk register, and has been designed to be informative but reader focused. This document replaces the Fund’s Statement of Investment Principles.

This statement will be reviewed and consulted on at least triennially and reviewed by the Committee more frequently should any significant change occur.

***2. Investment Beliefs and Objectives***

The Fund has the following investment beliefs[[1]](#footnote-1) 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
* Risk mitigation will be prioritised according to size of potential impact and risks will only be taken where they are expected to be rewarded
* Environmental, Social and Corporate Governance (ESG) factors are important for the sustainability of investment returns over the long term
* Active stewardship can promote the long term success of companies for the benefit of stakeholders including investors
* Value for money from investments is important, not just absolute costs. Asset pooling will help reduce costs whilst providing more choice of investments and will therefore be additive to Fund returns.
* High conviction active management can add value to returns

The Administering Authority’s long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due

### 3. Investment strategy and the process for ensuring suitability of investments.

The Fund’s objective is to pay benefits as they fall due and this requires the build-up of sufficient reserves in advance. The Fund is currently assessed to have a deficit, in respect of historic benefits accrued, and so the asset strategy is focused on achieving returns in excess of CPI inflation, without taking undue risk in order to reduce this deficit. Having a thorough understanding of the risks facing the Fund is crucial and these are covered later in this statement.

The asset strategy, along with an overview of the role each asset plays in achieving the Fund’s objectives is set out in the table below[[2]](#footnote-2):

|  |  |  |  |
| --- | --- | --- | --- |
| **Asset class** | **Allocation %** | **Allowable ranges %** | **Role(s) within the strategy** |
| Equity | 60.0 | 55-65 | Long term growth in excess of inflation expected |
| Global Fixed Income | 15.0 | 12.5-17.5 | Diversified source of return from a range of sources. Not specifically income generating |
| Property | 8.0 | 6-10 | Diversification.Generates investment income; Returns expected to be inflation-sensitive Exposure to Illiquidity premium |
| Alternatives | 17.0 | 12-22 | Diversified source of returnsSome inflation protectionSource of income  |

The Pension Fund Committee is responsible for the Fund’s asset allocation which is determined via a triennial strategy review as part of the valuation process, but is kept under constant review; noting that strategic changes are an evolutionary process.

The triennial review looks at both qualitative and quantitative analysis, covering:

* The required level of return that will mean the Fund can meet its future benefit obligations as they fall due
* The level of risk that the Fund can tolerate in absolute terms, and in relation to its funding level and deficit
* An analysis of the order of magnitude of the various risks facing the Fund is established in order that a priority order for mitigation can be determined
* The desire for diversification across asset class, region, sector, and type of security.

### 4. Risk measurement and management

The Committee assesses risks both qualitatively and quantitatively, with the starting point being the triennial strategy review. Risks are considered, understood and then prioritised accordingly.

**A Investment Risks**

The Committee uses Risk Attribution Analysis to prioritise the main investment risks facing the Fund. The principal risks are a fall in equity markets and a rise in inflation. To control these risks, the Investment Strategy of the Fund aims to:

1. Diversify away some equity exposure into alternatives and bonds
2. Reduce the volatility of the market exposure of the equity portfolio through a risk management overlay strategy
3. Invest in assets which are expected to generate returns exceeding inflation or providing inflation linked income

The chart below shows the VaR (Value at Risk, essentially the losses (in £m) that would occur in a 1-in-20 event) facing the Fund’s assets over three years (un-annualised), split into major asset categories.



3 year 95% VaR. Source: Mercer. Assets only. Units are pounds million. Based on actual allocations and market conditions as at 31 March 2019.

In addition, the Fund also runs the risk that the liabilities of the Fund increases i.e. the value of benefits promised are more expensive than originally thought.

The main risks faced by the Fund across the assets and liabilities are as follows:

*Equities*

The largest risk that the Fund is running is in relation to its equity holdings. Should equity market conditions deteriorate significantly this will have a negative impact on the funding level. The Fund holds equities in order to provide the necessary returns to ensure that the Fund remains affordable. The Committee believes that the extra returns that are expected to be generated by equities compensates the level of risk equities bring to the Fund, but does believe in risk management and diversification, and looks to mitigate equity risk by employing an equity protection strategy and investing in bonds and alternative assets. The Fund is a long-term investor but does require income over and above contributions received in order to pay pensions. A strategy is therefore being developed that would seek income from alternative assets and bonds, rather than from equities, in order to avoid being a forced seller at a low point in the market.

*Inflation*

The Fund’s liabilities are impacted by inflation both explicitly and implicitly and the required return on assets is expressed in terms of inflation plus a premium. The Fund will seek to invest in a range of assets that provide returns in excess of inflation and in some cases provide an inflation linked income, subject to a tolerable level of volatility.

*Alternatives*

The Fund has a significant amount of assets allocated to a range of alternatives, with allocations to property, infrastructure and social impact private equity. The risks that these investments bring at an individual level is not insignificant however the Committee believe that over the long term alternatives will provide returns that compensate for the risks being run. Additionally the level of diversification the assets provide helps to reduce the Funds reliance on returns from equities. Illiquid assets such as property and infrastructure are also a valuable source of income.

*Active Manager Risk*

Investment Managers are appointed to manage the Fund’s investments on its behalf. This risk is small relative to other risks; however the Fund still addresses this risk. Extensive due diligence is used before managers are selected, with a number of different managers chosen to prevent concentration risk The investment managers are also monitored regularly by the Committee, Officers and by the Fund’s Advisors.

The Fund’s portfolio is well diversified across asset classes, geography and asset managers. As different asset classes have varying correlations with other asset classes, the Fund by investing in a range of different investments can minimise the level of risk run to a degree.

**B Demographic Risks**

The Fund is subject to a range of demographic risks, but with particular reference to investment strategy, the Committee is aware of the potential for the Fund to mature over time as the pensioner liability increases. A mature pension fund is likely to take less investment risk over time and this is considered at each strategy review. The more mature a pension fund, the more likely it is that disinvestments would need to be made to pay benefits. The Fund is not in that situation at present as income from contributions and investments are greater than benefit payments. However, this situation is monitored regularly and formally as part of the actuarial valuation and strategy review.

**C Cashflow Management Risks**

As noted above, the Fund is cash flow positive after taking investment income into account. However, this position will be reviewed regularly and is a factor that is incorporated into the Fund’s investment strategy reviews in order that a portfolio of income generating assets is built up over time.

**D Governance Risks**

The Fund believes that there is a benefit to the Fund to be gained from good governance in the form of either or both of an increased return and/or decreased risk. Poor governance can lead to opportunities and risks to be missed, and have a detrimental effect on the funding level and deficit.

Details of the Fund’s governance structure can be found in the Governance Compliance Statement, details of which can be found in the Annual Report and Accounts.

Details of the Fund’s training plan can be found in the Annual Report and Accounts.

**E Environmental, Social and Governance (‘ESG’) Risks**

The Committee believes that ESG risks should be taken into account on an ongoing basis and are an integral part of the Fund’s strategy and objective of being a long term investor.

The Committee believes that engagement is key in relation to strong corporate governance and managing ESG risks, which in turn will enhance returns. Details of the Fund’s policies can be found later in this statement.

The Committee has made a commitment to decarbonise the Fund’s portfolio over time by reducing its exposure to carbon intensive companies and assets. A particular focus for the 2020/2021 strategy review will be to consider in more detail the risks posed by climate change and the associated issue of stranded assets. The strategy review will include analysis of the carbon footprint of the Fund’s equity portfolio and consider reduction options, as well as conducting a scenario analysis based on multiple climate change scenarios with different warming outcomes, ranging from 2ºC to 4ºC that may have implications for the Fund’s future asset allocation.

### 5. Approach to asset pooling

The Fund has formally agreed to join the London Collective Investment Vehicle (CIV) as part of the Government’s pooling agenda. The London CIV has been operational for some time and has opened a range of sub-funds covering liquid asset classes and some less liquid asset classes.

The Fund transitioned Global Equity assets into the London CIV during 2018. These assets came from the funds current Global Equity manager and an overweight to UK equities (given the agreed shift in allocation between global and UK equities from 60% UK and 40% Global to 40% UK and 60% Global).

25% of the Fund is held 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 not to reinvest.

There are also areas of the Fund’s investment strategy that cannot currently be implemented by the CIV. The Fund will transition these areas of the portfolio to the CIV when suitable implementation options are available.

### 5. Environmental, Social and Corporate governance policy and policy of the exercise of rights (including voting rights) attaching to investments

With regard to responsible investment the Committee is mindful of the following legal principles, which are based on recent decisions in the courts and which apply to all pension schemes:

a. Administering authorities are free to adopt a policy of socially responsible investment, provided that they treat the financial interests of all classes of scheme members as paramount and their investment policies are consistent with the standards of care and prudence required by law.

b. Administering authorities are free to avoid certain kinds of prudent investment, which they consider scheme members would regard as objectionable as long as they make equally financial advantageous and prudent investments elsewhere. They may also make “ethical” investments provided these are otherwise justifiable on investment grounds.

c. Administering authorities are not entitled to subordinate the interests of members to ethical or social concerns. The financial performance of the Fund consistent with proper diversification and prudence is paramount.

ESG issues can have a material impact on long-term risk and return outcomes and considering these issues is consistent with the fiduciary duty of the Committee. The Fund is a long-term investor and is committed to being an active owner. It wishes to promote a policy of dialogue on responsible investment issues, through its investment managers, with company management.

The Committee has identified the following ESG issues as a focus for engagement:

* Environmental issues: including conserving energy, promoting alternative energy sources, recycling, avoiding pollution and using environmentally friendly and sustainable resources
* Human rights: including child labour issues in foreign subsidiaries of UK companies or operations in countries with oppressive regimes
* Employment standards: including equal opportunities, health and safety, trade union recognition and employee participation

The Committee has a fiduciary duty to invest Fund assets in members’ best interests and so must ensure that assets are invested in an appropriate manner; as a result any ESG considerations must be taken in light of expected return implications.

The Fund invests via pooled funds and therefore expects its underlying investment managers to exercise voting and engagement rights on its behalf. The Fund is therefore subject to the ESG and voting policies of the individual investment managers. The Committee considers these policies when appointing a new manager and when monitoring investment managers, the Officers consider whether each manager’s actions and engagement activities have been appropriate and in keeping with the Fund’s policy.

The Fund complies with the current UK Stewardship Code (‘the Code’) has prepared a formal statement of commitment with the Code for assessment. The current draft is set out in Appendix A. The Fund will also work towards the revised 2020 UK Stewardship Code.

The Fund encourages its underlying investment managers to comply with the Code.

It is proposed to monitor action by investment managers on a quarterly basis and further develop this policy on an annual basis on the basis of experience. The Committee also receives an annual report from its Investment Consultant on the ESG credentials of its investment managers.

The Committee recognises that taking a collaborative approach with other investors can help to achieve wider and more effective outcomes. The Fund has joined the Local Authority Pension Fund Forum (LAPFF) to promote best practice on corporate governance and SRI issues amongst the companies in which it invests, through cooperative action with other local authority funds. LAPFF exists to promote the investment interests of local authority pension funds and to maximise their influence as shareholders in promoting corporate social responsibility and high standards of corporate governance amongst companies in which they invest.

With more than half of all local authority funds as members, LAPFF can negotiate with companies with a single authoritative voice, impossible for smaller funds acting alone. LAPFF is carrying out research and engagement with companies on many issues, including environmental issues such as the climate change impact of the transport sector, and the impact of oil extraction from tar sands. Other initiatives include engagement with investment managers to try to improve transparency of proxy voting policies by the managers, and on corporate governance issues.

With respect to Social Investments, the Fund recognises that there is a broad range of investment opportunities. The Fund considers investments that are expected to generate positive social and/or environmental benefits with competitive financial returns. The Fund currently invests a small proportion of its assets in a private equity fund run by LGT Venture Philanthropy that invests in projects aiming to deliver a positive social impact.

As noted earlier, the Fund has also made a commitment to reduce its exposure to carbon intensive companies and assets. The Fund also takes a proactive stance by investing in clean energy initiatives via its infrastructure strategy.

**Myners Principles**

Although no longer referenced in the Regulations, the Committee feels that assessment of compliance with the Myners Principles is a valuable governance tool. A copy of the Fund’sMyners Compliance Statement can be found in the Annual Report and Accounts.

**Advice Taken**

In creating this statement, the Fund has taken advice from its Officers, Investment Consultant and Independent Advisor (John Raisin Financial Services Limited). Also, in relation to each of the constituent parts, such as the asset allocation and risk mitigation, the Fund has taken advice from its Investment Consultant, Mercer, and the Scheme Actuary, also Mercer. In providing investment advice, Mercer is regulated by the Financial Conduct Authority.

Appendix A

**LONDON BOROUGH OF WALTHAM FOREST PENSION FUND**

**Draft Statement of Commitment with the UK Stewardship Code**

**Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.**

The Fund takes its responsibilities as a shareholder seriously and has made a commitment to the informed exercise of its ownership rights as detailed in the Fund’s Investment Strategy Statement.

The Fund invests via pooled funds and therefore expects its underlying investment managers to exercise voting and engagement rights on its behalf. The Fund encourages its underlying investment managers to comply with the UK Stewardship Code.

The Fund is subject to the ESG and voting policies of its underlying investment managers. The Pension Fund Committee (‘the Committee’) considers these policies when appointing a new manager and when monitoring investment managers, the Fund’s Officers consider whether each manager’s actions and engagement activities have been appropriate and in keeping with the Fund’s policy.

In considering its stewardship activities, the Fund monitors the activities of its investment managers with regard to the following:

• The exercise of voting rights

• The integration and management of Environmental, Social and Corporate Governance (ESG) issues

• Engagement activities and progress

The Fund is a long-term investor and is committed to being an active owner. It wishes to promote a policy of dialogue on responsible investment issues, through its investment managers, with company management.

The Committee has identified the following ESG issues as a focus for engagement:

• Environmental issues: including conserving energy, promoting alternative energy sources, recycling, avoiding pollution and using environmentally friendly and sustainable resources

• Human rights: including child labour issues in foreign subsidiaries of UK companies or operations in countries with oppressive regimes

• Employment standards: including equal opportunities, health and safety, trade union recognition and employee participation

The Fund recognises that taking a collaborative approach with other investors can help to achieve wider and more effective outcomes and is a member of the Local Authority Pension Fund Forum (LAPFF), which aims to promote best practice on corporate governance and RI issues through co-operative action with other local authority funds.

The Fund regularly reviews its approach to responsible investment and the exercise of its stewardship activities.

**Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.**

The Fund expects its investment managers to have effective policies addressing potential conflicts of interest related to stewardship.

In respect of potential conflicts of interest within the Fund, the Committee members are required to make declarations of interest prior to panel meetings.

All declarations are captured in the minutes of the meeting, which are publicly available, Potential conflicts, based on declarations, are managed accordingly by the Chair of the Committee.

**Principle 3: Institutional investors should monitor their investee companies.**

While the day-to-day responsibility for managing the Fund’s equity holdings is delegated to the Fund’s appointed investment managers, the Fund recognises that it cannot delegate its stewardship obligations. The Fund’s Committee and Officers monitor the Fund’s investment managers on a regular and ongoing basis, including with respect to stewardship activities.

As such the Fund expects its investment managers to monitor investee companies, intervene where necessary, and report back regularly on activity undertaken. This may be via written reports, phone calls, or meetings with the Officers and the Committee.

In addition, the Committee receives an annual report from the Fund’s investment consultant on the ESG credentials, including active ownership, of its investment managers.

**Principle 4: Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.**

Responsibility for day-to-day interaction with companies is delegated to the Fund’s investment managers, including the escalation of engagement when necessary.

The Fund’s Officers and Committee monitor the escalation activities undertaken by the Fund’s investment managers through the regular reporting provided by the Fund’s managers.

On occasion, the Fund may itself choose to escalate activity; this will typically be through its membership of LAPFF or via one of the underlying investment managers.

Escalation activities undertaken by LAPFF may include writing a letter to the board or additional meetings with company management.

**Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate.**

The Fund seeks to work collaboratively with other institutional shareholders in order to maximise the influence that it can have on individual companies.

The Fund undertakes collective engagement activities through its membership of LAPFF as well as through initiatives proposed by the Fund’s investment managers or advisors.

In addition, the fund has formally agreed to join the London Collective Investment Vehicle (CIV) and regularly collaborates with other members of the CIV with respect to ESG and stewardship issues.

**Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.**

The Fund invests via pooled funds and is therefore subject to the underlying investment managers’ policies. The Fund expects its investment managers to exercise all votes associated with the Fund’s equity holdings where practicable. The Fund encourages its investment managers to publicly disclose their voting records.

Generally, the Fund expects its investment managers to support resolutions that are consistent with the UK Corporate Governance Code and represent best practice. In overseas markets, the Committee expects the managers to take account of local best practice principles.

Where resolutions or issues fall short of the expected standards, the Committee expects managers will either abstain or vote against, depending on the individual circumstances of the company and the issues presented. The Committee expects the investment managers to report on their voting activities on a regular basis and the Fund’s Officers consider whether each manager’s actions and engagement activities have been appropriate and in keeping with the Fund’s policy.

The policy is reviewed at least annually in order to take account of regulatory developments and timely or controversial issues may be discussed at Committee meetings.

**Principle 7: Institutional investors should report periodically on their stewardship and voting activities.**

The Fund expects its underlying investment managers to report regularly to both the Officers and the Committee with respect to voting and engagement activities, including examples of company engagement, progress on engagement over time and collaborative activities. The Fund encourages its investment managers to publicly report on their stewardship activities.

The Fund will report on its stewardship activity to the Committee on an annual basis.

In addition, quarterly reports of voting actions are posted as part of the funds reporting to Committee and are available on the Council’s website <http://democracy.walthamforest.gov.uk/ieListMeetings.aspx?CId=495&Year=0>

The Committee will provide an annual report on how the Fund satisfies its UK Stewardship Code obligations requirements, which will be made publicly available.

This statement has been approved by the Committee on 26 June 2018.

If you have any questions on this statement or the Fund’s approach to stewardship, please contact Debbie Drew, Pensions and Treasury Manager by e-mail at the following address Debbie.drew01@walthamforest.gov.uk

1. The beliefs noted above and overleaf, have been collated from previously detailed beliefs that underpin the current investment strategy and previous decisions made by the Committee. [↑](#footnote-ref-1)
2. The allocations set out within table are the overarching ones set to meet the funding objective.  The detailed allocation will be set in light of advice from the funds advisors and will be consistent with this strategy statement, which will include, for example, consideration of the style of manager, type of mandate, geographic allocation etc. required to implement this strategy [↑](#footnote-ref-2)