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London Pensions Fund Authority Investment Strategy Statement

September 2021



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London Pensions Fund Authority

Investment Strategy Statement

1. Introduction

The Board (“the Board”) of the London Pensions Fund Authority (“LPFA”) has prepared this Investment Strategy Statement (“the Statement”) in respect of the London Pensions Fund Authority Pension Fund (“the Fund”). This Statement has been prepared in accordance with the Guidance on Preparing and Maintaining an Investment Strategy Statement and after taking appropriate advice.

As set out in the Regulations, the Board 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 in relation to any matter contained in this Statement, changes will be reflected within six months of the change occurring.

The Regulations require all Administering Authorities to take “proper advice” when formulating an investment strategy. In preparing this document and the overall investment strategy the Board has taken advice from Local Pension Partnership Investment Limited which is an FCA regulated investment manager with specific expertise and regulatory permissions to provide advice on investments. Advice has also been received from other advisers as necessary in respect of specific elements of the statement.

2. Investment objectives

The Fund’s primary 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 primary objective, the Board has adopted the following investment objectives:

- Optimise the net returns from investments whilst keeping risk within acceptable levels and ensuring liquidity requirements are at all times met;
- Contribute towards achieving and maintaining a sustainable future funding level;
- Enable employer contribution rates to be kept as stable as possible.

The Board has adopted a range of metrics to assess the likelihood of these objectives being achieved in practice.

The Fund will use its influence as a large institutional investor to encourage responsible long-term behaviour.

3. Strategic Asset Allocation

In order to prudently diversify sources of risk and return, the Fund allocates capital across a wide variety of different asset classes. To be added to the portfolio, asset classes are first judged for suitability; they have to be well understood by the Board, consistent with the Fund’s risk and return objectives; and they have to make a significant contribution to the portfolio by improving overall net return and risk characteristics. In addition, the new asset classes have to be less than perfectly correlated with equities and bonds, so that the portfolio benefits from increased diversification. The scheme has identified a total of seven asset classes plus cash (viewed as a store of liquidity) that combined form the Strategic Asset Allocation.

The seven asset classes shown on the following page have different exposures to economic factors (GDP growth and inflation) and combine different geographies. In assessing suitability, the Board has 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.

Asset class	Long-term return drivers	Economic Growth sensitivity*	Inflation sensitivity*	Geography
Credit	Yield (minus credit losses) Roll down Change in yield Liquidity premium	Low	Medium	Diversified
Diversifying strategies	Diversified	Low	Low	Diversified
Fixed income	Yield (minus credit losses) Roll down Change in yield	Low	High	Diversified
Infrastructure	Dividend income Dividend growth Capital growth	Medium	Medium	Predominantly OECD
Private equity	Dividend income Earnings growth Change in PE Liquidity premium	Medium	Medium	Diversified
Public equity	Dividend Income Earnings growth Change in PE	High	Low	Diversified
Real estate	Rental yield minus Capex Rental growth Capital growth	Medium	Medium	Predominantly UK

*Sensitivities shown are to positive shocks, i.e., if growth and inflation are higher than expected

These are the eight building blocks (seven asset classes plus cash) used to specify the Strategic Asset Allocation. The Board has determined benchmark weights for each asset class which it believes to be best suited to meeting the long-term objectives of the Fund. It has also identified tolerance ranges within which shorter term variations will be tolerated. Movements within these ranges are permitted for any reason, including changes in market values and opportunities to enhance returns or manage risks. The benchmark weights and tolerances are shown in the table below.

Asset class	Strategic Asset Allocation	Tolerance range
Cash	1.5%	0%-7.5%
Credit	12.5%	7.5%-17.5%
Diversifying strategies	10.0%	0%-20%
Fixed Income	1.0%	0%-10%
Infrastructure	12.5%	7.5%-17.5%
Private equity	5.0%	0%-10%
Public equities	45.0%	35%-55%
Real estate	12.5%	7.5%-17.5%
Total	100%	

The Fund's exposure to each asset class is to be maintained within the applicable range as long as attractive opportunities that meet LPFA's return, risk, and cash flow requirements can be found. In the absence of suitable opportunities, investments will not be "forced" and under/over allocations may be made to any asset class. This includes allocations falling outside of the tolerance range. Should any allocations fall outside of the range the Board shall require the allocation to be brought back within the range as soon as suitable opportunities are identified.

The mandates are managed by Local Pensions Partnership Investments Ltd (LPPI), to whom the Fund has delegated investment management and implementation duties in line with the principle of asset pooling within the LGPS. LPPI has discretion to act on behalf of the Board in order to implement the allocations set out in the Strategic Asset Allocation. This includes determining any over/under allocation within the tolerance ranges. Should allocations fall out of the ranges, LPPI is responsible for informing the LPFA and agreeing appropriate action.

Each asset class has its own specific investment objective and within each asset class there are further diversification controls. The investment objective for each asset class is set out in the table on the following page. Note that all returns referred to below are net of fees and expenses.

Asset class	Objective	Benchmark	Target Return
Cash	To provide a store of liquidity for benefit payments and investment purchases.	ICE GBP LIBOR (1-month)	In line with benchmark.
Credit	To gain cost effective exposure to credit and credit-related assets globally, with a focus on harvesting illiquidity, complexity and idiosyncratic credit risk premia and on minimising expected losses.	50:50 composite of <ul style="list-style-type: none"> 50% S&P Leverage Loans Total Return Index, Hedged GBP; and 50% Bloomberg Barclays Multiverse – Corporate Aggregate Total Return Index, Hedged GBP calculated monthly 	Exceed benchmark by 1% pa to 3% pa, net of all fees and expenses.
Diversifying strategies	To gain cost effective exposure to diversifying sources of return distinct from global equity beta and bond duration. The aim is to generate returns in excess of cash at low correlations to equities and bonds.	HFRI Fund of Funds Conservative GBP Hedged Index.	Exceed benchmark by 1% pa, net of all fees and expenses.
Fixed Income	To deliver long term total return from investing in Global Fixed Income instruments	Bloomberg Barclays Global Aggregate Bond Index, GBP Hedged	Exceed benchmark by 0.25% pa, net of all fees and expenses.
Infrastructure	To gain cost effective, diversified exposure to global infrastructure assets located predominantly in UK, Europe and North America. Provide predictable cash flows and partial inflation participation.	UK CPI +4% pa	Exceed benchmark by 0% pa to 2% pa, net of all fees and expenses.
Private equity	To provide long term total return by accessing attractive private equity opportunities at a competitive overall cost.	MSCI World SMID Cap, net dividends reinvested Index, in GBP.	Exceed benchmark by 2% pa to 4% pa, net of all fees and expenses.
Public equities	To deliver long term total return from investing in Global Public Equities, investing in underlying funds managed by LPPI and by external third parties.	MSCI All Country World, net dividends reinvested, in GBP Index.	Exceed benchmark by 2% pa, net of all fees and expenses.
Real estate	To gain cost effective, diversified exposure to UK and international property assets. Provide predictable cash flows and partial inflation participation.	MSCI UK Quarterly Property Index (GBP).	Exceed UK CPI by 3% pa to 5% pa, net of all fees and expenses

4. Strategic Currency Allocation

The risk and return profile of any asset is made up of two distinct elements:

- the characteristics of the asset itself, and
- the currency in which it is denominated.

It is possible to isolate these two elements and consider them separately. The Board has considered the characteristics of a range of developed market currencies and determined a Strategic Currency Allocation, which is complementary to the Strategic Asset Allocation.

The Strategic Currency Allocation specifies a target exposure to each currency, and ranges within which the exposure must be held. These target exposures can be higher or lower than the exposure provided directly by the underlying Fund assets. Forward contracts, managed by a specialist currency manager, are used to deliver the required exposure to each currency.

The Strategic Currency Allocation is set out below.

Geography	Currency	Underlying currency exposure at 31 March 2021	Strategic Currency Allocation	Tolerance range
UK	GBP	61.4%	45.0%	N/A
USA	USD	23.4%	36.0%	± 0.25%
Euro Area	EUR	7.8%	10.0%	± 0.10%
Japan	JPY	0.6%	5.0%	± 0.10%
Canada	CAD	0.8%	1.8%	± 0.05%
Switzerland	CHF	1.3%	0.8%	± 0.05%
Australia	AUD	0.8%	0.5%	± 0.05%
Norway	NOK	0.1%	0.3%	± 0.05%
Sweden	SEK	0.4%	0.3%	± 0.05%
New Zealand	NZD	0.2%	0.3%	± 0.05%
Other*	-	3.2%	N/A	N/A
Total		100%	100%	

*The exposures to currencies not specifically mentioned in the Strategic Currency Allocation (included as “other” in the table above) will be accepted at the level delivered by the underlying assets. The exposure to GBP (or in the case of Danish Krone, the exposure to Euros) will be reduced to accommodate these exposures.

5. Investment governance

The Board is responsible for setting the objectives and risk tolerances of the Fund. The Board has specified a number of metrics and triggers to measure and monitor the Fund's objectives. LPPI report quarterly to the Board against these metrics. Based on these parameters, the Board determines the Strategic Asset Allocation and Strategic Currency Allocation that it believes represents an appropriate balance between the investment objectives. The implementation of the asset allocation is delegated to an expert investment manager, in this case, LPPI. LPFA is a 50% shareholder in LPP (with the remaining 50% owned by Lancashire County Council) and maintains ongoing corporate governance controls but plays no direct role in Investment Management activities. The Board monitors the performance of LPPI and the portfolio.

6. Investment implementation

The implementation of all investments is delegated to LPPI, an FCA authorised company. The partnership was set up by the LPFA and Lancashire County Council for the purpose of achieving economies of scale, greater internal resource, and superior investment opportunities. The partnership brings the benefit of scale and expert resources beyond that which would be available to the Fund alone. This facilitates lower costs and a broader opportunity set which together facilitate improved net returns.

Pooled vehicles are used wherever appropriate. Where assets are not physically pooled the management is typically pooled. LPPI has created seven asset class categories to allow access to the asset classes listed in the Strategic Asset Allocation

Asset class	% Pooled*	Legal structure
Credit	100%	Limited partnership
Diversifying strategies	99%	Limited partnership
Fixed income	100%	Authorised contractual scheme
Infrastructure	100%	Limited partnership
Private equity	100%	Limited partnership
Public equities	98%	Authorised contractual scheme
Real estate	97%	Authorised contractual scheme

*Data as at 31 May 2021.

8. Risk management

Maintaining adequate funding, both at an individual employer level and for the Fund as a whole, is an important priority for the Board. Funding position is influenced by changes in asset and liability values and for this reason the Board has adopted an Asset and Liability Management approach. This approach has historically included the use of a liability hedging programme to manage exposure to inflation and interest rates. This programme is no longer in effect and is in the process of being removed.

Diversification is a very important risk management tool. As described in the section on Strategic Asset Allocation, the Board will seek to maintain a diversified exposure to several different asset classes, geographies, and currencies.

section. The asset class categories are a combination of internally managed and externally managed strategies that offer an effective and efficient way of achieving asset class exposures.

The Fund also expects to benefit from scale via pooling arrangements with other funds in order to better access direct investments in areas such as infrastructure. Some of the asset class categories are expected to use derivatives as part of their strategies. Derivatives can reduce implementation costs or change economic exposures. They may be used for both active and passive management strategies. The broad use of derivatives is explicitly approved by the Board both for investment purposes and efficient portfolio management. Both exchange traded and over the counter derivatives may be used.

7. Pooling of assets

The Board has delegated the management of its investments to LPPI who are responsible for managing 100% of the assets of the Fund. A significant majority of the Fund's assets have been transitioned into investment pooling vehicles managed by LPPI. A small minority of assets remain on the balance sheet of the Fund as "legacy assets". Assets are held as legacy assets if the costs of transitioning outweigh any potential gains, the assets have reached "harvesting period", or transitioning would have a negative impact on the Fund's investment strategy. Proceeds from assets in "harvesting period" will be reinvested through LPPI pooled funds.

The Board expects this to provide (at least) two levels of protection: first, in periods of market turmoil some assets will preserve capital better than others, allowing the portfolio to better withstand a shock. Second, in periods of rising markets, some assets will do better than others, and since the Board does not know with certainty which ones will do best, it is better to diversify.

Another line of defence at the Fund level is to examine how the portfolio would perform under different scenarios including stress scenarios. The objective is to minimise the impact that losses to the portfolio have on future contribution rates. When setting the Strategic Asset Allocation and Strategic Currency Allocation the Board has considered different stress scenarios and possible outcomes.

The asset class categories included in the Strategic Asset Allocation are also subject to a number of constraints to allow for intra-asset class diversification, including sector, country, manager, and maximum exposure to a single asset.

9. Performance measurement

Fund performance is measured at a number of different levels.

At the highest level, the Board has set a Return Objective of UK CPI +3.6% pa. LPPI will seek to manage the Fund with a view to achieving the Return Objective. The Board recognises that the Return Objective is intended to apply only over the very long time horizons over which the Fund's liabilities will be paid. The Board also notes that the achievement or otherwise of the Return Objective is not necessarily a good measure of LPPI's performance.

The performance of the Fund is also measured relative to the returns on the notional Policy Portfolio. The performance of the Policy Portfolio is calculated based on:

- allocations to each asset class in line with the Strategic Asset Allocation, and
- returns on each asset class in line with the benchmark for that class.

The performance of the pooling arrangements is monitored via regular reporting and through periodic meetings. Performance for LPPI is measured against the Policy Portfolio. LPPI seeks to outperform the Policy Portfolio on a risk adjusted basis by tilting asset weights in an opportunistic manner, via active sub-asset class selection, and selecting the best stocks/managers for each of the pooled funds.

The Board also monitors the performance of each asset class relative to the benchmark for that asset class.

Where performance falls short of expectations the Board will identify the cause of this underperformance and will respond appropriately. The Board's response could include:

- altering the Strategic Asset Allocation (for example where asset allocation is the underlying cause)
- requesting changes to the management of the pooled funds (for example where management skill within LPPI is the underlying cause) or
- withdraw approval of any of the LPPI pooled funds from the list of approved funds for use within the Policy Portfolio.

In practice LPFA would expect to work collaboratively with LPPI to identify and remedy the cause of any underperformance.

10. Environmental Social and Corporate Governance (ESG) Policy, and approach to social investments

LPFA is committed to being a long-term responsible investor. Through LPPI, the Fund complies with and follows the principles of both the UK Stewardship Code (2012) and to the UN-backed Principles of Responsible Investment. LPFA is also a member of the Occupational Pensions Stewardship Council, the Institutional Investors Group on Climate Change, and the Local Authority Pension Fund Forum.

Responsible Investment is an investment approach which recognises the significance of the long-term health and stability of the market as a whole and encompasses:

- the integration of material ESG factors within investment analysis and decision-making
- the active use of ownership rights in order to protect and enhance shareholder value over the long term – primarily through voting and engagement.

The objective of responsible investment is to decrease investor risk and improve risk-adjusted returns. Responsible investment principles are at the foundation of LPFA's approach to stewardship and underpin its fiduciary duty to its beneficiaries. Details of LPFA's approach to responsible investment are set out in our Responsible Investment Policy.

LPFA has identified climate change as a long-term material financial risk with the potential to impact all asset classes within the portfolio over time. Our policy on Climate Change sets out expectations of LPPI in relation to how the risks and opportunities arising from climate change will be identified, monitored and managed.

ESG integration and the active use of ownership influence are integral to the investment management services provided by LPPI, which are delivered in accordance with an LPPI Responsible Investment Policy. It is an LPPI RI belief that ESG factors are relevant at every stage in the investment cycle - within investment strategy, investment selection and within the stewardship of assets in ownership. As part of a prudent approach which applies care, skill and diligence, LPPI procedures ensure that ESG issues are routinely considered as part of the investment analysis, are incorporated into the due diligence leading to investment selection and continue to be monitored and reviewed as part of the active ownership of assets under management.

The approach to incorporating ESG factors is to establish the type and materiality of relevant issues on a case by case basis, whilst taking account of global norms, rather than to apply artificial exclusions through negative screening. ESG factors are considered over the time horizon within which specific investments are likely to be held, in order to clarify the context that risks and returns operate within and assist the evaluation of investment risks and opportunities.

LPFA's predominant concern is to invest the Fund on the basis of financial risk and return having considered a full range of factors contributing to financial risk including both those detailed above and relevant social factors to the extent these indirectly or directly impact on financial risk and return.

Where appropriate, LPFA may request that LPPI take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the Fund and where there is good reason to think that Fund members would support this decision.

11. Exercising the Rights of Ownership

The Fund recognises that encouraging the highest standards of corporate governance and promoting corporate responsibility by investee companies protects the financial interests of pension fund members over the long term. The Fund's commitment

to actively exercising the ownership rights attached to its investments, reflects the Fund's conviction that responsible asset owners should maintain oversight of the way in which the enterprises they invest in are managed and how their activities impact upon customers, clients, employees, stakeholders and wider society.

The routes for exercising ownership influence vary across asset types and a range of activities are undertaken on the Fund's behalf by LPPI, including direct representation on company boards, presence on investor & advisory committees and participation in partnerships and collaborations with other investors. In the case of listed equities, the most direct form of ownership influence comes through shareholder voting and engagement.

12. Voting

In most cases the Fund holds no direct ownership of shares of companies. However, through the investments managed by LPPI, the Fund has indirect ownership interests in listed companies across the globe. To ensure effective and consistent use of the voting rights attached to these assets LPPI works with an external provider of governance and proxy voting services. Voting is undertaken centrally rather than being delegated to individual managers and is in line with LPPI's Shareholder Voting Policy which promotes risk mitigation and long-term shareholder value creation by supporting responsible global corporate governance practices. The policy is reviewed and updated on an annual basis to reflect emerging issues and trends. A quarterly report on voting activity is available from the LPP website which is signposted via a link from the LPFA website.

13. Engagement

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. LPFA appreciates that to gain the attention of companies in addressing governance concerns, it needs to join with other investors sharing similar concerns. It does this primarily through:

- Membership of representative bodies including the Local Authority Pension Fund Forum (LAPFF) and the Pensions and Lifetime Savings Association (PLSA);
- Giving support to shareholder resolutions where these reflect concerns which are shared and represent the Fund interests;
- Joining wider lobbying activities when appropriate opportunities arise.

Through LPPI, the Fund complies with the UK Stewardship Code (2012) and a statement of compliance which explains the arrangements which support its commitment to each of the seven principles is displayed on LPPI's website.

For more information, please contact:

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