

INVESTMENT STRATEGY STATEMENT

LONDON BOROUGH OF ISLINGTON PENSION FUND – MARCH 2017

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 investment strategy statement (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 by the Pensions Sub-Committee ('the Committee') at least triennially or more frequently should any significant change occur.

Myners Principles

Although not specifically referenced in the Regulations, the Pensions Sub-Committee feels that assessment of compliance with the Myners Principles is a valuable governance tool. A copy of the Fund's Myners Compliance Statement can be found in the Annual Report and Accounts and is attached as Appendix A

2. Investment Beliefs and Objectives

The Committee has adopted policies with the primary objective being to pay members benefits as they fall due and the secondary objective to achieve maximum growth of pension fund investments to reduce the burden of employer contributions. The target for real investment returns above CPI is set out in the Fund's Funding Strategy Statement.

The 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.
- 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 Governance are important factors for the sustainability of investment returns over the long term. Value for money from investments is important, not just absolute costs.

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

As noted above, 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 terms of the reserves needed and so the asset strategy is focused on achieving returns in excess of CPI inflation, without taking undue risk. 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:

Asset class	Allocation %	Allowable ranges %	Role (s) within the strategy
Equity	46.0	+/-6.0	Long term growth in excess of inflation expected
Private Equity	4.0	+/-2.0	Additional returns in excess of public equity
Diversified Growth Funds	10.0		Diversification. Some inflation protection; Source of income
Property	15.0	+/-2.0	Diversification. Generates investment income; Returns expected to be inflation-sensitive Exposure to Illiquidity premium
Corporate Bonds	10.0	+/-2.5	Diversified source of return from a range of sources. Not specifically income generating
Diversifying ‘real’ assets e.g. Infrastructure Social Housing	15.0		Diversification. Generates investment income; Returns expected to be inflation-sensitive Exposure to Illiquidity premium

The Pensions Sub-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 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.

3. 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.

[Risk Attribution Analysis (to be added in following strategy review) to show size / impact of main investment risks]

[Impact of falls in equity markets, rises in inflation, falls in interest rates and investment manager underperformance on the funding level (to be added in following strategy review).]

A Investment Risks

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 diversification, and looks to mitigate equity risk by investing significantly in other diversifying assets.

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.

Diversifying assets – The Fund has a significant amount of assets allocated to a range of non-equity, diversifying assets, with allocations to property, bonds, diversified growth and a plan to build allocations to real assets such as infrastructure and social housing. The risks that these investments bring at an individual level are not insignificant but the Committee believes that over the long term these assets will provide returns that compensate for the risks being run. Additionally the level of diversification the assets provide helps to reduce the Fund's reliance on returns from equities. Illiquid assets such as property are also a valuable source of income.

Active Manager Risk – Investment Managers are appointed to manage the Fund's investments on its behalf, a number of which are active managers. Active manager risk is small relative to other risks; the Fund still addresses this risk. Extensive due diligence is undertaken before managers are selected, with a number of different managers employed to prevent manager concentration risk. The investment managers are also monitored regularly by the Committee 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 reduce the overall 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

The Fund is cash flow positive. However, this position will be reviewed regularly and is a factor that is incorporated into the Fund's investment strategy reviews with the long-term aim that a portfolio of income generating assets is built up over time.

D Governance Risks

The Committee 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 in the Annual Report found via <https://www.islington.gov.uk/about-the-council/apply-for-a-job/council-pension-scheme> useful documents. The Pensions Sub-Committee members receive training on a regular basis as a group and attend individual training courses and seminars. Each member must attend the 3 Day Trustee Training organised by the Local Government Association.

E ESG Risks

The Committee believes that ESG risks should be taken into account on an ongoing basis. ESG considerations are an integral part of the Fund's strategy and objective of being a long term investor. The Committee expects its investment managers to include information on how carbon risk is being managed within their respective portfolios as part of regular reporting for the Fund.

The Committee accepts that engagement is key in relation to strong corporate governance, which in turn will enhance returns. Details of the Fund's policies can be found later in this statement.

The Fund has made a commitment to reduce its exposure to carbon intensive companies and assets. After careful consideration, the Committee decided to change both the UK equity index benchmark for the Fund's internally managed passive equities and the global equity index benchmark for externally-managed passive assets, to low carbon variants of the standard index. As a result of these changes, the Fund will have a very much lower carbon footprint than a 'normal' equity portfolio, and therefore a low carbon footprint at the Total Fund level. The Pensions Sub-Committee expects to continue to review further opportunities, particularly in other asset classes, to reduce the Fund's carbon footprint further.

4. Approach to asset pooling

The Fund has formally joined the London Collective Investment Vehicle (CIV) as part of the Government's pooling agenda. 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 Fund has already transitioned liquid assets into the London CIV with a value of £92m and will look to transition further liquid assets as and when there are suitable investment strategies available on the platform that meet the needs of the Fund in advance of April 2018.

The Fund holds £90m 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.

A proportion (currently 20%) of the Fund is held in illiquid assets and these may remain outside of the London CIV pool where there is a strong business case. 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.

5. Social, environmental and corporate governance policy and policy of the exercise of rights (including voting rights) attaching to investments

With regard to socially 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 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.

The London Borough of Islington Pension Fund wishes to promote a policy of dialogue on socially responsible investment issues, through the Fund Managers, with company management. In the first instance, the Committee would like environmental issues, human rights, employment standards and modern day slavery to be raised with company management. Environmental issues could include issues such as reducing carbon emissions, conserving energy, promoting alternative energy sources, recycling, avoiding pollution and using environmentally friendly and

sustainable resources. Human rights could involve child labour issues in foreign subsidiaries of UK companies or operations in countries with oppressive regimes. Employment standards could relate to equal opportunities, health and safety, trade union recognition and employee participation.

The Fund invests via pooled funds and is therefore prepared to subscribe to the policies of the individual fund managers. When monitoring investment managers, the Pensions Sub-Committee considers whether managers' actions and engagement activities have been appropriate and in keeping with London Borough of Islington Pension Fund policy.

It is proposed to monitor action by fund managers on a quarterly basis and further develop this policy on an annual basis on the basis of experience.

The Fund has joined the Local Authority Pension Fund Forum 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. The Forum 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, the Forum can negotiate with companies with a single authoritative voice, impossible for smaller funds acting alone. The Forum is developing policy and 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 fund managers to try to improve transparency of proxy voting policies by the managers, and on corporate governance issues.

The Pension Sub-Committee is a member of the Institutional Investors Group on Climate Change (IIGCC). The IIGCC seeks to promote better understanding of the implications of climate change amongst its members and other institutional investors. It also aims to promote a lower carbon economy by encouraging the companies and markets in which IIGCC members invest to address their approach to climate change issues.

There are no proposals to invest any part of the Fund exclusively in Socially Responsible Investments at the current time. Nor is it proposed that positive or negative screening should be adopted by the Fund on socially responsible issues.

As noted earlier, the Fund has made a commitment to reduce its exposure to carbon intensive companies and assets.

6. Policy of the exercise of rights (including voting rights) attaching to investments

The Pensions Sub-Committee takes its responsibilities as a company shareholder seriously and exercises its votes at company AGMs/EGMs wherever practically possible. The Sub-Committee uses the Corporate Governance Service provided by Pension Investments Research Consultants (PIRC), and casts votes at all UK, European and North American company AGMs in line with PIRC recommendations unless the Council decides otherwise.

The Fund's investments through the London CIV are covered by the voting policy of the CIV which has been agreed by the Pensions Sectoral Joint Committee. Voting is 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.

In addition, voting records are published in the year end annual reports and quarterly reports of voting actions are posted on the Fund's website <https://www.islington.gov.uk/about-the-council/apply-for-a-job/council-pension-scheme> useful documents. The Fund has not issued a separate Statement of Compliance with the Stewardship Code, but fully endorses the principles embedded in the 7 Principles of the Stewardship Code Or

The Committee will provide an annual report on how the Fund satisfies its UK Stewardship Code obligations requirements.

Advice Taken

In creating this statement, the Pensions Sub-Committee has taken advice from its Investment Consultant and independent Investment Advisor. 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

Myners Investment Principles - Compliance Statement

In accordance with regulation 9A(3A) of the LGPS (Management and Investment of Funds) Regulations 1998, as amended the Council is required to state the extent to which the administering authority comply with the ten principles of investment practice set out in the document published in April 2002 by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom (Guidance note issue No. 5)"; and give the reasons for not complying where they do not do so. This CIPFA publication is based on ten principles proposed by the Myners review of Institutional Investment in the United Kingdom, and adopted by the Government as a model for best practice in 2001.

The Myners Principles were reviewed by the NAPF during 2008 and a revised set of six principles were issued in October 2008. CIPFA expect to issue a new publication based on the revised six principles in the near future.

Principle 1 - Effective decision-making

- Trustees should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation.
- Trustees should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Comment

The Fund is generally compliant with the requirements of this Principle. The Pensions Sub-Committee requires new members serving on the Sub-Committee to source appropriate training within six months of joining the Sub-Committee. The three-day course run by the Local Government Pensions Committee of the Local Government Association is recognised as particularly relevant training for new Members, but other routes and courses, and requisite experience are also recognised as appropriate. Where several new Members are appointed together, tailor-made training will be considered.

Principle 2 - Clear Objectives

- Trustees should set out an overall investment objective(s) for the Fund that takes account of the scheme's liabilities, the strength of the sponsor covenant and the attitude to risk of both the trustees and the sponsor, and clearly communicate these to advisers and investment managers.

Comment

The Council seeks to undertake regular reviews of investment strategy, most recently in 2014, which took into account the scheme's liabilities, the strength of the employer covenant and the attitude to risk of both the trustees and the sponsor.

Principle 3 - Risk and Liabilities

- In setting and reviewing their investment strategy, trustees should take account of the form and structure of liabilities.
- These include the strength of the sponsor covenant, the risk of sponsor default and longevity risk.

Comment

In setting the investment strategy, the Trustees have considered the form and structure of liabilities, along with the strength of the sponsor covenant, risk of sponsor default and longevity risk, taking advice from independent professional advisors where appropriate.

Principle 4 - Performance Assessment

- Trustees should arrange for the formal measurement of the performance of the investments, investment managers and advisers.
- Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

Comment

Overall Fund performance and detailed portfolio performance is measured quarterly, annually and over longer periods by external independent measurement specialists BNY Mellon. Performance is also monitored against the local authority peer group of pension funds, also based on old State Street Company data but from 1 April 2016 run by PIRC (for the local authority universe), although in line with the Myners Principles the peer group is no longer considered the benchmark for overall fund performance. The overall benchmark is specific and customised to the Fund's objectives based on the outcome of the successive asset/liability studies.

Performance of the Fund is also subject to annual review by external auditors and by internal audit through regular audits programmed into the Audit Plan.

Pension benefits administration performance is reported regularly to Pensions Board

Principle 5 - Responsible Ownership

- Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.
- A statement of the scheme's policy on responsible ownership should be included in the Investment Strategy Statement Trustees should report periodically to members on the discharge of such responsibilities.

Comment

The Sub-Committee uses the Corporate Governance Service provided by Pension Investments Research Consultants (PIRC), and casts votes at all UK, European and North American company AGMs in line with PIRC recommendations unless the Council decides otherwise.

The Fund encourages each active investment manager to take account of social, environmental and ethical considerations insofar as the manager believes such considerations will benefit performance and/or reduce risk.

For those assets of the Scheme managed in pooled funds, the Trustees accept that the assets are subject to the investment manager's own policy on socially responsible investment. The Trustees are satisfied that this corresponds with its responsibilities to the beneficiaries.

The Fund's attitude to and policies regarding responsible ownership are set out within the body of the its Investment Strategy Statement.

The Trustees issue member newsletters in which this discharge of responsibilities is noted.

Mercer has adopted the Institutional Shareholders' Committee Statement of Practice relating to investment consultants.

Principle 6 - Transparency and Reporting

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

Comment

The Council's SIP (and its replacement the Investment Strategy Statement from 1 April 2017) is currently published and available to scheme members on the Council website. Summaries of performance and monitoring of managers are reported in the Pension Fund Annual Report and available to all pensioners and employees each year. Further performance reporting is provided to contributors and pensioners at the AGM. The full Pension Fund Report and Accounts are published as part of the Council's overall Annual Report and Accounts and available to all members of the public.