



The London Borough of Tower  
Hamlets Pension Fund  
Investment Strategy Statement  
22 March 2023

## **Investment Strategy Statement**

### **1. Introduction and background**

- 1.1 This is the Investment Strategy Statement (“ISS”) of the Tower Hamlets Pension Fund (“the Fund”), which is administered by Tower Hamlets 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.
- 1.2 The Administering Authority has delegated all its functions as administering authority to the Pensions Committee (“the Committee”). The ISS is subject to periodic review at least every three years or 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 – for example, pensions board, independent adviser, local authority employers such as admitted bodies and scheduled bodies.
- 1.3 The Committee will invest in accordance with the ISS, any Fund money that is not needed immediately to make payments from the Fund.
- 1.4 The Committee is charged with the responsibility for the governance and stewardship of the Fund. The Fund has adopted a long-term, risk aware investment strategy, which is kept under regular review. Asset allocation decisions are taken in the best long term interest of Fund employers and member beneficiaries.
- 1.5 The ISS should be read in conjunction with the Fund’s Funding Strategy Statement, which sets out how solvency risks will be managed with regard to the underlying pension liabilities.

### **2.0 Long-term view of investments**

- 2.1 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. This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.
- 2.2 The Committee aims to fund liabilities in such a manner that, in normal market conditions, all accrued benefits can be fully covered by the value of the Fund’s assets and that an appropriate level of contributions is agreed by the employers to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary and/or inflation increases.
- 2.3 The strength of the respective employers’ covenant and the present cash flow positive nature of the Fund allow a long-term deficit recovery period and enable the Fund to take a long-term view of investment strategy.
- 2.4 The most important aspect of risk is not the volatility of returns, but the risk of absolute loss, and of not meeting the objective of facilitating low, stable contribution rates for employers. Illiquidity and volatility are risks which offer potential sources of additional compensation to the long term investor. Although, it is more important to avoid being a forced seller in short term market setbacks.
- 2.5 Participation in economic growth is a major source of long term equity return. Over the long term, equities are expected to outperform other liquid assets, particularly government bonds and cash. The Committee believes that well governed companies

that manage their business in a responsible manner will likely produce higher returns over the long term.

- 2.6 The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund (see section 4). 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.
- 2.7 The Fund carried out an Asset Outperformance Assumption modelling exercise in conjunction with the 2022 Actuarial Valuation. In order to maintain a funding position of 100% the Fund would need to achieve investment returns of c. 3.3% p.a. In general, higher probabilities of success are achieved by paying higher contributions and relying less on volatile investment returns. The probability required for each employer is largely based on each employer's assessed covenant. For instance, a lower probability of success (e.g. 66%) may be required for a secure body as they may be considered to be able to pay higher contributions (or current rates for longer) should they not reach their funding target over their time horizon.
- 2.8 This approach helps to ensure that the investment strategy takes due account of 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 (relative to the funding bases used).
- 2.9 In line with the above overall objective the Fund will invest money in a wide variety of investments, having assessed the suitability of particular investments; the investment objectives, the impact of different economic scenarios on achieving required total Fund returns, and the resulting diversity across the whole Fund. Prior to any such decisions being made the Fund will take appropriate external independent advice.
- 2.10 The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation, and will take rebalancing action as deemed appropriate.

### **3.0 The investment objectives of the Fund**

- a) The long-term objective is for the Fund to be fully funded and be able to pay pensions as they fall due in an affordable way. This target will be reviewed following each triennial actuarial valuation and consultation with Fund employers.
- b) The actuarial valuation, at 31 March 2022, was prepared on the basis of an expected real return on assets of 1.9% p.a. over the long term, a nominal return of 4.6% p.a. assuming inflation (CPI) to be 2.7% p.a.
- c) The Fund's objective is to perform in line with this target over the long-term, by investing in a diversified portfolio of return-generating assets.
- d) In order to monitor the investment objective, the Committee requires the provision of detailed performance measurement of the Fund's investments. This is provided by the Fund's investment advisor, on a quarterly basis.

#### 4. Strategy Review and Strategic Benchmark

- 4.1 The investment strategy (including the core investment objectives and asset allocations) will be sufficiently flexible to meet longer term prevailing market conditions and address any short term cash flow requirements. Interim reviews may be undertaken to ensure that the Strategy remains appropriate.
- 4.2 The Fund will operate a fund-specific benchmark for the investment portfolio, with long-term allocations to the various investment asset classes, which reflect the circumstances of the Fund.
- 4.3 As is appropriate all asset classes and products will be kept under regular review. In addition to considering the benefits of individual products and asset classes for introduction into the strategy, consideration will be given to how the inclusion affects the overall risk/return characteristics of the total portfolio.
- 4.4 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. The Fund may also make use of derivatives either directly or in pooled funds investing in these products for the purpose of efficient portfolio management or to hedge specific risks.
- 4.5 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.
- 4.6 The Fund's target investment strategy is set out below.

Asset class	Targeted Strategic Asset Allocation %	Investments Range (%)
Active Global Equities	29%	(24% - 34%)
Passive Low Carbon Global Equities	21%	(16% - 26%)
<b>Total Global Equities</b>	<b>50%</b>	<b>(45% - 55%)</b>
Property	12%	(9% - 15%)
Diversified Growth Funds	15%	(10% - 20%)
Multi-Asset Credit	6%	(3% - 9%)
Renewable Energy Infrastructure	6%	(3% - 9%)
Affordable Housing	5%	(2% - 8%)
Index Linked Gilts	6%	(3% - 9%)
<b>Total</b>	<b>100%</b>	<b>100%</b>

#### 5. Restrictions on investment

- 5.1 The Regulations do not permit more than 5% of the Fund's value 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(e). The investment

policy of the Fund does not permit any employer-related investment, other than is necessary to meet the regulatory requirements with regards to pooling.

## 6.0 Managers

- 6.1 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.
- 6.2 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.
- 6.3 The Fund's investment managers will hold a mix of investments which reflect 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.
- 6.4 The Fund's current structure and performance targets are set out in the table below.

Manager	Mandate	Benchmark Allocation	Performance Target
Legal & General	Global Equities (Passive Low Carbon Hedged)	16%	MSCI World Low Carbon Target Index GBP Hedged
	Global Equities (Passive Low Carbon)	5%	MSCI World Low Carbon Target Index
LCIV	Baillie Gifford	20%	MSCI ACWI + 2%
	Global Paris Aligned Equities Diversified Growth	5%	UK Base Rate + 3%
LCIV	RBC	9%	MSCI World + 2%
	Global Sustainable Equities		
LCIV	Ruffer Absolute Return	10%	SONIA (30 day Compounded) +3%
LCIV	Renewable Energy Infrastructure	6%	Internal Rate of Return of 7% - 10%

LCIV	Multi Asset Credit	6%	SONIA (30 day compounded) +4.5%
Schroders	Property	12%	MSCI UK Quarterly Property Funds Indices Weighted Average benchmark + 0.75% over a rolling 3 year period
	UK Index Linked Gilts	6%	FTSE A Gov Index Linked >5yrs
LCIV	UK Housing Fund	5%	Internal Rate of Return of 5% - 7%

## 7.0 The approach to risk

- 7.1 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 a 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.
- 7.2 The principal risks affecting the Fund and the Fund’s approach to managing these risks and the contingency plans that are in place are set out below:

### *Funding risks*

- Financial mismatch – The risk that Fund assets fail to grow in line with the 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 impacts is reducing the value of investments/assets and requiring increased employer’s contributions).
- 7.3 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.
- 7.4 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.
- 7.5 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.

## 7.6 *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”), including Climate Change related risks - 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.

## 7.7 The Committee measure and manage asset risks as follows:

- a) The Fund’s strategic asset allocation benchmark invests in a diversified range of asset classes. The Committee has delegated rebalancing arrangements to Officers to ensure the Fund’s “actual allocation” does not deviate from its maximum limits. 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.
- b) The Fund invests in a range of overseas markets which provides a diversified approach to currency markets.
- c) 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 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.

## 7.8 *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.

## 7.9 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.



7.10 A more comprehensive breakdown of the risks to which the Fund is exposed and the approach to managing these risks is set out in the Fund's risk register and policy documents.

## 8. Pooling of investments

8.1 The Fund is a participating scheme in the London Collective Investment Vehicle (LCIV) Pool.

8.2 The Fund has made strong progress transitioning assets to the London CIV, and will look to invest further via this platform as and when there are suitable investment strategies available on the platform that meet the needs of the Fund.

8.3 The performance of the pooling arrangements is monitored via regular reporting and through periodic meetings.

8.4 Where performance falls short of expectations the Committee, Officers and the Investment Advisers for the Fund will identify the cause of this underperformance and will respond appropriately.

## 9. Environmental Social, and Governance ("ESG")

9.1 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 responsible investment in two key areas:

- *Sustainable investment / ESG 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.

### **Sustainable investment / ESG**

9.2 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 training on and information sessions on matters of social, environmental and corporate governance.

9.3 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.

9.4 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.



- 9.5 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.
- 9.6 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 where these present financial risks to the delivery of portfolio objectives and therefore impact on the sustainability of the Fund's returns.
- 9.7 Where appropriate, the Committee considers how it wishes to approach specific ESG factors in the context of its role in asset allocation and investment strategy setting. The Committee considers exposure to carbon risk in the context of its role in asset allocation and investment strategy setting. The Fund has limited exposure to fossil fuel companies given the proactive approach taken to lower the carbon footprint. However, some limited fossil fuel exposure remains in the equity portfolio and the investments in Diversified Growth Funds.
- 9.8 Taking into account the ratification in October 2016 of the Paris Agreement, the Committee considers that significant exposure to fossil fuel reserves within the Fund's portfolio could pose a material financial risk. Each year since 2017, a Carbon Risk Audit for the Fund has been carried out, quantifying the Fund's exposure through its equity portfolio to fossil fuel reserves and power generation and where the greatest risks lie. This analysis has led to the implementation of more carbon aware strategies. Regular analysis shows that the carbon intensity of the equity portfolio is materially lower than the benchmark.
- 9.9 Where necessary, the Fund will also engage with its Investment Managers and or the London CIV to address specific areas of carbon risk. The Fund expects its investment managers to integrate financially material ESG factors into their investment analysis and decision making and may engage with managers and the London CIV to ensure that the strategies it invests in remain appropriate for its needs. In particular the equity funds currently utilised by the Fund all have a specific ESG related focus. The active RBC fund is a sustainability themed strategy, the Baillie Gifford strategy is a global Paris-aligned mandate (both broadly looking to materially reduce carbon exposure and allocate capital to companies that are contributing towards leading the charge in terms of the transition to a lower carbon economy), whilst the third is a passive low carbon index fund, looking to remove exposure to the heaviest global emitters. As a combination the Committee feel this represents a powerful and robust solution.
- 9.10 Whilst the Fund does not at this time operate an exclusion policy in respect of specific sectors or companies, as noted above, significant analysis and progress has been taken in relation to lowering the Fund's carbon footprint more generally.
- 9.11 The Committee reviews its approach to non-financial factors periodically when selecting, retaining or realising its investments, taking into account relevant legislation. Additionally, the Committee monitors legislative and other developments with regards to this subject and will review its approach in the event of material changes.

- 9.12 The Fund in preparing and reviewing its ISS 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.

## **Voting rights**

- 9.13 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.
- 9.14 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.
- 9.15 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. The managers are strongly encouraged to vote in line with voting alerts issued by the Local Authority Pension Fund Forum (LAPFF) as far as practically possible to do so and will hold managers to account where they have not voted in accordance with the LAPFF directions in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2)(f). The Committee has elected to monitor the voting decisions made by all its investment managers on a regular basis.
- 9.16 The Fund's investments through the London CIV are covered by the voting policy of the CIV which has been agreed by the London CIV Board and Shareholder Committee. Voting is delegated to the external managers and monitored on a quarterly basis. The CIV will arrange for managers to vote in accordance with voting alerts issued by the Local Authority Pension Fund Forum (LAPFF) as far as practically possible to do so and will hold managers to account where they have not voted in accordance with the LAPFF directions. Full details of London CIV Voting Policy can be found in the link below. <https://londonciv.org.uk/stewardship>
- 9.17 The Fund will incorporate a report of voting activity as part of its Pension Fund Annual report which is published on the Council / Pension Fund website.

## **Stewardship**

- 9.18 The Fund embraces the 12 principles of the Financial Reporting Council's UK Stewardship Code 2020 (the Code). Whilst not yet compliant, the Committee is looking to develop a plan over time to identify areas for improving the monitoring of investment managers and further steps necessary to meet the standards required to become a signatory to the 2020 Code.
- 9.19 The Fund expects its external investment managers to be signatories of the Stewardship Code and reach Tier One level of compliance or to be seeking to achieve a Tier One status within a reasonable timeframe. Where this is not feasible the Fund expects a detailed explanation as to why it will not be able to achieve this level.

9.20 In addition, 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.

9.21 The Committee recognises that taking a collaborative approach with other investors can help to achieve wider and more effective outcomes.

The Fund:

- (a) is a member of the Local Authority Pension Fund Forum (LAPFF) and in this way joins with other LGPS Funds to magnify its voice and maximise the influence of investors as asset owners;
- (b) is a member of the Pension and Lifetime Savings Association (PLSA) and in this way joins with other investors to magnify its voice and maximise the influence of investors as asset owners;
- (c) gives support to shareholder resolutions where these reflect concerns which are shared and represent the Fund interest;
- (d) Produced its first TCFD report and became a TCFD Supporter in September 2022 and:
- (d) joins wider lobbying activities where appropriate opportunities arise.

### **Full compliance**

The Fund's annual report includes all of the Fund's policies including the governance policy statement, governance policy compliance statement, communications policy statement, responsible investment and stewardship policy, funding strategy statement and investment strategy statement. The annual report can be found on the council's website.

Quarterly reports to the Pensions Committee and Pensions Board on the management of the Fund's investments are publicly available on the council's website. <http://democracy.towerhamlets.gov.uk/mgCommitteeDetails.aspx?ID=392>

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