Investment Strategy Statement (Published January 2017)

Introduction and background

This is the Investment Strategy Statement ("ISS") of the Leicestershire County Council Pension Fund ("the Fund"), which is administered by Leicestershire County 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 Local 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 17th January 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 (dated 17th January 2017).

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.

The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is set for each employer to meet the cost of future benefits accruing. The funding level and the cost of benefits accruing will be based on service completed and will take account of expected future salary and/or inflation increases. If necessary an adjustment is made to the employers' contribution rate to take account of any surplus/deficit within their sub fund.

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 annually at a meeting of the Committee that will focus almost exclusively on the strategy. Information available from a number of sources, including the triennial actuarial valuation, will be used to guide the setting of the investment strategy but the strategy does not look to match assets and liabilities in such a way that their values move in a broadly similar manner. Asset/liability matching in this way would lead to employers' contribution rates that are too high to be affordable, so there will inevitably be volatility around the funding level (i.e. to ratio of the Fund's assets to its liabilities).

The Fund will seek to maintain an investment strategy that is expected to produce a long-term investment return that is at least in line with the assumptions made within the actuarial valuation for future investment returns, and in all probability will set a strategy that is expected to produce a marginally higher return than this. The setting of the target investment return to be in-line with, or marginally above, the assumption on which the present value of accrued liabilities are discounted within the actuarial valuation produces a framework around which the level of risk can be based.

It is recognised that the maturity profile of the Fund (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit have a role to play in the setting of investment strategy. As the Fund grows more mature it is likely that a more defensive investment strategy will be adopted, whereby a lower level of return is considered an attractive 'trade off' as it should be achieved at a lower level of volatility. These issues do not currently have a material influence on the investment strategy adopted.

In general terms the investment strategy approved will be a blend of asset classes that are diverse enough to dampen down some volatility (e.g. if equity markets fall, some of the other assets may rise), without being so diverse that the strategy become unmanageable and costly. Expected long-term returns, levels of volatility and correlation in the performance of different asset classes will all have a role to play in setting the strategy.

By their very nature investment markets are unpredictable and it is impossible to have any certainty around future returns and volatility, so the setting of any investment strategy can never be more than an imprecise way of arriving at an 'appropriate' split of assets. As strategy is, however, the biggest driver of future investment returns it is important that sufficient time is spent in designing and implementing a strategy that is considered to be sensible for the Fund.

The Committee sets an investment strategy that focuses 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 Fund's actual allocation is monitored by Officers on a regular basis to ensure it does not notably deviate from the target allocation.

The Fund has a number of investment beliefs that are taken into account when agreeing an asset allocation policy. These are:

- A long term approach to investment will deliver better returns
- The long term nature of the Fund's liabilities is well suited to a long term approach to investment
- Asset allocation policy is the most important driver of long term returns
- Risk premiums exist for certain types of asset and taking advantage of these can help to improve investment returns
- Markets can be inefficient, and sometimes 'mispriced' for long periods of time, and there is a place for both active and passive investment management
- Diversification across investments with low correlation improves the risk/return profile, but over-diversification is both costly and adds little value
- The Fund should be flexible enough in its asset allocation policy to take advantage of opportunities that arise as a result of market inefficiencies, and also flexible enough to protect against identifiable short-term risks when this is both practical and cost-effective
- Responsible investment can enhance long term investment performance and investment managers will only be appointed if they integrate responsible investment into their decision-making processes

- Investment management fees are important and should be minimised wherever possible, but it is ultimately the net return to investors (i.e. the return after all fees and costs) that is the most important factor

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, infrastructure and commodities either directly or through pooled funds. These asset classes are only examples of the types of investments that may be held, and are not intended to be an exhaustive list. 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. As far as is practical and cost-effective, attempts will be made to maintain an actual asset allocation split that is close to the target strategy. 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*
Quoted equities	46.5%- 48.5%
Private equity	4%
Targeted return	11.5%
Property	10%
Index-Linked bonds	7.5%
Credit	5%
Emerging Market debt	2.5%
Infrastructure	5%
Timberland	2%
Other opportunities	4% - 6%

*the target allocation shown is based on the asset allocation strategy approved on January 2016 and this table will be updated when the target allocations change.

In January 2016, the expected return of this portfolio was 4%p.a.above Consumer Price Inflation.

Restrictions on investment

The Regulations have removed the previous restrictions that applied under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. Given that the Fund's approach to setting asset allocation policy takes account of the various risks involved as an integral part of the decision-making process, it is not felt necessary to impose any specific investment restrictions.

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. Officers and investment consultants manage, measure, monitor and (where possible) mitigate the risks being taken, in order that they remain consistent with the overall level of risk that is acceptable to the Committee. One of the Committee's overarching beliefs is to only take as much investment risk as is necessary.

The principal risks affecting the Fund are set out below, as is 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 after taking into account expected future returns from the different asset classes, and also took into account historic levels of volatility of each asset class and their correlation to each other.

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 seeks to understand the assumptions used in any analysis 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 investment 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. This currency risk is managed through a variable currency hedging programme, designed to take account of both the risks involved with holding assets that are not denominated in sterling and also the perceived value of overseas currencies relative to sterling. Details of the Fund's approach to managing ESG risks are 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 multiple investment managers and by having a large proportion of the Fund's equities managed on a passive basis. The Committee assess the investment managers' performance on a regular basis and will take steps, including potentially replacing one or more of their managers, if underperformance persists. The Committee also recognises that individual managers often have an investment 'style' that may be out-of-synch with market preference for prolonged periods, and that this could lead to meaningful periods of underperformance relative to the relevant benchmark. If the Committee remain convinced by the quality of the investment manager, and the fact that their views remain relevant, underperformance will not necessarily lead to their replacement.

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.
- Stock-lending – The possibility of default and loss of economic rights to Fund assets.

The Committee expects Officers to monitor and manage risks in these areas through a process of regular scrutiny of the Fund's 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.

A separate schedule of risks that the Fund monitors is set out in the Fund's Funding Strategy Statement.

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

The Fund is a participating scheme in the LGPS Central Pool. The proposed structure and basis on which the LGPS Central 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 LGPS Central 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.

It is expected that virtually all of the Fund's assets will be transferred to the Pool on 1st April 2018, although it will take some time for the Pool to restructure the assets into appropriate sub-funds within the Pool. These sub-funds are likely to be set-up over a period of 2 – 3 years, with the timing being dependent on market conditions and operational circumstances, and until such time as the appropriate sub-fund is set up the assets transferred into the Pool will be overseen by LGPS Central on behalf of the Fund. It is not expected that any significant decisions (e.g. replacement of a manager) will be taken on the assets transferred over to the Pool without prior consultation with the Fund, unless it is part of the process that leads to the setting up of a sub-fund.

At present it is expected that any transitory cash will be held outside the Pool (but not strategic cash holdings), and it is possible that currency management will continue to be carried out at an individual Fund level.

Structure and governance of the LGPS Central Pool

The eight administering authorities of LGPS Central will all be equal shareholders of the company. A Shareholders' Forum, comprising of one elected member from each administering authority, will fulfil the shareholders' role in ensuring that the company is managed efficiently and effectively and in the best interests of the Funds.

A Joint Committee, also comprising one elected member from each administering authority, will be formed that will hold the company to account on all investment-related issues. The Joint Committee will have no decision-making powers and all actions that are felt to be appropriate will ultimately require approval at an individual fund level.

A Practitioners' Advisory Forum, comprising of Officers of the administering authorities, will also be set up. The intention of this forum is to provide support and guidance to elected members on some of the practical issues, and to act as a conduit between the Joint Committee and the Committees of individual Funds.

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

It is recognised that ESG factors can influence long term investment performance and the ability to achieve long term sustainable returns. The Committee consider the Fund's approach to ESG in two key areas:

- **Sustainable investment / Environmental and social factors** – considering the financial impact of environmental, social and governance (ESG) factors on its investments.
- **Stewardship and governance** – acting as responsible and active investors/owners, through considered voting of shares, and engaging with investee company management as part of the investment process.

In combination these two matters are often referred to as 'Responsible Investment', or 'RI' and this is the preferred terminology of the fund.

The Committee takes RI matters seriously and will not appoint any manager unless they can show evidence that RI considerations are an integral part of their investment decision-making processes. Following appointment managers are required to report any changes in their approach to RI to Officers.

At the present time the Committee does not take into account non-financial factors when selecting, retaining, or realising its investments. The Committee understand the Fund is not able to exclude investments in order to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

To date, the Fund's approach to Responsible Investment has largely been to delegate this to their underlying investment managers as part of their overall duties.

In its July 2016 submission in respect of investment pooling within the LGPS, the eight administering authorities of LGPS Central agreed to a common Responsible Investment Framework.

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

Voting rights

The Committee has delegated the exercise of voting rights to the investment manager(s) 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 supports the Stewardship Code as published by the Financial Reporting Council. The Committee expects both the LGPS Central Pool and any directly appointed fund managers to comply with the Stewardship Code as published by the Financial Reporting Council.

Prepared by:-

Chris Tambini

For and on behalf of the Local Pension Committee of the Leicestershire County Council Pension Fund

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