Investment Strategy Statement

1. Introduction and background

This is the Investment Strategy Statement (“ISS”) of the London Borough of Merton Pension Fund (“the Fund”), which is administered by London Borough of Merton, (“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 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 29 June 2023, 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 31 March 2023.

The Committee has agreed the following target investment strategy for the Fund.

Asset class	Target allocation (%)
Global equities	28
Emerging markets equities	5
Diversified growth funds	5
Property	5
Infrastructure	11.5
Social Impact	5
Private credit	6.5
Multi-asset credit	9
Risk Management Framework[1] / Corporate bonds	25
Total	**100.0**

2. 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. The funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

[1] A portfolio of gilts, US treasuries and currency forward contracts.

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 agreed by the employer 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.

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 at least every three years following actuarial valuations of the Fund. The approach that the Fund has taken to setting an appropriate investment strategy is set out below.

The Fund carried out an investment strategy review in conjunction with the 31 March 2022 actuarial valuation. A number of different investment strategies were modelled and the future evolution of the Fund considered under a wide range of different scenarios. The Committee considered the chances of the Fund being fully funded at the end of the projection period, reviewing the expected return of several strategies alongside the level of volatility associated with each.

This approach was deemed to be suitable and accounted for the need of the Fund to meet the required discount rate plus prudence margin agreed as part of the valuation cycle whilst seeking to minimise or reduce volatility around the expected level of return.

In addition, the Committee monitors investment strategy on an ongoing basis, focusing 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
- Environmental, Social and Governance (ESG) factors

The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation.

3. 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 and commodities 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.

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. The table also includes the maximum percentage of total Fund value that it will invest in these asset classes. 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.

Asset class	Target allocation (%)	Range allowed (%)
Global equities	28	18 - 40
Emerging markets equities	5	0 - 10
Diversified growth funds	5	0 – 10
Property	5	0 – 10
Infrastructure	11.5	4 - 19
Social Impact	5	2.5 – 7.5
Private credit	6.5	2.5 – 11.5
Multi-asset credit	9	3 – 15
Risk Management Framework / Corporate bonds	25	10 – 40
Total	**100.0**	**-**

The long-term asset class returns assumed within the asset liability modelling exercise were as follows. These returns reflect financial conditions as at 31 December 2022.

Asset class	Median expected return over 10 years (% p.a.)
UK equities	7.7
Global (ex UK) equities	7.6
Emerging markets equities	8.8
Diversified growth funds	7.7
Property	6.5
Infrastructure	7.0
Private credit	6.6
Multi-asset credit	6.4
Corporate bonds	4.6
Government index-linked gilts	3.1

Government conventional gilts	4.0
Total Fund	**7.3**

At 31 December 2022, the expected volatility of the investment strategy was 11.6% p.a. over a 1 year time period. The volatility shown is defined as the dispersion around the median of expected return and represents the degree of uncertainty or risk associated with the chosen strategy. This volatility includes an assumed diversification benefit. Further details on the Fund's risks, including the approach to mitigating risks, is provided in the following section.

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 index-tracking funds in which the Fund invests holds a mix of investments within each pooled fund that reflects that of their respective benchmark indices.

4. 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. It has an active risk management 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. One of the Committee's overarching beliefs is to only to take as much investment risk as is necessary.

The principal risks affecting the Fund are set out below, we also discuss 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, based on modelling carried out in early 2023. This analysis will be revisited as part of the 2025 valuation process.

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.

The Committee also seeks to understand the assumptions used in any analysis and modelling so these 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 risk

- 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).
- Manager underperformance – The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.
- Environmental, social and governance ("ESG") – The risk that ESG related factors reduce the Fund's ability to generate the long-term returns.
- Climate change – The extent to which climate change causes a material deterioration in asset values as a consequence of factors including but not limited to policy change, physical impacts and the expected transition to a low-carbon economy.

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. To manage this risk, the Fund currently hedges 60% of its equity currency exposure for the following three currencies, USD, EUR and YEN. The currency hedging mandate is reviewed on an annual basis. Details of the Fund's approach to managing ESG risks is 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 more than one manager. 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.

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 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.

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

5. Approach to pooling investments, including use of collective investment vehicles and shared services

The Fund is a participating scheme in the London Collective Investment Vehicle ("LCIV") Pool. The proposed structure and basis on which the LCIV Pool ("the Pool") will operate was set out in the July 2016 submission to Government.

Assets to be invested in the LCIV Pool

The Fund's intention is to invest its assets through the 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. The key criteria for assessment of Pool solutions will be as follows:

1 That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund

2 That there is a clear financial benefit to the Fund in investing in the solution offered by the Pool, should a change of provider be necessary.

At the time of preparing this statement the Fund has already invested the following assets via the Pool:

Asset class	Manager	% of total Fund assets	Benchmark and performance objective
Global equities (Active)	RBC Baillie Gifford	9.9 8.4	MSCI World Index + 2% MSCI ACWI + 2%
Global equities (Passive)	BlackRock[2]	12.0	Index tracking
Emerging market equities	JP Morgan	4.0	MSCI EM Index + 2.5%
Diversified growth fund	Baillie Gifford Ruffer	4.0 7.3	UK Base Rate + 3.5% SONIA (30 day) + 3%
Multi asset credit	CQS / Pimco	8.5	SONIA (30 day) + 4.5%
Total		54.1	

[2] The BlackRock investment is held with the manger directly. Given the low cost, index-tracking nature of this mandate it is considered to be part of the LCIV Poo and therefore shown in this table.

At the time of preparing this statement the Fund has elected not to invest the following assets via the LCIV Pool.

Asset class	Manager	% of Fund assets[1]	Benchmark and performance objectives	Reason for not investing via the Pool
Global equities (factor)	UBS	5.6	Index-tracking	No pool equivalent offered; this may change in future and will be reviewed.
Emerging market equities	UBS	5.6	MSCI Emerging market + 5% p.a. over 3-5 years	Diversification
Property	UBS BlackRock	2.0 0.9	Outperform IPD UK index Outperform IPD UK index	No pool equivalent
Social Impact	Henley	2.6	6-7% p.a. total return	No pool equivalent
Infrastructure	Macquarie Quinbrook JP Morgan	2.4 3.6 7.6	7.3% p.a. 7.3% p.a. / 15% IRR plus 6% p.a. cash yield	No pool equivalent, and illiquid nature of investment would cause transition costs
Private credit	Permira Churchill	2.8 2.6	7.0% p.a. 7.0% p.a.	Illiquid nature of investment would cause transition costs
Risk Management Framework	Allspring	7.2	Currency hedging	Bespoke arrangement; unlikely to be offered within pool.

[1] Allocations as at 31 December 2022

The Fund will consider participating in pooling arrangements for the current and/or future property investment investments if a suitable solution is made available by the Pool.

Any assets not currently invested in the Pool will be reviewed at least every three years to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money. The next such review will take place no later than 2025.

Structure and governance of the LCIV Pool

The July 2016 submission to Government of the Pool provided a statement addressing the structure and governance of the Pool, the mechanisms by which the Fund can hold the Pool to account and the services that will be shared or jointly procured. As the Pool develops and the structure and governance of the Pool are fully established the Fund will include this information in future iterations of the ISS.

6. 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 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.

The Committee has also developed set of Responsible Investment beliefs, which are set out below. A link is provided to the current beliefs statement:

https://www.merton.gov.uk/system/files/London%20Borough%20of%20Merton%20-%20Responsible%20Investment%20Beliefs%20Statement%202023.pdf

The Committee recognises that climate change presents a particular systemic risk to the financial stability of the global economy and has the potential to impact on the Fund's investments and, as such, represents a long-term financial risk to the Fund and its holdings. The Committee prepares an annual Carbon Footprint Report which sets out the carbon intensity of the Fund's portfolio and seeks to identify and manage risks and opportunities associated with climate change. In time, the Committee will also be able to refer to TCFD reports.

The Committee recognises the commitments made by countries, regions, organisations and local authorities such as the London Borough of Merton in relation to climate change. Merton Council declared a climate emergency in 2019 and set a carbon reduction target to make the Council and Borough carbon neutral by 2030 and 2050 respectively. Consistent with this, the Committee commits to actively decarbonise its investments so that its investment portfolio reaches net zero carbon by 2050. The Fund continues to review this commitment and how it will achieve net zero carbon by 2050 over the forth coming years.

At the present time the Committee does not prioritise non-financial factors when selecting, retaining, or realising its investments.

Investment beliefs

The Committee has agreed the following set of investment beliefs in relation to Responsible Investment:

- The Fund recognises the primacy of its fiduciary duties, but believes that it can still exercise these while investing responsibly, and securing the required investment returns to ensure the financial sustainability of the Fund.
- Responsible Investment issues (including Environmental, Social and Governance factors, and particularly climate risk) can have a material impact on the long-term performance and reputation of the Fund.
- Climate change and the expected transition to a low carbon economy is an area of significant financial risk and opportunity to the Fund, and therefore the Fund will seek to proactively manage risks and pursue long-term investment opportunities arising from this.

- The Fund's investment managers and its Pool (the London Collective Investment Vehicle ("LCIV")) should demonstrate their commitment to responsible investment by being signatories to the Principles for Responsible Investment and UK Stewardship Code.
- The LCIV is a key component of the Fund successfully delivering on its RI objectives and any climate-related targets set. The Fund will actively engage with, and monitor, LCIV and expects it to provide leadership in helping Funds address the potential risks associated with ESG, and particularly climate change.
- The Fund should ensure that LCIV exercises robust stewardship of its assets, with underlying managers expected to deliver consistent votes (except in limited circumstances) on common company resolutions.
- The Fund recognises its responsibility to proactively monitor investment managers' integration of ESG analysis, and voting and engagement activities regularly, and hold managers accountable for their decisions.
- Investment managers are best placed to implement policy on ESG matters. They should embed ESG and RI considerations throughout their processes, be responsible for engaging with investee companies and issuers on ESG factors and take responsibility for voting (where relevant), disclosing to the Fund on all such activities.
- Responsible ownership of companies benefits long-term asset owners. Companies that manage their business responsibly are expected to outperform companies that do not, over the longer term.
- The Fund should be aware of, and monitor, financially material ESG-related risks, and issues (including voting and engagement activity) through its investment managers and will continue to receive annual reporting on these areas.
- Divestment on ESG grounds can be a mechanism for managing ESG risks and should be considered by investment managers (if the mandate allows), if engagement with individual companies proves unsuccessful, or is unlikely to have impact.
- Appropriate disclosure of the Fund's responsible investment activities is a priority for the Fund to ensure accountability, and the Fund will also seek to collaborate with other institutional investors on RI issues to deliver greater impact than it could achieve individually.
- The Fund believes that it is necessary and desirable to set a net-zero investment emissions target, and will prioritise this activity to ensure a credible plan for delivery is constructed.
- The Fund is also mindful of the Administering Authority's RI and net-zero commitments and the Committee may seek to align with these as appropriate.

To date, the Fund's approach to Social investments has largely been to delegate this to their underlying investment managers as part of their overall ESG duties. The Fund's managers report on this matter as part of the Fund's annual ESG review.

At present the Fund takes the following approach to social investments:

- The Fund has taken an active approach to social investments. During 2022 the Fund made a commitment to fund the social impact mandate with Henley. This actively targets supporting disadvantaged persons with complex care needs, providing stability with regards to their long term accommodation and care.
- The Fund will continue to review opportunities within the social investment space for additional opportunities to investment where appropriate.

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

Voting rights

The Committee considers the Fund's approach to stewardship also as a key area by acting as a responsible and active investor, by commissioning considered voting on the Fund's behalf as shareholders, and by indirectly engaging with investee company management as part of the investment process.

The Committee has delegated the exercise of voting rights to the investment managers 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 monitor the voting decisions made by all its investment managers on a regular basis.

Engagement

The Committee endorses the Stewardship Code as published by the Financial Reporting Council. The London Borough of Merton as administering authority for the Merton Pension Fund is not currently a signatory to the 2020 UK Stewardship Code. However, the Fund attempts to follow the principles, and plans to become a signatory in the future.

The Committee expects both the LCIV Pool and any directly appointed fund managers to be signatories to the UK Stewardship Code 2020.

In addition, the Fund believes in collective engagement and is a member of the LAPFF, through which it collectively exercises a voice across a range of corporate governance issues. In addition to the Fund's compliance with the Stewardship Code, the Fund believes in collective engagement and is a member of the LAPFF, through which it collectively exercises a voice across a range of corporate governance issues.

The Committee supports engagement activity that seeks to:

- Achieve greater disclosure of information on the ESG-related risks that could affect the value of an investment
- Achieve transparency of an investment's carbon exposure and how such companies are preparing for the transition to a low carbon economy
- Encourage its asset managers to actively participate in collaborative engagements with other investors where this is deemed to be in the best interests of the Fund.

Investments made via the LCIV Pool are subject to its Responsible Investment Policy, which is developed in consultation with all of the Pool's partner funds.

Prepared by:-

Nick Jellema, Senior Investment Consultant

Jamie McLaughlan, Associate Investment Consultant

For and on behalf of London Borough of Merton Pension Fund Committee