PENSION INVESTMENT STRATEGY STATEMENT

Effective: 28th February 2020

1. Introduction and background

The Local Government Pension Scheme ("LGPS"), of which the Fund is a part, is established under the Superannuation Act 1972 and is regulated by a series of Regulations made under the 1972 Act.

All LGPS funds in England and Wales are required to have an Investment Strategy Statement ("ISS" or "Statement"). 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 composed 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"). Committee acts on the delegated authority of the Administering Authority.

The ISS, which was approved by the Committee on 28th February 2020, 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 28th February 2020.

The remaining parts of this statement will cover the following; policies for investments, asset allocation, risks, and our approach to pooling which will appear in the following order.

- Governance
- Fund Objectives
- Fund Management
- Asset Allocation
- Risks
- Asset Investment Pooling
- Responsible Investment

2. Governance

Leicestershire County Council, as the administering authority, has delegated responsibility for the management of the Fund to the Local Pension Committee (Committee). The Committee has responsibility for establishing an investment policy and its ongoing implementation.

Members of the Pension Committee have a fiduciary duty to safeguard, above all else, the financial interests of the Fund's beneficiaries. Beneficiaries, in this context, are the members of the Fund who are entitled to benefits (pensioners, previous and current employees) and the employing organisations. Other key stakeholders are the beneficiaries of the employing organisations services, for example local Council Tax payers.

Decisions affecting the Fund's investment strategy are taken with appropriate advice from the Fund's advisers. Only persons or organisations with the necessary skills take decisions affecting the Fund. The Members of the Pension Committee do receive training as and when deemed appropriate, to enable them to critically evaluate any advice they receive.

The Chief Financial Officer of Leicestershire County Council has responsibilities under Section 151 of the Local Government Act 1972 and provides financial advice to the Committee, including financial management, issues of compliance with internal regulations and controls, budgeting and accounting.

3. Fund Objectives

The primary objective of the Fund is to provide pension and lump sum benefits as and when they fall due for members or their dependents.

The funding position will be reviewed triennially through an actuarial valuation, or more frequently as required. Payments will be met by employer contributions, resulting from the funding strategy, employee contributions or financial returns from the investment strategy.

The funding strategy and investment strategy are therefore inextricably linked. Leicestershire County Councils funding strategy can be found online on the [Pensions Self-Service website](#).

The Committee believes in a long-term investment strategy with regular reviews, usually annually in the form of the asset allocation review. We aim to maximise returns from the Fund whilst maintaining an acceptable level of risk.

The Committee sets an investment strategy that focuses on the suitability of investments based on factors including, but is not limited to:

- The level of expected risk
- Outlook for asset returns
- Liquidity and cashflow

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

- The long-term nature of LGPS liabilities allows for a long-term approach to investing.
- Liabilities influence the asset structure; funds exist to meet their obligations.
- Risk premiums exist for certain investments, taking advantage of these can improve investment returns.
- Markets can be inefficient, and mispriced for long periods of time, therefore there is a place for active and passive investment management.
- Diversification across investments with low correlation reduces volatility, 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 from 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 risk adjusted investment performance and investment managers will only be appointed if they integrate responsible investment into their decision-making processes.
- Investment management costs should be minimized where possible but net investment returns after costs are the most important factor.

4. Fund management

The Committee aims to structure 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 Fund considers the employers covenant to meet liabilities. The Fund will work in partnership with these employers where their ability to meet liabilities may be in question in order to protect other Fund employers from the consequences of default.

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. Information available from several sources, including the triennial actuarial valuation, will be used to guide the setting of the investment strategy, however, 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).

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 some volatility (e.g. if equity markets fall, other assets may rise or fall less significantly), without being so diverse that the strategy becomes 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 cannot 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 sensible for the Fund.

The Fund’s actual allocation is monitored by Officers and Committee on a regular basis to ensure it does not notably deviate from the target allocation.

5. Asset Allocation

5.1 Investing in a variety of asset classes

The Fund may invest in quoted and unquoted securities of UK and overseas markets including equities, fixed interest, 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 difference and other derivatives either directly or in pooled funds investing in these products for efficient portfolio management or to hedge specific risks.

The Committee reviews the nature of Fund investments on a regular basis, with reference to suitability and diversification. The Committee seeks and considers written advice from our advisors for such a review. If, at any time, an investment in a security or product not previously known to the Committee is proposed, appropriate advice is sought and considered to ensure its suitability.

Asset class	Target Allocation Jan 2020 % Lower & Upper limits	
Listed Equities	40.00	44.00
Private equity	4.75	
Total Equity	**44.75**	**48.75**
Index linked bonds	5.00	
Infra / Timberland	9.75	
Property	10.00	
Real assets	**24.75**	
Targeted Return	7.50	
Emerging Market Debt	2.50	
Currency Overlay	0.00	
Investment grade credit	3.00	
Liquid multi-asset credit	4.00	
Global credit and opportunity	10.50	
Alternatives	**27.50**	

The Fund's target asset allocation as at January 2020 is set out above. 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.

5.2 Target Asset Allocation

As at January 2020, the expected return of this portfolio allocation is 5.9% p.a. with an 80% likelihood of achieving a return of 3.8% pa which is consistent with our Funding Strategy.

5.3 Restrictions on investment

Restrictions are based on the strategic asset allocation policy which is described in section 5 above.

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.

5.4 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.

6. Risks

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, investment consultants and for relevant assets LGPS Central 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 overall risk is that the Fund's assets are insufficient to meet its liabilities. The Funding Strategy Statement calculates the value of the Fund's assets and liabilities and with the triennial valuation sets out how any difference in value will be addressed.

The principal risks affecting the Fund are set out below. They are grouped into 3 areas, funding risks, asset risk and other risk. The Fund's approach to managing these 3 types of risks are explained after each section.

6.1 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 to the Fund of providing 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.

6.11 How we manage funding risks

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 considering expected future returns from the different asset classes and considers 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.

6.2 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 incorporating climate risk may 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.

6.21 How we manage asset risks

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.

The Fund is currently cashflow positive, in that contributions from employees and employers are larger than benefits being paid. The Fund invests 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. Whilst the fund has a growing proportion of less liquid assets we have a large proportion of highly traded liquid assets that can be sold readily in normal market conditions so that the Fund can pay immediate liabilities.

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 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 within section 8.1.

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 the managers, if underperformance persists. The Committee also recognises that individual managers often have an investment 'style' that may be out-of-sync with market preference for prolonged periods, and that this could lead to lengthy 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.

6.3 Other provider risk

- Transition risk - The risk of incurring costs in relation to the transition of assets between 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.

6.31 How we manage these other risks

The Committee expects Officers to monitor and manage risks in these areas through a process of regular scrutiny of the Fund's investment managers and audit of the operations it conducts for the Fund. In some cases, the Committee will have 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 an investment manager should serious concerns exist.

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

7. Pooling

Government instigated 'pooling' of pension fund investments in 2015 with the publication of criteria and guidance on pooling of Local Government Pension Scheme assets. Pension funds formed their own groups and eight asset pools were formed, which are now all operational.

The Fund is a participating scheme in the LGPS Central Pool (Central). The proposed structure and basis on which the LGPS Central Pool will operate was set out in the July 2016 submission to Government.

The LGPS Central Pool consists of the LGPS funds of: Cheshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands, the West Midlands Integrated Transport Authority and Worcestershire.

Collective investment management offers the potential for substantial savings in investment management fees, increased opportunities for investor engagement and access to a shared pool of knowledge and expertise.

The eight administering authorities of the pension funds within the LGPS Central Pool are equal shareholders in LGPS Central Limited. LGPS Central Limited has been established to manage investments on behalf of the Pool and received authorisation from the Financial Conduct Authority in January 2018.

7.1 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. LGPS Central has been operating since 1st April 2018.

The Fund transitioned its first assets to Central, as part of the Global Equity Active Multi-Manager Fund, at the end of February 2019. The Fund contributed approximately 15% of the overall £2.1 billion assets managed in the Global Equity fund. The Fund has since transferred funds into Central's Global Emerging Markets Fund and also into the first vintage of the Private Equity fund.

Central have a prioritised product development pipeline which takes into account the relative funds available from the Pool's participants and interest to invest into each product type.

8. Responsible Investing

8.1 Overview and background

Responsible investment is an approach to investment that aims to incorporate environmental including climate risk, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable investment returns. 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 including climate risk, 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 fund will complete an annual RI plan that builds on the current ESG undertakings.

8.2 Principles for Responsible Investment (PRI)

The Principles for Responsible Investment are recognised as the global standard for responsible investment for investors with fiduciary responsibilities.

The Fund declares its support for the PRI and it's 6 principles listed below.

Signatories' commitments adhere to the following including annual reporting to the PRI.

"As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time).

We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5: We will work together to enhance our effectiveness in implementing the Principles.

Principle 6: We will each report on our activities and progress towards implementing the Principles.

The fund is aware of RI duties and ultimately aim to balance our approach with the cost to LGPS employers, who in the main are providing social and environmental services to the local population.

8.3 Responsible Investing and LGPS central

In addition to support for the PRI, the Fund's investments that LGPS Central manages and advises upon are subject to Central's Responsible Investment and Engagement (RI and E) Framework. The Framework is published online.

Critical to the framework is Central's Investment and RI beliefs, which the committee has endorsed and is summarised below:

Long termism:

A long term approach to investment will deliver better returns and the long term nature of LGPS liabilities allows for a long term investment horizon.

Responsible investment:

Responsible investment is supportive of risk adjusted returns over the long term, across all asset classes. Responsible investment should be integrated into the investment processes of the Company and its investment managers.

Diversification, risk management and stewardship:

Diversification across investments with low correlation improves the risk return profile. A strategy of engagement, rather than exclusion, is more compatible with fiduciary duty and more supportive of responsible investment, because the opportunity to influence companies through stewardship is waived in a divestment approach. Even well diversified portfolios face systematic risk. Systematic risk can be mitigated over the long term through widespread stewardship and industry participation.

Corporate governance and cognitive diversity:

Investee companies and asset managers with robust governance structures should be better positioned to handle the effects of shocks and stresses of future events. There is clear evidence showing that decision making and performance are improved when company boards and investment teams are composed of cognitively diverse individuals.

Fees and remuneration:

The management fees of investment managers and the remuneration policies of investee companies are of significance for the Company's clients, particularly in a low return environment. Fees and remuneration should be aligned with the long term interests of our clients, and value for money is more important than the simple minimisation of costs.

Risk and opportunity:

Risk premia exist for certain investments; taking advantage of these can help to improve investment returns. There is risk but also opportunity in holding companies that have weak governance of financially material ESG issues. Opportunities can be captured so long as they are aligned with the Company's objectives and strategy, and so long as there is a sufficient evidence base upon which to make an investment decision.

Climate change:

Financial markets could be materially impacted by climate change and by the response of climate policymakers. Responsible investors should proactively manage this risk factor through stewardship activities, using partnerships of likeminded investors where feasible.

By highlighting climate change, rather than other RI risk factors, we are not asserting that climate risk has, for all assets, greater economic significance than other factors. Our motivation for referring specifically to climate change risk derives from our recognition that it is a risk factor of particular importance to a number of stakeholders, and we have communicated our investment beliefs about climate change for reasons of transparency.

LGPS Central is a signatory to the PRI and as such the Fund's investments via Central will be in line with the principles outlined earlier in this report. In addition, we have a pipeline of Fund transitions to Central as well as a number of advisory mandates which benefit from Central's RI approach and resource.

8.4 The Funds current ESG approach

As institutional investors, we have a duty to act in the best long-term interests of the beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios to varying degrees across companies, sectors, regions, asset classes and through time.

We also recognise that applying these Principles may better align investors with broader objectives of society.

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.

The Committee understand the Fund is not able to exclude investments 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.

8.5 The Fund's planned ESG roadmap

The funds outside of Central's direct management will be transitioned over a period of years. This could be for an extended period of time, due to the cost implications of a transition. The Fund has access to RI resource and expertise provided by Central which we will assess and help guide the Fund's approach to RI whilst we transition funds to Central.

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

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).

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.

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