

Investment Strategy Statement (Published March 2017)

Introduction and background

This is the Investment Strategy Statement (“ISS”) of the London Borough of Sutton Pension Fund (“the Fund”), which is administered by Sutton Council, (“the Administering Authority”). The ISS is made in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (“the Regulations”).

The ISS has been prepared by the Fund’s Pension Committee (“the Committee”) having taken advice from the Fund’s investment adviser, Hymans Robertson LLP. The Committee acts on the delegated authority of the Administering Authority.

The ISS, which was approved by the Committee on 20 March 2017, is subject to periodic review at least every three years and without delay after any significant change in investment policy. The Committee has consulted on the contents of the Fund’s investment strategy with such persons it considers appropriate.

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 [Barnett Waddingham currently providing updated draft].

The suitability of particular investments and types of investments

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 benefits basis. This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

In order to meet this primary objective the Committee aims to:

- Maximise the returns from investments whilst keeping risk within acceptable levels
- Contribute towards achieving and maintaining a future funding level of 100%
- Enable employer contribution rates to be kept as stable as possible

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.

In addition, the Committee monitors its 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. Actual against target allocation for each of the main asset classes is recorded within the quarterly performance monitoring report. Any planned rebalancing activity is reported and discussed at committee.

[Fund’s Investment Beliefs to be inserted –These will be developed at the member session being held on 13/3/17. These will help the fund to clearly define its strategic approach]

Investment of money in a wide variety of investments

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. 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”.

Table 1: Fund allocation

Asset class	Target allocation %
UK equities	13
Overseas equities	42
Total equities	55
Property	10
Absolute Return	15
Bonds	15
Infrastructure	5
Total	100

As part of the 31 March 2016 actuarial valuation the Fund Actuary has assumed a discount rate and therefore required rate of return on the Fund assets of 5.2% p.a. This includes an allowance for prudence. The Committee believes that the current investment strategy will generate returns in excess of the required return while taking an appropriate degree of risk and tests the ability of the strategy to meet the Fund’s objectives as part of the strategy review process.

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.

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:

Funding risks

- Financial mismatch – The risk that Fund assets fail to grow in line with the developing cost of meeting the liabilities.
- 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. The Committee is currently in the process of carrying out a strategic review following the completion of the 2016 actuarial valuation which will consider the probability of achieving the Fund's objectives and the level of risk being taken within the strategy. 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 also seeks to understand the assumptions used in any analysis and modelling so they can be compared to their own views and the level of risks associated with these assumptions to be assessed.

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.

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 the 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 measure and manage 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. By investing across a range of assets, including liquid quoted equities and bonds, as well as property, the Committee has recognised the need for access to liquidity in the short term.

The Fund invests in a range of overseas markets which provides a diversified approach to currency markets; the Committee also assess the Fund’s currency risk during their risk analysis. 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, using a range of approaches for equity investment 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.

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.

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts 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 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 (CIV) Pool. The proposed structure and basis on which the London CIV Pool will operate was set out in the July 2016 submission to Government.

Assets to be invested in the Pool

The Fund's intention is to invest its assets through the London CIV Pool as and when suitable Pool investment solutions become available. An indicative timetable for investing through the Pool was set out in the July 2016 submission to Government. The key criteria for assessment of Pool solutions will be as follows:

- 1 That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund
- 2 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 already invested the following assets via the London CIV Pool:

Asset class	Manager	% of Fund assets	Benchmark and performance objective
Absolute Return	Baillie Gifford	7.3	Benchmark: 3 month LIBOR + 3% Performance objective: 3% above benchmark over rolling 3 year period (gross of fees)
Absolute Return	Pyrford	7.1	Benchmark: 3 month LIBOR + 3% Performance Objective: 3% above benchmark over rolling 3 year period (gross of fees)

The fund holds 12% or £68m 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.

Plans are also in place for a transfer of the Newton Global Equities mandate into the London CIV.

At the time of preparing this statement the Fund holds the following mandates outside of the London CIV. Opportunities for investing in these asset classes through the CIV will be reviewed as and when opportunities arise.

Asset class	Manager	% of Fund assets	Benchmark and performance objectives	Reason for not investing via the London CIV Pool
Global Equities	Harding Loevner	15.7	Benchmark: MSCI All Countries World NDR Index Performance objective: 3% above benchmark over rolling 3 year period (gross of fees)	No other global equity managers available
Global Equities	Schroder	15.9	Benchmark: MSCI All Countries World NDR Index Performance objective: 3% above benchmark over rolling 3 year period (gross of fees)	No other global equity managers available
Bonds	M&G (Alpha Fund)	8	Benchmark: 3 Month LIBOR + 3% Performance objective: 3 Month LIBOR + 3 to 5 %	No bond managers on London CIV panel
Bonds	M&G (Index Linked)	8	Benchmark: FTSE A British Government Over 5 Years Index-Linked Performance objective: 0.75% above benchmark over rolling 3 years period (gross of fees)	No bond managers on London CIV panel
Property	Blackrock	3.7	Benchmark: IPD UK All Pooled Property Funds Index Performance objective: To	No property managers on London CIV panel

			outperform the benchmark	
Property	Aviva	2	Benchmark: IPD UK All Pooled Property Funds Index Performance objective: To outperform the benchmark	No property managers on London CIV panel
Property	Invesco	0.4	Performance objective: Unleveraged return of 8-9%	No property managers on London CIV panel

The fund holds £16.7m or 2.8% 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

Structure and governance of the London CIV Pool

The July 2016 submission to Government of the London CIV Pool 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. As the Pool develops and the structure and governance of the Pool are fully established the Fund will include this information in future iterations of the ISS.

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

The Fund is committed to being a long term steward of the assets in which it invests and 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 and this will include on training and information sessions on matters of social, environmental and corporate governance.

The Fund requires its investment managers to integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments. It 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.

The Fund expects its external investment managers (and specifically the London Collective Investment Vehicle through which the Fund will increasingly invest) 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 such as corporate governance and environmental factors. The Fund expects its fund managers to integrate material ESG factors within its investment analysis and decision making.

Effective monitoring and identification of these 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, 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 monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

The Fund will invest on the basis of financial risk and return having considered a full range of factors contributing to the financial risk including social, environment and governance factors to the extent these directly or indirectly impact on financial risk and return.

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

Voting rights

The Fund recognises the importance of its role as stewards of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which its investments reside. The Fund recognises that ultimately this protects the financial interests of the Fund and its ultimate beneficiaries. 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 it ultimately invests recognising 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.

The Committee has delegated the exercise of voting rights to the investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the Fund's managers have produced written guidelines of their process and practice in this regard. The managers are strongly encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2)(f).

Stewardship

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 Pool and any directly appointed fund managers to also comply with the Stewardship Code and this is monitored on an annual basis.

As part of its compliance with the Stewardship Code the Fund has adopted a set of Voting Intention Guidelines. The current guidelines can be found on the Fund's website. The Committee publishes an annual report of voting activity as part of the Fund's annual report. In addition to the Fund's compliance with the Stewardship Code, the Fund believes in collective engagement and is a member of the Local Authority Pension Fund Forum (LAPFF), through which it collectively exercises a voice across a range of corporate governance issues.

Prepared by:-

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For and on behalf of the London Borough of Sutton Pension Fund Committee