London Borough of Hillingdon Pension Fund

Investment Strategy Statement

April 2017

HILLINGDON
LONDON

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INTRODUCTION

The Pensions Committee of the London Borough of Hillingdon Pension Fund ("the Fund") has prepared this Investment Strategy Statement in accordance with the DCLG Guidance on Preparing and Maintaining an Investment Strategy Statement.

As set out in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, the Pensions Committee will review this Statement from time to time, but at least every three years, and revise it as necessary. Also, in the event of a significant change, changes will be reflected within three months of the change occurring.

The Regulations require all Administering Authorities to take “proper advice” when formulating and applying its investment strategy. In preparing this document and in managing the overall investment strategy the Pensions Committee has taken advice from KPMG LLP, the Fund's investment adviser and Scott Jamieson, the Fund's independent advisor.

The purpose of this document is to set out the Investment Strategy for the Fund, including outlining the objectives of the Fund for investment decisions and setting the limit and range of the investment value in any investment or class of investments. The Fund can then be monitored against how compliant it is with this strategy.

INVESTMENT OBJECTIVES

The Fund’s primary investment objective is to ensure that over the long term the Fund will have sufficient assets to meet all pension liabilities as they fall due. In order to meet this overriding objective, this Investment Strategy Statement looks to:

- Maximise returns from investment
- Manage risk within acceptable levels
- Ensure appropriate liquidity
- Contribute towards 100% Funding level
- Stabilise employer contribution rates as far as possible
- Invest in a wide range of investments
- Pool assets
- Take proper advice

Consistent with the 2016 triennial revaluation of the Fund, the agreed investment aim is to generate, over time, a rate of return that is at least 3.6% p.a. over gilt yield and to achieve this, the Fund will invest in a wide variety of investments to reduce portfolio risk and reduce volatility.

ASSET ALLOCATION

Asset allocation of the Fund is determined by the administering authority acting on professional advice in the best long term interest of scheme beneficiaries, while looking to maintain overall target return. The Pensions Committee review asset allocation and performance against achieving the target return regularly at quarterly meetings. A full formal review will be undertaken every three years following publication of the triennial revaluation results.
The Fund will only invest in asset classes that are deemed to be suitable investments and so must meet the following criteria:

- investments that are well understood by the Committee;
- investments which are consistent with the Fund’s risk and return objectives;
- investments which make a significant contribution to the portfolio by improving overall return and risk characteristics; and
- a wide range of assets will be selected to increase diversification.

The Fund's current asset allocation includes seven asset classes that combine to form the policy portfolio. Each asset class is selected to have different exposures to economic factors (GDP growth and inflation); to combine different geographies; and span different currencies. In assessing suitability, the Pension Committee considered the respective return drivers, exposure to economic growth and sensitivity to inflation – each an important consideration, relative to the sensitivities of the Fund’s liabilities and managing risk.

These seven asset classes are the building blocks used to create the policy portfolio. The Pension Committee determined benchmark weights to each asset class which it believes to be best suited to meeting the long term objectives of the Fund. Committee also identified tolerance ranges within which shorter term variations would be tolerated and/or actively pursued due to a combination of relative returns and investment opportunity.

The agreed benchmark weight and tolerances are shown in the table below. The weights will be maintained within the ranges if the scheme can find attractive opportunities that meet its return, risk, and cash flow requirements. In the absence of opportunities, investments will not be “forced” and the fund will be under or over allocated to any asset class.

Asset Class	Benchmark Weight *	Range
Equities	47.00%	35%-60%
Private Equity	4.00%	0%-5%
Bonds	12.00%	0%-20%
Private Credit	10.00%	0%-15%

Property	12.00%	0%-15%
Infrastructure	3.00%	0%-10%
DGF/Absolute Return	12.00%	0%-25%

* Benchmark weight reflects agreed changes to asset allocation as at Pension Committee September 2016

Each asset class has its own specific investment objective and within each asset lass there are further diversification controls. The mandates are managed by various Fund managers and the London CIV (LCIV), to whom the Fund has delegated investment management and implementation duties in line with LGPS asset pooling.

Equities: UK/Global

The Fund invests in Equities through both active and passive management. For active UK Equities the objective is to outperform the FTSE All share ex tobacco (UK) Benchmark. For active Global Equities the Funds objective is seek defensive assets with a focus on income generation as well as growth; the aim is to outperform the MSCI All Country World benchmark. Net dividends will continue to be reinvested until the funds cash flow changes. Passive Equities are held to keep investment manager fees low and to contribute to the return objective by tracking the relevant benchmarks. All equity investments are made via segregated or pooled Fund mandates and where appropriate sub Funds are available investments will be held within the London CIV.

Bonds

The Fund invests in nominal and inflation-linked government and investment grade corporate bonds to improve the resilience of the portfolio. Exposure includes securities issued by the UK Government, given their similarities within the Scheme's liabilities. To enhance yield, the Fund may maintain investments in credit securities issued by UK and global companies. This asset class is managed through both passive and active mandates. When active management is selected the manager will aim to maximise risk adjusted returns across a full market cycle.

Diversified Growth Fund (DGF) / Absolute Return

Diversified Growth Funds are included in the asset allocation to seek to preserve capital first then grow the Funds at a rate higher than cash.

Private Equity

The Fund is invested in Private Equity with the objective to outperform the MSCI World benchmark. Private Equity is an illiquid asset class; harvesting illiquidity premia is an attractive means of enhancing aggregate returns.

Infrastructure

The Fund has committed to investing in infrastructure as the duration of this class of assets matches the long-term nature of the Funds liabilities. The Funds existing holding in Infrastructure looks to gain cost-effective, diversified exposure to global infrastructure assets. Further investment in infrastructure will be added, if available, with the aim of generating predictable, index-linked cash flows; this reduces the inflation risk of the portfolio and adds diversification

Private Credit
The Fund invests in Private credit to seek income and benefit from the long term nature of the Fund. The existing allocation seeks to generate value from direct lending via the secondary market and also exploit specific opportunistic investments. This allocation is directly invested in external pooled Funds and provides a contractual income to the fund.

Property
The Fund holds an allocation in UK Property to support the overall aim to generate a return in excess of the IPD benchmark while earning predicable cash flows.

POOLING OF ASSETS

The Fund is committed to pooling of assets and the London Borough of Hillingdon as Administering Authority of the London Borough of Hillingdon Pension Fund formally agreed to join the London Collective Investment Vehicle (CIV) on 25 February 2016 and were on-boarded on 1 March 2016. Through the LCIV the Fund will benefit from economies of scale, by pooling assets with other Funds, enabling the LCIV to negotiate lower investment and implementation fees across the board on various asset classes.

London CIV

The London CIV was formed as a voluntary collaborative venture by the 33 London Boroughs in 2014 to pool their LGPS investments. It received regulatory authorisation from the Financial Conduct Authority in November 2015 and launched its first sub Fund in December 2015. The London CIV has been established as a collective investment vehicle for LGPS Funds. The current regulatory permissions allow for operation as an Authorised Contractual Scheme (ACS) Fund. The London CIV was created in line with the government directive aimed at reducing investment costs across the board for all LGPS Funds pooling assets of 89 administering authorities into 6 "wealth Funds".

Since its initial launch, the London CIV has opened 6 sub Funds within the global Equities and multi asset absolute return space and is in the process of opening further sub-Funds covering liquid asset classes. Less liquid asset classes will follow. The London CIV structure and associated business plan is consistent with the criteria contained within the November 2015 Investment Reform and Criteria guidance.

The London CIV will ultimately be responsible for managing all the Fund's assets. The Fund has begun transitioning assets into the London CIV transferring assets with a value of £102m or 11% of the portfolio in June 2016 to the London CIV Ruffer Diversified Growth Fund. In addition to the Funds held directly on the London CIV platform the Fund transferred £215 or 24% of its assets to LGIM as passive funds in October 2016 to benefit from work carried out by the London CIV to reduce fees through economies of scale. These passive funds will be retained outside of the London CIV operating model for the time being, in accordance with government guidance on the retention of life funds outside pools, although the London CIV will monitor the passive funds as part of the broader pool. The Fund 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's investment strategy.

The Fund currently holds £225m or 25% of its assets in illiquid assets. The cost of exiting these strategies early would have a negative financial impact on the Fund as the costs of transitioning outweigh any potential gains. These will be held as legacy assets until they mature and proceeds will be re-invested through the Pool, if it has appropriate strategies available, or until the Fund changes asset allocation and decides to disinvest. The Fund's illiquid assets currently held include Private Equity, Private Credit and Property.

Pool Governance

The legal ownership of assets held within the LCIV is with the depository which is currently Northern Trust, with the beneficial ownership of the assets remaining with the Fund; the LCIV is the Fund manager.

The governance structure of the LCIV has been designed to ensure that there are both formal and informal routes to engage with the investing Funds both as shareholders and investors, making the LCIV accountable at both levels. Governance is achieved through the Sectoral Joint Committee, comprising nominated Member representatives from each investing Fund within the pool; including the Chairman of the London Borough of Hillingdon Pensions Committee, Councillor Corthorne. In addition there is an Investment Advisory Committee ("IAC") formed of nominated officers from the investing Boroughs. The London Borough of Hillingdon Fund is currently represented on the IAC.

At a company level for London CIV the Board of Directors is responsible for decision making, which includes the decisions to appoint and remove investment managers. The share structure of London CIV involves each member body being shareholders who all retain equal shares in the ownership and voting making the company accountable to its shareholders. In addition the Company has a highly respected Non-Executive Board, meeting the requirements for strong governance arrangements to be in place.

INVESTMENT IMPLEMENTATION

The implementation of all investments is delegated to the Corporate Director of Finance, supported by a team of officers. The officers are assisted in the implementation of the investment strategies by the Fund's appointed investment advisors. All investment decisions will firstly look to implementation into a sub Fund held within the London CIV.

INVESTMENT GOVERNANCE

The Pensions Committee sets the objectives, risk tolerances and sets the required rate of return in conjunction with the scheme's actuary. Once the parameters are established, the Committee determine the strategic asset allocation that it believes has the highest probability of succeeding, taking into account proper advice from the Fund's investment advisors.

The Pensions Committee meet quarterly to discuss investment decisions and review Fund performance, in addition to receiving a training discussion item at each meeting to ensure effective governance of the Fund investments.

In April 2015, a Local Pensions Board was created to ensure further governance over the administration of the Fund and decision making processes. The Local Pensions Board reviews compliance and Pensions Committee decisions to ensure the Fund complies with the code of practice on the governance and administration as issued by the Pension Regulator.

PERFORMANCE MEASUREMENT

The Pension Committee reviews the performance of the investment managers and assets on a quarterly basis discussing performance, market conditions and asset allocation and making appropriate decisions where necessary. They review the report from Northern Trust, the Fund's custodian who provides an independent monitoring service and reports from officers and advisors on performance review meetings with Fund Managers. In addition, the performance of the pooling arrangements is monitored via regular reporting and updates from the London CIV. Local benchmarking information is received from PIRC to review performance against other LGPS schemes.

RISK MANAGEMENT

The Fund has a Risk Management Policy which can be found on the Council's website at http://www.hillingdon.gov.uk/article/6492/Pension-fund. The Risk Management Policy details the risk management strategy for the Fund, which explains:

- the risk philosophy for the management of the Fund, and in particular attitudes to, and appetite for, risk;
- how risk management is implemented;
- risk management responsibilities;
- the procedures that are adopted in the Fund's risk management process; and
- the key internal controls operated by the Administering Authority and other parties responsible for the management of the Fund.

The Fund adopts best practice risk management, which supports a structured and focused approach to managing risks, and ensures risk management is an integral part in the governance at a strategic and operational level.

The Fund recognises that it is not possible or even desirable to eliminate all risks. Accepting and actively managing risk is therefore a key part of the risk management strategy. A key determinant in selecting the action to be taken in relation to any risk will be its potential impact on the Fund's objectives in light of the risk appetite, particularly in relation to investment matters. Equally important is striking a balance between the cost of risk control actions against the possible effect of the risk occurring.

In managing risk, the Administering Authority on behalf of the Fund will:

- ensure that there is a proper balance between risk taking and the opportunities to be gained;
- adopt a system that will enable the Fund to anticipate and respond positively to change;
- minimise loss and damage to the Fund and to other stakeholders who are dependent on the benefits and services provided; and
- make sure that any new areas of activity (new investment strategies, joint-working, framework agreements etc.), are only undertaken if the risks they present are fully understood and taken into account in making decisions.

Risk Management is a sound management technique that is an essential part of stewardship of the Fund. The benefits of a sound risk management approach include better decision-making, improved performance and delivery of services, more effective use of resources and the protection of reputation.

The Pensions Committee analyse the level of risk and the drivers of risk and monitor and review the investment strategy and investment performance on an ongoing basis and take mitigating action where required. This may include rebalancing the allocation of assets when set benchmark weighting of asset classes exceeds tolerance thresholds

The Committee has established a strategic asset allocation benchmark for the Fund. They assess risk relative to that benchmark by monitoring the asset allocation and investment returns relative to the benchmark. The Committee also assesses risk relative to liabilities, monitoring the delivery of benchmark returns relative to liabilities on a regular basis.

The Pensions Committee provides a practical constraint on the Funds investments deviating greatly from the intended approach by adopting a specific asset allocation benchmark and by monitoring the underlying asset class weights relative to this benchmark on a regular basis.

The investment strategy is suitable diversified, with the balance of different asset classes and investment managers mitigating the impact at an aggregate level of underperformance of an individual manager. Diversification is a very important risk management tool. The scheme seeks to maintain a diversified exposure via a wide range of asset classes, geographies, and currencies.

ENVIRONMENTAL SOCIAL AND GOVERNANCE (ESG) POLICY

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 specialist investment advisers.

The Fund expects its external investment managers, including the London CIV 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.

Where the Fund invests on a segregated basis, it requests the exclusion of investment within the Tobacco sector as part of the mandate. The Fund will not pursue policies that are contrary to UK foreign policy or UK defence 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.

Exercising the rights of Ownership and Voting

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. The Fund's investments through the London CIV are covered by the voting policy as agreed by the Pensions Sectoral Joint Committee advising managers to vote in accordance with voting alerts issued by the Local Authority Pension Fund Forum (LAPFF) as far as practically possible. The London CIV will hold managers to account where they have not voted in accordance with these directions.

The Fund's approach to engagement recognises the importance of working in partnership to magnify the voice and maximise the influence of investors as owners. The Fund expects its investment managers to work collaboratively with others if this will lead to greater influence and deliver improved outcomes for shareholders and more broadly. The Fund appreciates that to gain the attention of companies in addressing governance concerns; it needs to join with other investors sharing similar concerns. To ensure effective and consistent use of the voting rights, investment managers are tasked with exercising the voting rights accruing to the Fund. If important issues impacting local residents do emanate from actions of invested companies, the Pensions Committee will contact investment managers in charge of assets of such a company to make their opinion known and ask for such to be presented at meetings with the company or reflected in their voting pattern.

Going forwards, the Fund will incorporate a report of voting activity as part of its Pension Fund Annual report which is published on the Council's website. The Fund complies with the UK Stewardship Code and a statement of compliance which explains the arrangements which support its commitment to each of the seven principles is also published on the website.