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PENSIONS INVESTMENT SUB-COMMITTEE

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6 PENSION FUND INVESTMENT STRATEGY STATEMENT - APPENDIX 1
(Pages 3 - 10)

Appendix 1, marked as “to follow” on the agenda, is now attached.

Copies of the documents referred to above can be obtained from
http://cds.bromley.gov.uk/

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LONDON BOROUGH OF BROMLEY PENSION FUND
INVESTMENT STRATEGY STATEMENT (ISS)

INTRODUCTION

This Statement has been prepared by the London Borough of Bromley (the Administering Authority) to set out the Investment Strategy for the London Borough of Bromley Pension Fund (the Fund), in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, and the guidance paper issued by the Department for Communities and Local Government.

The ISS has been prepared by the Fund's Pensions and Investment Sub-committee (the Committee) having taken advice from Mercers, the Fund's Actuary and the Fund's investment advisor and with such persons as the Committee considers appropriate.

The Regulations provide that an administering authority must prepare, maintain and publish a written statement of the principles governing its decisions about investments. The Regulations specify six issues that must be addressed in the statement. The following sections of this statement address these issues in turn. In addition, an appendix is included which sets out the Committees Investment Beliefs. This is in line with the recommendations in the Stewardship Code 2020 produced by the Financial Reporting Council (FRC). It is the intention that these beliefs act as broad guidance for the Committee's actions going forward.

This statement will be approved by the Committee in February 2020 and will be kept under review and revised from time to time, but at least every three years.

(a) Investing fund money in a wide variety of investments

The Fund's main long-term objective is to ensure that it has sufficient assets to meet its pension liabilities as they fall due. In order to achieve this, the Fund invests its assets with the aim of maximising investment returns whilst maintaining an acceptable risk level.

The Fund's asset allocation strategy of 58% Global Equities; 13% Fixed Income; 20% Multi Asset Income Funds, 4% UK Property and 5% International Property or US Property (TBC) Funds aims to ensure that the Fund's assets are broadly diversified in terms of geography, foreign exchange, sector and asset class exposure to help reduce overall portfolio risk and volatility, whilst aiming to deliver or exceed the target returns on its investments and the cashflow requirements of the Fund. The aim is to periodically rebalance back to the allocations listed above in order to control investment risk as markets move.

Within these asset classes, there are two investment managers with a mandate to invest in Global Equities, two for Fixed Income and two for Multi Asset Income and two for Property, who are all authorised to invest in all assets permitted under the Regulations, subject to the provisions of their benchmarks and certain minor restrictions. Details of the Investment Guidelines and Restrictions are included below.

The committee keeps the Fund's investments under review, any changes are made only after considering advise from a suitably qualified person or people as required by legislation.

(b) The suitability of particular investments and types of investments

The funding strategy adopted for the 2019 valuation is based on an assumption of real investment return of 2.0% per annum above CPI inflation for past service benefits and 2.25% above inflation for future service benefits. The Fund is over 100% funded on a technical provisions basis and the investment strategy is set to maintain this level and thereby maintain as stable as possible a level of employer contributions going forward.

As the trustees of the Fund, the Committee, recognise the changing nature of the cash flow and liquidity requirements of the Fund as it matures, with cash outflows from the payment of benefits exceeding cash inflows from employer and employee contributions leading to a cash-negative position which requires investment income to meet its liabilities.

A key driver of the asset allocation strategy and investment manager selection is to ensure that the Fund is able to meet its future cashflow and liquidity requirements whilst aiming to meet or exceed the target return and maintain an appropriate balance of risk and volatility. The effectiveness of this strategy in achieving these aims is a major component of the Committees responsibilities and will be kept under review.

The Fund believes in investing over the long-term and will use its influence as a large institutional investor to encourage responsible long-term behaviour in financial markets where possible.

(c) The approach to risk, including the ways in which risks are to be assessed and managed

At the last full valuation of the Fund (as at 31st March 2019), the actuary valued the fund's assets at 110% of the fund's liabilities (91% in the previous valuation as at 31st March 2016). He determined employers' contribution rates with a view to maintaining the current 100% solvency of the Fund and covering future pension accruals going forward, taking into account the investment strategy as set out in this statement.

The Committee is aware that the Fund must take investment risk to generate future returns and achieve its funding objective over the long-term. The Committee believes that a high allocation to growth assets, particularly Equities, is justified as part of this strategy.

The principle Funding risks are as follows:

- Financial – The risk that the Fund fails to grow in line with the developing cost of meeting its liabilities in the long-term.
- Demographics – The risk that demographic factors change in a way which increases the Fund's liabilities.
- Systemic – The possibility of an interlinked financial failure which affects the majority of the Funds' assets simultaneously.

The Committee measures and monitors financial risk through setting the Strategic Asset Allocation in relation to the Fund's actuarial data including future liability accrual and cashflow requirements. It then monitors the variation of the actual asset allocation around this Strategic Benchmark, rebalancing as necessary.

The principle investment risks are as follows:

- Concentration/credit – The risk of underperformance or default from a significant allocation to any single investment or type of investment resulting in difficulties maintaining the funding level

- Illiquidity – The risk that the Fund has insufficient liquid assets to meet its cash flow requirements.

- Currency risk – The risk that the currencies of the Fund's assets underperform relative to Sterling (the currency of the Fund's liabilities).

- Manager underperformance – The failure by the investment managers to achieve their benchmark rate of investment return.

- Environmental, Social and Governance (ESG) – The risk that the relationship between shareholders in a financial asset and stakeholders in society in general alters in a way which reduces the Fund's ability to generate the required investment returns.

The Committee manages these investment risks through maintaining a diverse portfolio invested in multiple asset classes and through multiple fund managers. The Fund rebalances across managers and asset classes when appropriate. This diversification brings currency risk as not all the assets the Fund invest in are Sterling based. The Committee monitors this risk and will discuss hedging overseas currencies back to Sterling periodically but at least every three years in line with the Actuarial review and ensuing reappraisal of the Strategic Asset Allocation Benchmark.

The Fund monitors its cashflow requirements and the necessary generation of income from the Fund's assets. Whilst the Fund still covers all cashflow requirements from contributions and asset income it is appropriate to invest a proportion of the Fund's assets in less liquid strategies if there is a believe that this will aid the balance between risk and return.

The Committee believes in working with asset managers over the long-term and monitors them on this basis. To date the selected managers have added significantly to the Fund's assets by outperforming their benchmarks over the long-term. The diversification by manager and long-term nature of the relationship with the asset managers reduces the probability of a single asset manager underperforming to the extent that it affects the Fund's ability to meet its liabilities in a significant way.

The management of ESG risks is covered later in this report.

Other key risks that could have an adverse impact on the achievement of the Fund's funding strategy and target funding levels are analysed in the Fund's Funding Strategy Statement, these include governance and regulatory risks.

(d) The approach to pooling investments, including the use of collective investment vehicles and shared services

The Fund formally became a member of the London Collective Investment Vehicle (London CIV) in October 2016 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 and less liquid asset classes. The Committee is aware that the Ministry for Housing, Communities and Local Government is currently engaged in a further consultation regarding the mechanisms for pooling and the Fund will take any updated recommendations and advice into account when it is issued.

As at 31/12/2019 the Fund has not transferred any assets to the London CIV but continues to review the availability of funds within the London CIV and their acceptability and fit with the Fund's requirements. Following the outcome of the asset allocation review in February 2020, work will continue to explore all options for transferring investments into the CIV. Assets may be retained outside of the London CIV pool, for example if it is not deemed cost effective in terms of management fees and transition costs, or if the CIV does not have a suitable sub-fund which meets the requirements of the Funds asset allocation and investment strategy.

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

The authority has been advised that its primary responsibility is to secure the best returns for the Fund in the interests of its council taxpayers and its members. As a Pension Fund. with pension obligations stretching out many years into the future, the Fund, by its nature, is a long-term investor. The authority recognises that investing responsibly over the long-term must include the consideration of not just financial data but also of the impact of the Fund's investments in terms of the environment, effects on broader society and corporate governance (ESG issues). The Fund has appointed asset managers who invest for the long-term and explicitly consider ESG issues as an integral part of their research effort when investing the Fund's assets. The Fund expects to vote, where practical, on all Annual and Extraordinary general meetings held by companies in which it is invested. It has delegated this responsibility to its asset managers and monitors their fulfilment of this obligation.

The Fund will not seek to exclude investments that are not barred by UK law in the belief that engagement is preferable to divestment. Whilst there is obvious risk in investing in companies with material ESG issues, there can be long-term financial gain where such companies are actively attempting to manage and improve these risks and as such the Fund adopts a policy of risk monitoring and engagement in order to positively influence company behaviour and enhance future returns to investors and believes this is more compatible with its fiduciary responsibility and more supportive of its long term investment goals. If a company fails to engage on these issues with the Fund's asset managers or if the asset managers have reason to believe a company is not being honest and open about its intended actions in this area, divestment on a stock by stock basis remains an option.

The Fund will work with like-minded investors to promote best practice in the long-term stewardship of investments.

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

The investment managers have been authorised to exercise voting rights on behalf of the Fund unless specifically instructed to vote in a particular way on any individual resolution by the Committee. In exercising those rights, they will have regard to best practice as set out in the Stewardship Code 2020 produced by the Financial Reporting Council. They have been instructed to report back to the Committee every quarter on any material divergence from the recommendations of the Combined Code by companies in which the Fund is invested and on action taken by them in response to the divergence. They have also been instructed to report to the Sub-Committee at least every six months on their corporate governance activities generally, including their dialogue with companies' management to encourage sound social, environmental and ethical practices in their activities.

The Committee will issue instructions on individual matters only in exceptional circumstances, when asked for instructions by a manager or when a specific resolution is brought to their attention. With regard to other rights such as the taking up of rights issues, this is left for the investment managers to decide in the light of their assessment of market conditions at the time.

INVESTMENT GUIDELINES AND RESTRICTIONS

General

Investment is permitted in all classes of assets, subject to the limits imposed by the Regulations on the proportion of the fund which may be invested in certain investments and certain other restrictions imposed by the authority. In addition, the investment managers do not use certain investments as a matter of policy.

All references to percentages in this appendix are to percentages of the total value of all existing investments in the fund before making the investment which is subject to the limit. The limits only apply at the time the investment is made.

Limits imposed by the Regulations

- 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(d): Maximum 5%

Other restrictions imposed by the authority

- Cash held at custodian's bank is not to exceed £2.5m for each individual fund manager, with any excess placed on the money market with the main clearing banks or placed in institutional cash funds approved by the authority
- No sub-underwriting
- Certain limits on use of futures and options are recorded in the relevant investment management agreements and fund prospectuses

Asset Allocation

The current investment strategy comprises the following asset allocations:

	%	
Global Equities	58	
Multi Asset Income	20	
Fixed Income	13	
UK Property	4	
International Property or US Property (TBC)	5	
Grand Total	**100**	

The Fund managers have been set the following targets/benchmarks:

- Global equities – Baillie Gifford and MFS are required to outperform the MSCI All Countries World Index.
- Multi-Asset Income – Fidelity are required to generate a total return in excess of LIBOR +4% p.a and Schroders LIBOR +5%.
- Fixed income – Baillie Gifford are required to outperform 88% Sterling Aggregate Benchmark (50% FTSE UK Conventional Gilts Actuaries All stocks index and 50% Bank of America Merrill Lynch Sterling Non-Gilt Index), 6% JP Morgan GBI-EM Global Diversified Index un-hedged in Sterling and 6% Bloomberg Barclays Global Aggregate Credit GBP Hedged Index; Fidelity are required to outperform 50% Sterling Gilts/ 50% Sterling non-Gilts
- Property – Fidelity are required to outperform the IPD UK PFI - All Balanced Property Fund Index

Investment Beliefs

Statement of Investment Beliefs

The Committee believes that

- It is important that funding related aspects and, in particular, funding level and cash flow profile feed into investment strategy decisions. Given this, actuarial and investment matters, most notably setting investment strategy, are looked at in tandem by the Committee.
- The Committee targets a strong funding level to provide some buffer to the risk of future employer contribution increases. This enables the Committee to adopt a long term investment horizon, and is thereby prepared to accept short term volatility or illiquidity, in order to achieve higher investment returns. In this context, the Committee believes that, over the longer term, equities are expected to outperform other liquid assets, in particular government bonds. The Committee is therefore comfortable that the Fund maintains a significant allocation to equities in order to support the affordability of contributions.
- Strategic asset allocation is a key determinant of investment risk and return, and thus is typically more important than manager or stock selection. In addition, the Committee believes that periodic rebalancing of asset class weightings back to their strategic can add value over the long term.
- Risk can be mitigated through the diversification of the portfolio, by selecting a variety of both asset classes and managers. A balance needs to be struck between the need for diversification and keeping a small enough number of mandates to ensure good governance.
- Markets are dynamic and are not always efficient, and therefore offer opportunities for investors. Active management can add value over time but it is not guaranteed and can be hard to access. Where generating ‘alpha’ is particularly difficult, passive management may be preferred, but brings some of its own risks. In all cases, managers will be judged on after fees returns.
- Managing fees and costs matter, especially in low-return environments. The Committee believes in considering managers’ performance on the basis of returns net of fees/costs and not of fees/costs alone.
- A strong ESG / Responsible Investor policy is required by regulation and should be seen within the context of the Fund’s long-term investment and futureproofing its financial security. ESG considerations can help identify superior long-term investments and the Committee requires its managers to include them in their investment processes, provided these considerations do not impact financial returns or risk. The Fund requires managers to report back on them on ESG matters. The Committee believes that a policy of engaging with investee companies to improve their behaviour, rather than exclusion, is more compatible with their fiduciary duty and more supportive of their long term investment goals.
- Effective governance and decision-making structures that promote decisiveness, efficiency and accountability add value to the Fund. The Committee identifies good managers with which to work in partnership, delegates authority to them, and monitors their overall performance, on key matters, regularly.
- The Committee expects to assess the London CIV pool in any future management arrangements of investments on behalf of the Council’s fund.
- The Committee also believes that taking independent advice, notably in investment and actuarial matters, which can strengthen governance and add value to the Fund.

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