Lancashire County Pension Fund

# Investment Strategy Statement

**Updated June 2023**

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Lancashire County Council as administering authority of Lancashire County Pension Fund

# Contents

# Introduction

Lancashire County Council ("LCC") is the administering authority of the Lancashire County Pension Fund (the "Fund"). The investment strategy of the Fund plays a critical role in ensuring that there are sufficient funds to meet the pensions obligations to its Fund members. This document is the Investment Strategy Statement ("ISS") adopted by the Fund and it outlines:

- **Investment objectives** – objectives which reflect the long-term nature of the pension obligation and are focused on ensuring the long-term sustainability of the Fund;

- **Investment beliefs** – reflecting the beliefs upon which the Fund investments are governed, and ensuring alignment with the investment management ethos of our investment manager;

- **Risk management** – outlining how the Fund will manage the risks associated with its investments;

- **Asset allocation** – assets that the Fund intends to invest in, such as equities, bonds and property, and the relative proportions of each; and

- **Environmental, social, and governance ("ESG")** – setting out the Fund's approach to responsible investment, stewardship, ESG factors and the Fund's Responsible Investment ("RI") Policy.

# Investment Objectives and Beliefs

**Investment Objectives**

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. To meet this overriding objective, the Pension Fund Committee ("the Committee") maintains an investment policy so as to:

- Maximise the returns from investments whilst keeping risk within acceptable levels and ensuring liquidity requirements are at all times met;

- Contribute towards achieving and maintaining a future funding level of 100%; and

- Enable employer contribution rates to be kept as stable as possible.

**Investment beliefs**

A number of investment beliefs have been identified by the Fund and these are recognised in the development of the investment strategy. These investment beliefs set out core principles that guide the investment strategy of the Fund and serve as a framework for our asset allocation decisions, investment manager monitoring and dialogue and overall strategic direction including our approach to responsible investing. The investment beliefs were derived from guiding principles that govern the asset allocation and governance process in place at the Fund. The beliefs were developed by the Investment Panel (made up of the Head of Fund (as Chair) and independent advisers who provide expert professional independent advice to the Committee in relation to investment strategy), with reference to best practice among peers in the LGPS. The principles contained reflect accepted practices of institutional investing.

These are outlined in Appendix A.

# Investment Governance

Lancashire County Council delegates responsibility for the administration and management of the Fund to the Committee who, in turn, delegates certain responsibilities to the Head of Fund which includes leading and delivering strategy, accountability to the Committee and Local Pension Board and financial and investment management of the Fund.

The Investment Panel is made up of the Head of Fund (as Chair) and independent advisers who provides expert professional independent advice to the Committee in relation to investment strategy and supports the Head of Fund with specialist advice as required by the PFC. All decisions in relation to the Fund's strategic asset allocation are subject to Investment Panel advice.

Local Pensions Partnership Investments Limited ("LPPI")[1] is responsible for the implementation of investment strategy, including day to day decision-making around the appointment of asset managers, the selection of investment products, and the exercise of ownership responsibilities. LPPI is responsible for managing 100% of the assets of the Fund, the majority of which have been transitioned into investment pooling vehicles, also managed by LPPI. A small minority of assets remain on the balance sheet of the Fund as "legacy assets."

Further detail on roles and responsibilities is provided in Appendix B.

The Regulations require all Administering Authorities to take "proper advice" when formulating an investment strategy. In preparing this document and the overall investment strategy the Committee has taken advice from the Investment Panel and LPPI which is a FCA regulated investment manager with specific expertise and regulatory permissions to provide advice on investments.

**Compliance with Myners Report**

In 2000, the Government commissioned a 'Review of Institutional Investment in the United Kingdom' by Paul Myners. Following the report, the Government issued a set of investment principles which have subsequently been reviewed by HM Treasury. These principles cover:

- Arrangements for effective investment management decision-making;
- Setting and monitoring clear investment objectives;
- Focus on asset allocation;
- Arrangements to receive appropriate expert advice;
- Explicit manager mandates;
- Shareholder activism;
- Use of appropriate investment benchmarks;
- Measurement of performance;
- Transparency in investment management arrangements; and
- Regular reporting.

The Fund has considered the principles and considers that it is compliant with them.

[1] LPPI is wholly owned by Local Pensions Partnership Limited (LPPL), a joint venture between Lancashire County Council (LCC) as Administering Authority and London Pensions Fund Authority (LPFA).

**Regulatory environment**

This ISS is prepared in accordance with regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the "Regulations") and associated guidance. The regulations ensure that the Fund is managed in a way that is consistent with its long-term obligations to members, while also considering the Fund's risk tolerance and funding level.

Under the Regulations, a written investment strategy must be put in place, which sets out the asset allocation policy and investment strategy for the Fund and this is to be reviewed at least every 3 years and revised, as necessary. Also, in the event of a significant change – for example, following actuarial valuations, investment performance reviews, relevant legislation changes, or significant changes to the Funding Strategy Statement - changes will be reflected within six months of the change occurring.

# Economic Landscape

Macroeconomic factors play a critical role in shaping the asset allocation of the Fund. The key macroeconomic factors that influence asset allocation are summarised below:

- **Interest Rates**: have a direct impact on, amongst others, the fixed income asset class, as they affect the yield on bonds and other fixed income securities. Rising interest rates can lead to a decrease in bond prices, while declining interest rates can increase bond prices. Interest rates also have an impact on the Fund's liabilities;

- **Inflation**: has a direct impact on the purchasing power of money, and it can affect the performance of different asset classes in different ways. For example, equities may perform well during periods of low inflation, as companies can increase their earnings without having to raise prices. Inflation, like interest rates, also has an impact on the Fund's liabilities;

- **Economic Growth**: can impact the performance of different asset classes in different ways. For example, during periods of strong economic growth, equities may perform well as companies benefit from increased sales and profits; and

- **Exchange Rates**: can have a significant impact on the performance of international investments, as they affect the value of investments made in foreign currencies.

# Asset Allocation Framework

One of the key decisions that must be made when managing the Fund is the asset allocation strategy, which determines how the Fund's assets will be invested across different asset classes. Further detail on asset classes is in Appendix C. It is important to understand the overall investment objective of the Fund and the asset allocation strategy should be designed to meet the objectives. It should also take into account the broader economic and market environment.

To pay benefits over time the Fund needs to generate a rate of return that is at least equal to the actuarial discount rate (this is the rate of interest used to convert a cash amount, e.g. benefit payments occurring in the future, to a present value). The starting point for considering asset allocation is a simple portfolio of bonds and equities. However, this basic portfolio does not maximise diversification and therefore risk adjusted return.

To prudently diversify sources of risk and return, the Fund allocates capital across a wide variety of different asset classes with different risk return expectations. To be added to the portfolio, asset classes are first judged for suitability:

- they have to be well understood by the Committee, consistent with the Fund's risk and return objectives;
- they have to make a significant contribution to the portfolio by improving overall return and risk characteristics; and
- so that the Fund benefits from increased diversification.

The Fund has identified a total of eight asset classes that will be invested in.

The eight asset classes shown in the table below have different exposures to economic factors (GDP growth, interest rates and inflation) and combine different geographies and currencies. In assessing suitability, the Committee has considered the respective return drivers, exposure to economic growth and sensitivity to inflation – each an important consideration, relative to the sensitivities of the Fund's liabilities and managing risk.

The table below sets out the strategic asset allocation including:

- **Weightings (or target weightings) for each asset class** - the Committee, advised by the Investment Panel and LPPI, has determined benchmark weights to each asset class which it believes to be best suited to meeting the long-term objectives of the Fund;
- **Minimum and maximum tolerance ranges** - the Committee also identified tolerance ranges within which shorter term variations would be tolerated and/or actively pursued due to a combination of relative returns and investment opportunity;
- **Investment return benchmark –** this is a measure against which asset class performance is to be judged; and
- **Target rate of return** (or investment objective) for each asset class.

## Table 1: Strategic Asset Allocation

| Asset Class | Asset Allocation (%) | Tolerance Range (%) | Benchmark | Investment Objective |
|---|---|---|---|---|
| Global Equity | 45 | 40 to 52.5 | MSCI All Country World (net dividends reinvested) Index (GBP) | Benchmark +2.0% p.a. over a full market cycle, at least seven years |
| Private Equity | 5 | 0- to 10 | MSCI World SMID (net dividends reinvested) Index (GBP) | Benchmark +2.0% - 4.0% p.a. over a rolling ten year period |
| Fixed Income | 5 | 0 to 10 | Bloomberg Barclays Global Aggregate Bond Index (GBP Hedged) | Benchmark +0.25% p.a. over a full market cycle, at least seven years |
| Credit | 18 | 12.5 to 22.5 | 50% Morningstar/LSTA US Leveraged Loans Index (GBP Hedged), 50% Bloomberg Barclays Multiverse Corporate Index (GBP Hedged) | Benchmark +1.0% - 3.0% p.a. over a full market cycle, at least seven years |
| Real Estate | 11 | 6 to 16 | MSCI UK Quarterly Property Index (GBP) | UK CPI +3.0% - 5.0% p.a. over a rolling ten year period |
| Infrastructure | 15 | 10 to 20 | UK CPI + 4% Per Annum. | UK CPI +4.0% - 6.0% p.a. over a rolling ten year period |
| Diversifying Strategy | 0 | 0 to 3 | HFRI Fund of Funds Conservative Index (GBP Hedged) | Benchmark +1.0% p.a over a rolling even year period |
| Cash | 1 | 0 to 5 | SONIA | n/a |

### Additional Assets

Assets in respect of members' additional voluntary contributions are held separately from the main Fund assets.

### Day to day custody

The Fund has appointed a custodian with regard to the safekeeping of the Fund's assets and other investment administrative requirements.

# Risk Management

Fund is exposed to a number of risks which pose a threat to the Fund meeting its objectives. The overriding objective of the Fund in respect of its investments is to maximise return within an acceptable and understood level of risk. The Fund outlines its attitude to risk in a risk appetite statement. Risk Appetite refers to the Fund's willingness to tolerate a particular level of exposure to specific risks or risk groups. It is also an expression of the capacity to bear risk, which should not be exceeded. This is regularly monitored by the Investment Panel.

Also, key risks to the Fund are considered within the Fund's risk framework and risk register. The risk register covers member, operational, investment and transitional risk connected with management of the Fund and is subject to regular review and monitoring. Key investment risks are summarised below:

- **Investment Strategy -** inappropriate investment strategy leading to volatility and underperformance against the Fund's investment objectives;

- **Portfolio construction, Implementation and Performance -** the portfolio fails to deliver the required return within risk tolerances;

- **Custody of Fund assets -** failure to ensure the security and safe custody of Fund assets, leading to a loss of assets and/or income, and therefore a breach;

- **Actuarial Valuation and Monitoring of Funding -** asset / liability mismatch leads to insufficient assets to fund liabilities;

- **Cash-Flow Management** - insufficient funds to meet payments from the Fund;

- **Management of Employer risk -** Employers are unable to pay in full any shortfall of their share of the overall deficit on leaving the Fund;

- **ESG Risks -** the Fund's asset values are adversely impacted by environmental, social and governance risks.

# Performance Measurement

Fund performance is measured at a number of different levels.

- The objective of the Fund is to outperform the actuarial discount rate.
- The performance of the pooling arrangements is monitored via regular reporting and through quarterly Investment Panel meetings.
- Performance for LPPI is measured against the policy portfolio benchmark. LPPI seeks to outperform the policy portfolio on a risk adjusted basis, via active sub-asset class selection, selecting the best stocks/managers for each of the pools and by implementing investments in a low-cost manner.
- Performance for the investment pools is measured against widely used and transparent benchmarks and appropriate targets.

Where performance falls short of expectations the Committee and the Panel will identify the cause of this underperformance and will respond appropriately. In practice, the Fund would expect to work collaboratively with LPPI to identify and remedy the cause of any underperformance.

# ESG

The Fund’s approach to responsible investment is set out below and further detailed in its Responsible Investment Policy. Key points from the RI policy are:

- **RI priorities -** identifying core priorities for RI is an important part of focussing the attention of LPPI on the issues of greatest importance to the Fund. It also helps the Committee to monitor the stewardship activities that LPPI undertake on behalf of the Fund. The issues identified as being of primary concern to the Fund as asset owners are outlined in the RI Policy;

- **Investment management** - implementation of LCPF’s RI policy is through the activities of LPPI;

- **Engagement** - the Fund considers engagement to be a route for exerting a positive influence over investee companies and encouraging responsible corporate behaviour; and

- **Voting** - all aspects of shareholder voting are conducted in line with the LPPI 'Shareholder Voting Policy' which covers voting arrangements, 'reporting and disclosures' and voting philosophy.

# Appendix A – Investment Beliefs

**1** We believe that our investment horizon should be long-term, due to the fact that our liabilities as a pension fund are long-term in nature. Our primary investment objective as a fund is to have sufficient assets to meet our long-term liabilities as they become due. Comparing our portfolio to benchmarks and target returns is a critical part of our governance and will take our long-term objectives into account.

**2** We should only allocate to those assets which are adjudged to offer an appropriate risk/return, and we believe that asset allocation is a key driver of investment returns. Our asset allocation is set forth in our Investment Strategy Statement, as approved by the Pension Fund Committee and as modified from time to time.

**3** We believe that diversification can improve returns and reduce risk, particularly global diversification where appropriate. There are some circumstances where we may prefer not to build global exposure (e.g., in the Fund's property portfolio). Diversification by manager type (internal and external providers) is also desirable to avoid overly concentrated investment styles and key person risk.

**4** We believe in the benefits of active management as opposed to passive management across most asset classes, particularly where such management can be proven via evidence to deliver persistent excess return on a net of fee basis.

**5** We recognize that within asset classes, equities provide the highest risk and return potential and that risk aware exposure to this asset class is essential to ensure that our strategic investment objectives are met over time.

**6** We believe that our long-term investment horizon facilitates investment, where appropriate, in long-dated illiquid assets. Such assets should provide an illiquidity premium on returns and be subject to the appropriate level of specialist due diligence and monitoring that their complexity requires.

**7** We believe in managing costs across our investment portfolio (including fund structuring and implementation costs as well as management fees and performance fees) and believe that our size as an institutional investor should be taken into account when negotiating fees. We note that returns should be assessed on a net of fees basis and recognise that the lowest cost option may not always be the most suitable option for our portfolio. We believe that our managers should offer competitive fee structures and that investments should deliver value for money.

**8** We recognise the importance of cash flow to meeting our liabilities on an annual basis and intend that a portion of the portfolio will generate investment income to meet these needs. A coordinated approach with our investment manager whereby we have a clear understanding of cash needs and cash flow generation is essential to achieve this.

**9** We believe that robust risk management and mitigation improves risk adjusted returns. In addition to investment risk, operational, counterparty, conflicts of interest and reputational risk should be assessed and managed. We note that risks are both quantitative and qualitative and that both should be taken into account in the risk management process. We believe that all investments should be made based on data-based evidence which is frequently updated and validated.

**10** We have adopted a Responsible Investment Policy and believe management of climate change risk, good stewardship, proactive engagement with underlying companies should be a key element of our investment strategy.

**11** We believe that strong and effective governance, and a collegial corporate culture, both within the Fund and our investment managers (primarily LPPI) is a key requirement for long-term investment performance and broader organisational success.

# Appendix B – Roles & Responsibilities

Roles and responsibilities of the different bodies in the governance structure are outlined below.

| | |
|---|---|
| Pension Fund Committee | • To determine the strategic asset allocation policy, giving due recognition to the options made available by LPPI<br>• To monitor the performance of the Fund's investments and ensure that best practice is being adopted and value for money is being delivered<br>• To submit an annual report to the Full Council on the performance and state of the Fund and on the investment activities during the year<br>• To approve and review on a regular basis an overall Investment Strategy and subsidiary strategies for such asset classes as the Investment Panel consider appropriate<br>• To have overall responsibility for the Fund's investment policy. |
| Investment Panel | • To review the Fund's long term Investment Strategy and where necessary make recommendations to the Pension Fund Committee<br>• To advise on strategic and/or tactical asset allocations proposed by the LPPI<br>• To restrict and control the range of asset allocations used by LPPI as set out in the Investment Strategy Statement<br>• To consider appropriate risk management strategies to include the matching of pension liabilities with suitable investments, possibly involving derivatives, and where necessary make recommendations to the Pension Fund Committee<br>• To consider foreign exchange hedging strategies and where necessary make recommendations to the Pension Fund Committee<br>• To monitor and review the investment activity<br>• To review and report on the performance of the Fund and where necessary make recommendations to the Pension Fund Committee |

| | |
|---|---|
| | As part of the above, the Independent Investment Advisers provide advice to the Pension Fund Committee and Head of Fund in their own capacity as well as reviewing and developing advice from LPPI (see below). |
| Head of Fund | • To place any monies not allocated to investments on short term deposit in accordance with arrangements approved by the Pension Fund Committee.<br><br>• In consultation with the Investment Panel, monitor and review the performance of investments made by LPPI and report to each meeting of the Pension Fund Committee on the exercise of this delegation.<br><br>• To prepare and submit to the Pension Fund Committee an Investment Strategy Statement (to include policy on the management of cash balances).<br><br>• In addition, responsibilities are delegated to the Head of Fund including leading and delivering strategy, accountability to the Committee and Local Pension Board and financial and investment management of the Fund. |
| LPPI | • To implement the Fund's investment approach, including making decisions to invest the assets of the Fund in accordance with the Fund's investment objectives and strategic asset allocation.<br><br>• To provide advice from time to time; the advice model operated by the Fund is that LPPI is required, as appropriate, to provide advice to the Fund. In practice, this is done via the Investment Panel. This input by LPPI supports the Investment Panel in delivering its professional advice to the Pension Fund Committee and Head of Fund. |
| Custodian | • The Fund has appointed a custodian with regard to the safekeeping of the assets in the Fund and other investment administrative requirements. |
| Local Pensions Board | • To assist Lancashire County Council as the Administering Authority in its role as Scheme Manager (as delegated to the Pension Fund Committee):<br><br>i. to secure compliance with the Local Government Pension Scheme (LGPS) regulations and any other legislation relating to the governance and administration of the LGPS; |

| | |
|---|---|
| | ii. to secure compliance with requirements imposed in relation to the LGPS by the Pensions Regulator; and<br><br>iii. in such other matters as the LGPS regulations may specify.<br><br>Local Pensions Board does not have any decision-making powers. |

# Appendix C – Asset Classes

Choice of asset classes has a significant impact on the risk and return profile of the Fund, and it is therefore important to understand the different types of assets that the Fund invests in.

- **Public equities**: Equities represent ownership in a company. Public equities are publicly traded stocks and shares in companies that are listed on a public stock exchange, for example the FTSE 100 Index in the UK. They are often considered to be one of the riskiest asset class due to their volatility. However, they also offer the potential for higher returns over the long term and represent the largest asset class exposure for the Fund.

- **Private equity**: Private Equity refers to owning part of a company whose stock is not listed on a public exchange. Compared to Public Equity, Private Equity typically offers a higher return and risk profile. Private Equity is also a less liquid asset class, meaning that investors capital is locked up for a period of time - a 10-year fund life is not uncommon – although this is compensated for by the expected higher returns.

- **Fixed Income**: Fixed Income assets are broadly those types of assets where an investor lends an amount of money to an entity (often a government or company) and, in exchange for this, receives a set of cashflows back in the form of fixed interest or dividend payments, until a given maturity date in the future. At the maturity date the investor is also repaid the original amount they had invested. Fixed income securities, such as bonds, are considered to be a lower-risk asset class.

- **Real Estate**: Real Estate as an asset class involves investing in property, land and the buildings on it. As well as changes in the value of the underlying properties driving performance, income generation, for example from rental payments from tenants in the properties, also plays a key role. However, real estate investments are also considered to be relatively illiquid.

- **Credit**: Credit as an asset class refers to company lending and accepting the debt of issuing companies/Governments with a view to benefiting from favourable repayment strategies.

- **Infrastructure**: Infrastructure assets are those which are necessary for society and the economy to function. Examples include assets in energy generation (gas, electricity and renewable), transport and health care/ hospitals. Infrastructure assets typically offer long-term returns whilst also providing portfolio diversification and cashflows with a degree of inflation-linkage. Infrastructure assets are also typically illiquid in nature, meaning that investors' capital is locked up for a period of time, although this is compensated for by expected higher returns.

- **Diversifying strategies**: The Fund's allocation to Diversifying Strategies seeks to generate a diversifying source of return to complement the Fund's funding objective, whilst maintaining a low correlation to Public Equities (especially in times of market stress).

- **Cash**: Cash investments, such as bank deposits, offer low risk and low returns. They may be used as a short-term holding place for funds that are waiting to be invested in other asset classes.

# Appendix D – Future Review

This Strategy will next be reviewed in detail as part of the next triennial valuation due 31 March 2025. Key principles will be reviewed and monitored on an annual basis and updated appropriately and as a matter of course in the event of significant change (for example, in scheme regulation/guidance and/or funding and investment developments).

**Version Control**

| | | |
|---|---|---|
| 0.1 | Initial draft | 15.02.2023 |
| 0.2 | Feedback from LPPI | 28.02.2023 |
| 0.3 | Feedback from LPPI and Investment Advisers at Investment Panel meeting on 9th March 2023 | 22.03.2023 |
| 0.4 | Feedback from Investment Advisers at Investment Panel meeting on 3rd April 2023. Updated Strategic Asset Allocation table on page 7 with information from LPPA Triennial Review of Strategic Asset Allocation paper. | 05.05.2023 |