

***ROYAL BOROUGH OF KINGSTON UPON
THAMES PENSION FUND***

INVESTMENT STRATEGY STATEMENT

April 2018

1. Introduction

- 1.1 This is the Investment Strategy Statement (ISS) of the Royal Borough of Kingston Pension Fund adopted by Kingston Council (the Council) in its capacity as Administering Authority of the Local Government Pension Scheme. In this capacity the Council has responsibility to ensure the proper management of the Fund.
- 1.2 The Council has delegated to its Pension Fund Panel (“the Panel”) “all the powers and duties of the Council in relation to its functions as Administering Authority except for those matters delegated to other committees of the Council or to an officer.”
- 1.3 The ISS has been prepared by the Panel having taken appropriate advice. It meets the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the Regulations).
- 1.4 The ISS is subject to periodic review at least every three years and without delay after any significant change in investment policy. The Panel has consulted on the contents of the Strategy with each of its employers and the Pension Board. The ISS should be read in conjunction with the Fund’s Funding Strategy Statement.

2. Statutory background

- 2.1 Regulation 7(1) of the Regulations requires an administering authority to formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State.

3. Directions by the Secretary of State

- 3.1 Regulation 8 of the Regulations enables the Secretary of State to issue a Direction if he is satisfied that an administering authority is failing to act in accordance with guidance issued by the Department of Communities and Local Government.
- 3.2 The Secretary of State’s power of intervention does not interfere with the duty of elected members under general public law principles to make investment decisions in the best long-term interest of scheme beneficiaries and taxpayers.

4. Advisers

- 4.1 Regulation 7 of the Regulations requires the Council to take proper advice when making decisions in connection with the investment strategy of the Fund. In addition to the expertise of the members of the Pension Fund Panel and Council officers such advice is taken from:

- Aon Hewitt Ltd – investment consultancy

4.2 Actuarial advice, which can have implications for investment strategy, is provided by Hymans Robertson LLP.

5. Objective of the Fund

5.1 The 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. The sums required to fund these benefits and the amounts actually held (i.e. the funding position) are reviewed at each triennial actuarial valuation, or more frequently as required.

5.2 The target investment strategy is designed to have an expected return in excess of the discount rate while achieving a level of risk the Panel considers to be appropriate. The aim is to ensure contribution rates are set at a level to attain 100% funding as agreed with the Fund Actuary.

6 Investment beliefs

6.1 The Fund's fundamental investment beliefs which inform its strategy and guide its decision making are:

- The Fund has a paramount duty to seek to obtain the best possible return on its investments taking into account a properly considered level of risk
- A well-governed and well-managed pension fund will be rewarded by good investment performance in the long term
- Strategic asset allocation is the most significant factor in investment returns and risk; risk is only taken when the Fund believes a commensurate long term reward will be realised
- Asset allocation structure should be strongly influenced by the quantum and nature of the Fund's liabilities and the Funding Strategy Statement
- Since the lifetime of the liabilities is very long the time horizon of the investment strategy should be similarly long term
- Risk of underperformance by active equity managers is mitigated by allocating a significant portion of the Fund's assets to other asset classes
- Long-term financial performance of companies in which the Fund invests is likely to be enhanced if they follow good practice in their environmental, social and governance policies
- Costs need to be properly managed and transparent

7 The suitability of particular investments and types of investments

- 7.1 The Panel decides on the investment policies most suitable to meet the liabilities of the Fund and has ultimate responsibility for investment strategy.
- 7.2 The Panel has translated its investment objective into a suitable strategic asset allocation benchmark for the Fund. This benchmark is consistent with the Panel’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.
- 7.3 The approach seeks 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) and the liabilities arising therefrom, together with the level of disclosed surplus or deficit (relative to the funding bases used) and the Fund’s projected cash flow requirements.
- 7.4 Following the triennial valuation in 2016 the Panel, as advised by Aon Hewitt, considered its investment strategy alongside its funding objective and agreed the following structure:

ASSET CLASS	MANAGEMENT APPROACH	ALLOCATION	RANGE
		%	%
Equities	Active	60.0	55.0 – 65.0
Diversified Growth Funds	Active	20.0	15.0 – 25.0
Property	Active	5.0	n/a
Bonds	Active	15.0	5.0 – 15.0
TOTAL		100.0	

- 7.5 The most significant rationale of the structure is to invest the majority of the Fund assets in “growth assets” i.e. those expected to generate ‘excess’ returns over the long term. The structure also includes an allocation to “matching” assets, mainly corporate bonds. The investments in property and diversified growth funds provide both diversification and expected returns in excess of the discount rate used to value the liabilities in the triennial valuation.
- 7.6 The Panel monitors investment strategy on an ongoing basis, focusing on factors including, but not limited to:
 - Suitability and diversification given the Fund’s level of funding and liability profile
 - The level of expected risk

- Outlook for asset returns

- 7.7 The Panel also monitors the Fund's actual allocation on a regular basis to ensure it does not deviate from within the target range. If such a deviation occurs, a re-balancing exercise is carried out to ensure that the allocation remains within the range set.
- 7.8 It is intended that the Fund's investment strategy will be reviewed at least every three years, following actuarial valuations of the Fund. The investment strategy review will typically involve the Panel, in conjunction with its advisers, undertaking an in-depth Asset Liability Modelling exercise to understand the risks within the Fund's current investment strategy and establish other potentially suitable investment strategies for the Fund in the future. This approach was adopted following the 2013 triennial valuation.
- 7.9 An Asset Liability Modelling exercise was undertaken and the strategy reviewed in 2017 following the results of the 2016 actuarial valuation. As at 31 December 2016, modelling the current investment strategy relative to a proxy for the Fund's liabilities, the 10 year expected relative return was 5.2% p.a. with an expected volatility of 18.8%. As a result of the investment strategy review, the Panel has decided to consider ways to further diversify the bond and property portfolios.
- 7.10 The Panel decided to commit £25m (c.3.0% of total Fund assets) to a residential property fund. This commitment is expected to be drawn down over a period of two years. The impact of this commitment on the structure detailed in paragraph 7.4 above is shown below.

ASSET CLASS	MANAGEMENT APPROACH	ALLOCATION	RANGE
		%	%
Equities	Active	57.0	55.0 – 65.0
Diversified Growth Funds	Active	20.0	15.0 – 25.0
Property	Active	8.0	n/a
Bonds	Active	15.0	5.0 – 15.0
TOTAL		100.0	

8 Asset classes

- 8.1 The Fund may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest, index linked and corporate bonds, cash and property either directly or through pooled funds. 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.

- 8.2 In line with the Regulations, the Council'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 the Council within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007".
- 8.3 With investment returns included, the Fund has a positive cash flow that enables investment in illiquid asset classes e.g. property. The majority of the Fund's assets are highly liquid i.e. can be readily converted into cash, and the Council is satisfied that the Fund has sufficient liquid assets to meet all expected and unexpected demands for cash. However, as a long term investor the Council considers it prudent to include illiquid assets in its strategic asset allocation in order to benefit from the additional diversification and extra return this should provide.
- 8.4 For most of its investments the Council has delegated to the fund managers responsibility for the selection, retention and realisation of assets. The Fund retains sufficient cash to meet its liquidity requirements, and cash balances are invested in appropriate interest earning investments pending their use. The investment of these cash balances is managed internally.

9 Fund Managers

- 9.1 The Council has delegated the management of the Fund's investments to professional investment managers, appointed in accordance with the Local Government Pension Scheme Regulations. Their activities are specified in either detailed investment management agreements or subscription agreements and regularly monitored. The Panel is satisfied that the appointed fund managers, all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business, have sufficient expertise and experience to carry out their roles.
- 9.2 The investment style is to appoint fund managers with clear performance benchmarks and place maximum accountability for performance against that benchmark with them. Multiple fund managers are appointed to give diversification of investment style and spread of risk. The fund managers appointed are mainly remunerated through fees based on the value of assets under management.
- 9.3 The managers are expected to hold a mix of investments which reflect their views relative to their respective benchmarks. Within each major market and asset class, the managers maintain diversified portfolios through direct investment or pooled vehicles.
- 9.4 The investment management agreement in place for each fund manager, sets out, where relevant, the benchmark and performance targets. The agreements also set out any statutory or other restrictions determined by the Council. Investment may be made in accordance with The Regulations in equities, fixed interest and other bonds and property, in the UK and overseas markets.
- 9.5 As at the date of this ISS the details of the managers appointed by the Panel are as follows:

9.5.1 Fidelity Investments

Asset class – Global equities

Benchmark – MSCI All-World Index

Performance objective – Outperform the benchmark by 1.5 to 2.0% p.a.

9.5.2 Columbia Threadneedle Investments

Asset class – Global equities

Benchmark – MSCI All-World Index

Performance objective – Outperform the benchmark by 2.5 to 3.0% p.a.

9.5.3 Schroder Investment Management

Asset class – Global equities

Benchmark – MSCI All-World Index

Performance objective – Outperform the benchmark by 3.0% p.a.

9.5.4 Janus Henderson Investors

Asset class – Corporate bonds

Benchmark – iBoxx Sterling Non-Gilts Index

Performance objective – Outperform the benchmark by 0.5% p.a.

9.5.5 Janus Henderson Investors

Asset class – Bonds

Benchmark – n/a

Performance objective – An absolute return of 6.0% p.a.

9.5.6 Pyrford International Limited

Asset class – Diversified Growth Fund

Benchmark – RPI

Performance objective – RPI + 5% p.a.

9.5.7 Standard Life Investment

Asset class – Diversified Growth Fund

Benchmark – 3 Month GBP LIBOR

Performance objective – LIBOR (6 month) +5% p.a. over rolling 3 year periods (gross of fees)

9.5.8 Baillie Gifford

Asset class – Diversified Growth Fund

Benchmark – UK base rate

Performance objective – Outperform the benchmark by 3.5% p.a. (net of fees) over rolling 5 year periods

9.5.9 Ruffer LLP

Asset class – Diversified Growth Fund

Benchmark – UK base rate

Performance objective – To achieve a consistent return significantly greater than the Bank of England base rate

9.5.10 UBS Global Asset Management

Asset class – Property

Benchmark – IPD UK All Balanced Funds Median Index

Performance objective – To outperform the benchmark by maximising total returns through a combination of capital growth and income return.

9.5.11 M&G Residential Property

Asset class – Property

Benchmark – n/a

Performance objective – A total return of 6-8% p.a. (net of fees) over the long term, targeting an income return of 3-4% p.a.

9.6 Where appropriate, custodians are appointed to provide trade settlement and processing and related services. Where investments are held through pooled funds, the funds appoint their own custodians.

9.7 Performance targets are generally set on a three-year rolling basis and the Panel monitors manager performance quarterly. Advice is received as required from officers, the professional investment adviser and the independent advisory member. In addition, the Panel requires managers to attend a separate manager day meeting twice a year, and officers meet each of the managers in the “alternate quarters” (i.e. when there is no “manager day” meeting) to review and scrutinise performance.

9.8 The Council also monitors the qualitative performance of the Fund managers to ensure that they remain suitable for the Fund. These qualitative aspects include changes in ownership, changes in personnel, and investment administration.

10 Stock lending

10.1 The Panel's current policy is not to engage in stock lending.

11 Approach to risk

11.1 The Panel recognise a number of risks involved in the investment of the assets of the Fund.

11.2 Funding risks

11.2.1 As described by the investment objectives, the Fund invests in asset classes which are expected to demonstrate volatility when compared to the development of the Fund's liabilities. This policy is adopted in anticipation of achieving returns above those assumed in the actuarial valuation. The Panel considered a number of investment strategies with varying degrees of risk relative to the Fund's liabilities. In determining an appropriate level of risk (or expected volatility) the Panel considered:

- a) The strength of the Employer's covenant and attitude to risk.
- b) Contribution rate volatility.
- c) Likely fluctuations in funding level.

- d) The required return to restore the funding level over a set period in conjunction with the funding policy.
- e) The tolerance to a deterioration in the funding level as a result of taking risk.
- f) The term and nature of the Fund's liabilities.

11.2.2 To monitor the volatility of the Fund's funding level and the success or otherwise of the investment decisions the Panel monitor on a regular basis:

- a) The return on the assets, the benchmark and the liabilities.
- b) Estimated funding level development and how it compares to the expected or targeted development in the funding level.
- c) The probability of the Fund achieving its long-term funding objectives.

11.3 Manager risks

11.3.1 The Panel monitor the managers' performance on a quarterly basis, and compare the investment returns with the appropriate performance objectives to ensure continuing acceptable performance. The Panel also examine the risk being run by each of the investment managers. In particular, the performance reporting reviewed by the Panel considers the achieved variation in returns between each manager's portfolio and its benchmark and compares the level of active manager risk and excess return of each manager against a universe of similar mandates and the benchmark.

11.4 Liquidity risk

11.4.1 The Panel have adopted a strategy that makes due allowance of the need for liquidity of the Fund's assets.

11.5 Concentration risk

11.5.1 The Panel have adopted a strategy that ensures that the risk of an adverse influence on investment values from the poor performance of a small number of individual investments is reduced by diversification of the assets:

- by asset class (Global Equities, Diversified Growth Funds, Fixed Interest and Property)
- by region (UK, overseas)
- within asset classes, by the use of a range of products with different risk/return profiles

11.6 Market risk

11.6.1 The failure of investment markets to achieve the rate of investment return assumed by the Panel. This risk is considered by the Panel and its advisors when setting the Fund's investment strategy and on an ongoing basis.

11.7 Operational risk

- 11.7.1 The risk of fraud, poor advice or acts of negligence. The Panel has sought to minimise such risks by ensuring that all advisers and third party service providers are suitably qualified and experienced and that suitable liability and compensation clauses are included in all contracts for professional services received.

12 Approach to pooling

- 12.1 The Fund has formally agreed to join the London Collective Investment Vehicle (CIV) 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 asset classes, with less liquid asset classes to follow.
- 12.2 The Fund has already transitioned assets into the London CIV with a value of £148.150.6m or 187.18% (as at 31 March 2018/2017) of the assets and will look to transition further liquid assets as and when there are suitable investment strategies available on the platform that meet the needs of the Fund.
- 12.3 The Fund holds £43.2m or 5.1% (as at 31 December 2017) of the Fund held in illiquid assets, with a further planned investment of £25m or 3%, and these will remain outside of the London CIV pool. The cost of exiting these strategies early would have a negative financial impact on the Fund. These will be held as legacy assets until such time as they mature and proceeds re-invest through the pool assuming it has appropriate strategies available or until the Fund changes asset allocation and makes a decision to disinvest.

13 Social, environmental and governance considerations

- 13.1 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.
- 13.2 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.
- 13.3 The Fund expects its external investment managers (and specifically the London Collective Investment Vehicle through which the Fund will increasingly invest) 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.

- 13.4 The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.
- 13.5 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 to the extent these directly or indirectly impact on financial risk and return.
- 13.6 The Fund in preparing and reviewing its Investment Strategy Statement will consult with interested stakeholders including, but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with.

14 Exercise of the rights (including voting rights) attaching to investments

- 14.1 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. 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.
- 14.2 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.
- 14.3 The Fund's investments through the London CIV are covered by the voting policy of the CIV which has been agreed by the Pensions Sectoral Joint 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 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.

15 Stewardship

- 15.1 The Fund has not issued a separate Statement of Compliance with the Stewardship Code, but fully endorses the principles embedded in the 7 Principles of the Stewardship Code.
- 15.2 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. 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.

- 15.3 The Fund through its participation in the London CIV will work closely with other LGPS Funds in London to enhance the level of engagement both with external managers and the underlying companies in which invests. In addition, the Fund gives support to shareholder resolutions where these reflect concerns which are shared and represent the Fund interest.

16 Compliance with “Myners” Principles

- 16.1 In Appendix 1 are set out the details of the extent to which the Fund complies with the six updated “Myners” principles set out in the CIPFA publication “Investment Decision-Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles”.

Appendix 1

Compliance with “Myners” Principles”

Principle 1: Effective Decision Making

Compliant: The Royal Borough of Kingston upon Thames has an appointed Pension Fund Panel consisting of elected members and other non-voting representatives and there is a clearly defined decision-making process. The Panel is supported by the Director, Corporate and Commercial on investment and administration issues. It also employs an investment consultant and actuary. Training on investment issues is provided by the Investment Managers at the regular meetings of the Panel. Members of the Panel are also encouraged to attend training sessions offered from time to time by other external bodies.

Principle 2: Clear Objectives

Compliant: The overall objective for the Fund is to keep the employers’ contribution rates as low and stable as possible while achieving full funding on an ongoing basis. The Panel had as its starting point the latest actuarial valuation when reviewing the investment arrangements to adopt the risk budget and set the investment strategy. The independent investment adviser gave comprehensive training and advice throughout this exercise. The Investment Managers have been advised of the strategy and have clearly defined investment performance targets. The objectives will be reconsidered following the next actuarial valuation and investment strategy review to ensure they remain appropriate.

Principle 3: Risk and Liabilities

Compliant: The Panel has given due consideration to risks and liabilities as explained in the ‘Risk’ section above. A strategic asset allocation benchmark has been set for the Fund. The Fund also subscribes to the Pensions and Investments Research Consultants Local Authority Universe as a broad comparison with other local authority schemes.

Principle 4: Performance Assessment

Compliant: The returns of the Investment Managers are measured independently against their performance objectives and they are required to report on investment performance each quarter.

Principle 5: Responsible Ownership

Compliant: The Panel’s policy on Sustainability is detailed in an earlier section of this document. The Investment Managers have been asked to adopt the Institutional Shareholders’ Committee (ISC) Statement of Principles on the responsibilities of shareholders and agents, and to report to the Panel on related activity at the regular meetings.

Principle 6: Transparency and Reporting

Compliant: Documents relating to the management of the Pension Fund investments are published on the Council's website – these include the Investment Strategy Statement, the Annual Report and Accounts, the Funding Strategy Statement and the Governance Compliance Statement. The 'Pensions Charter' is published on the website and this details the information which is provided to scheme members.