Merton Pension Fund

Investment Strategy Statement

March 2017

Investment Strategy Statement

London Borough of Merton

Administering Authority for the London Borough of Merton Pension Fund

Presented to the Pension Fund Advisory Committee and approved – 8 March 2017

1. Statutory Requirement for an Investment Strategy Statement (ISS)

The Public Service Pensions Act 2013 (The Act) enables the Secretary of State to make regulations creating schemes of pensions for, amongst others, local government workers.

In England and Wales, such a scheme was created by the Local Government Pension Scheme Regulations 2013 (The Regulations). These Regulations were made by the Secretary of State exercising powers in the Superannuation Act 1972.

Under powers contained in The Act and The Regulations, the Secretary of State made the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, which replace the 2009 Investment Regulations. These regulations came into force on 1st November 2016. Regulation 7(1) requires administering authorities to formulate an investment strategy statement (ISS) which must be in accordance with guidance issue by the Secretary of State.

The Investment Strategy Statement (ISS) is a document that replaces, and largely replicates, the Statement of Investment Principles under the proposed Investment Regulations. Administering Authorities will be required to prepare and maintain an ISS documenting how the investment strategy for the Fund is determined and implemented. The ISS will be required to cover a number of areas, specifically:

(a) A requirement to invest money in a wide variety of investments;
(b) The authority's assessment of the suitability of particular investments and types of investments;
(c) The authority's approach to risk, including the ways in which risks are to be measured and managed;
(d) The authority's approach to pooling investments, including the use of collective investment vehicles and shared services
(e) The authority's approach on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
(f) The authority's policy on the exercise of rights (including voting rights) attaching to investments.

The ISS must also set out the maximum percentage of the total value of all investments that it will invest in particular investments or classes of investments. This, in effect replaces Schedule 1 of the 2009 Regulations.

The statement must be published by 1st April 2017 and regularly reviewed and at least every three years. Under transitional arrangements key elements of the 2009 Regulations will remain in force until the ISS is published.

This document is designed to comply with the guidance given by the Secretary of State, and is effective from March 2017. It is proposed to review the ISS regularly with any material changes published, which is more regularly than the Regulations require, but deemed appropriate.

The ISS should be read in conjunction with the following statutory documents:

- Funding Strategy Statement
- Governance Policy and Compliance Statement
- Communications Policy Statement
- The Pension Fund Annual Report and Accounts
- Actuarial Valuation.

Background to the Fund

The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. The Administering Authority runs the London Borough of Merton Pension Fund, and has delegated responsibility for managing the Fund to the Pension Fund Advisory Committee (The Committee). The purpose of the Merton Fund is:

- To collect monies in respect of employee and employer contributions, transfer values and investment income.
- To accumulate and invest money received, and facilitate the management of this.
- To facilitate payment of Local Government Pension Scheme (LGPS) benefits, transfer values, costs, charges and expenses.

Primary Objective

The objectives of the Fund are as follows:

- To ensure that sufficient financial resources are available to meet all accrued Local Government Pension Scheme liabilities as they fall due.
- To ensure effective and efficient management of employer's liabilities.
- To allow the return from investments to be maximised within reasonable risk parameters.
- To enable employer contribution rates to be kept as nearly constant as possible, at reasonable cost to taxpayers, scheduled and admitted bodies.

These overall objectives are supplemented by the funding and investment objectives which are detailed in this document.

London Borough of Merton Pension Fund's Investment Strategy

The following sections details the Fund's investment strategy, which takes into account Regulation 7(2) (a), 7(2) (b) and 7(2) (c); listed below:

2. Investment of money in a wide variety of investments

Regulation 7(2) (a) requires that administering authorities invest in a diversified portfolio of assets to ensure that risk is appropriately managed and volatility of overall return is reduced. The guidance that accompanies the regulations does not prescribe the specific asset classes over which Fund monies must be invested.

3. Suitability of particular investments and types of investments

Regulation 7(2) (b) requires that in assessing the strategic allocation for the Fund, an administering authority assesses the suitability of particular investments and types of investments against the need to meet pension obligations as they fall due.

Objectives of the investment strategy

The Fund's investment objective is to achieve full financing of pension liabilities at least cost over time. The objective requires that the return on the investment of the assets of the Fund are maximised, but since investment performance can be variable, and its fluctuations affect actuarial results, the objective has to be tempered by seeking its achievement via reasonably stable performance and tolerable risks.

Within this, the fundamental objectives of the Fund's investment are:

- To maximise the return on the Fund's investments and achieve the investment return assumed in the Scheme's actuarial review.
- To achieve the required investment return through reasonably stable performance obtained at modest risk.
- To achieve the investment objective with responsible Corporate Governance and compliance with the Authority's policy regarding Socially Responsible and Ethical Investment.

Since the investment return assumed in actuarial reviews is an assessment of returns over the long term, and in the short term returns may exceed or fall short of this, the Fund will consult its advisors to determine appropriate short-term targets that reflect and contribute to the longer-term objective.

The Fund's overall investment objective relates to its actuarial need, and whilst subsidiary, interim, performance objectives/targets based on market and peer group benchmarks may be used for performance evaluation, these do not represent the fundamental performance objective.

The Fund will establish practical, subsidiary, objectives for any sub-funds into which particular investment categories may be placed for practical purposes; having considered appropriate professional advice.

In formulating the Investment Strategy the Fund must first consider its Funding Strategy.

Funding Strategy

The Fund's funding strategy seeks to achieve (via employee and employer contributions and investment income) two objectives, and these are detailed in the Funding Strategy Statement:

- A funding level of 100%, as assessed by the Fund's appointed actuary, triennially, in accordance with the LGPS regulations.
- As stable an employer contribution rate as is practical.

In the opinion of the Fund actuary, the current funding policy is consistent with the investment strategy of the Fund. The asset outperformance assumption contained in the discount rate is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government.

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target.

Setting the Strategy

To invest in assets to target as a minimum a rate of return consistent with the annual growth in liabilities assumed in the actuarial valuation as at 31 March 2016 (the discount rate to value the liabilities was 5.5%), with the weighting between constituent asset classes determined to reduce the expected volatility of the funding level going forward.

The Committee has determined its investment strategy after considering the Fund's liability profile and requirements of the Statutory Funding Objective, their own appetite for risk, the views of the Employers on investment strategy, the Employers' appetite for risk. The Committee have also received written advice from their Investment Advisers – JLT Employee Benefits.

Against these strategic targets, the Committee regularly reviews its Investment Strategy and in doing so considers the risk/return characteristics of each asset class and sub-asset class in this assessment. The Merton Pension Fund considers the mix of asset classes in forming an overall portfolio and considers the correlation in volatility and return of each.

The basis of the Committee's strategy is to divide the Fund's assets between a "growth" portfolio, comprising assets such as diversified growth funds (DGFs), equities and property, and a "stabilising" portfolio, comprising assets such as bonds. The growth/stabilising allocation is set with regard to the overall expected return objective of the Fund's assets, which is determined by the funding objective and current funding level, as well as the risk tolerance.

The Committee recognise the benefits of diversification across asset classes, as well as within them, in reducing the risk that results from investing in any one particular market. Where they consider it advisable to do so, the Committee have appointed investment managers and more recently the London CIV to select and manage the allocations across asset classes, in particular where it would not be practical (or appropriate) for the Committee to commit the resources necessary to make these decisions themselves.

In assessing the suitability of investments required to form the overall portfolio the Merton Fund considers a number of characteristics of each asset class, and sub asset class. These characteristics

include potential return, risk/volatility of returns and liquidity. In setting and reviewing an overall investment strategy for the Merton Fund the starting point is always the Actuary's assessment of the liabilities of the Fund. This assessment will include cash flow requirements and an assessment of the required return to ensure the long term solvency of the Fund, and it is essential that the investment strategy is compatible with this.

Investment Decisions

The Committee distinguish between three types of investment decision: strategic, tactical and stock-level.

Strategic Investment Decisions

These decisions are long-term in nature and are driven by an understanding of the objectives, needs and liabilities of the Fund.

The Committee takes all such decisions themselves. They do so after receiving written advice from their officers and investment adviser. Examples of such decisions and of tasks relating to the implementation of these decisions include the following:

- Setting investment objectives
- Determining the split between the growth and the stabilising portfolios
- Determining the allocation to asset classes within the growth and stabilising portfolios
- Determining the Plan benchmark
- Reviewing the investment objectives and strategic asset allocation

Tactical Investment Decisions

These decisions are short-term and based on expectations of near-term market movements. Such decisions may involve deviating temporarily from the strategic asset allocation and may require the timing of entry into, or exit from, an investment market or asset class.

These decisions are the responsibility of the Officers and the London CIV. However, where such decisions are made within a pooled fund; they are the responsibility of the investment manager of the fund.

Stock Selection Decisions

All such decisions are the responsibility of the London CIV and the Fund's investment managers with which the Fund invests.

Strategic Asset Allocation

The Committee are permitted to invest across a wide range of asset classes, including, but not limited to, the following:

- UK and overseas equities
- UK and overseas government bonds, fixed and index-linked
- UK and overseas corporate bonds
- Multi-asset credit (MAC)
- Convertible bonds
- Property
- Infrastructure
- Hedge Funds
- Private Equity
- Private Credit
- High yield bonds
- Emerging market debt
- Diversified growth
- Cash

The Fund currently invests in mainly pooled portfolios. In addition the Fund will normally hold a proportion of its monies in short-term bank deposits and money market funds to meet operational requirements.

Balance between different types of investments

The Regulations require the administering authority to have regard for the diversification of the Fund's investments.

The Fund will, at all times, invest across a diversified portfolio of investments to reduce investment risk. In addition to diversifying by assets, the Fund will invest across a number of managers and via different approaches and styles to investing.

The Fund may invest via pooled and segregated portfolios based on the appropriateness for each portfolio. The Fund can invest across a combination of passive, active and absolute return investment approaches based on return potential, cost and flexibility of implementation.

Asset Allocation and Long Term Expected Return on Investment

The Committee is responsible for setting the strategic asset allocation for the Fund which in turn must be consistent with the investment return assumed in the funding strategy.

The investment strategy reflects the medium to long term nature of the liabilities but must also provide flexibility to manage short term volatility in markets. In addition, the investment strategy must take account of possible changes to cash flows as the membership profile of the Fund or the benefits structure changes.

The investment strategy reflects the differing return and risk profiles of each asset class. However, long term risk and return expectations are not consistently generated over all time frames and, for all asset classes, there can be periods of under- or out-performance compared to the long term expectations.

Current Strategic Benchmark

After the results of the 2016 Actuarial valuation were received, the Fund reviewed its overall asset allocation, with advice received from the Fund's investment consultant, JLT. The results of this review were presented to the Committee in March 2017 and resulted in a revised Strategic Allocation which is shown in the table below. The revised strategy improves the potential return of the Fund's assets to a level higher than the Actuary's discount rate, and reduces the overall risk, when compared to the previous strategy.

The Fund's strategy, as set out below, does not assume any outperformance from the investment managers. The Minimum and Maximum range allowed acts as the Fund's own limit on its investment strategy, and ensures compliance with the guidance which requires this. The expected risks and returns stated in this table are as at the date of the 2016/17 strategic review.

Asset Class	Strategic allocation (%)	Minimum/Maximum range allowed (%)	Expected return p.a.*	Expected Risk (Volatility) p.a. **
Growth Assets				
UK Equity	10.0	0-45	6.2%	17.5%
Developed Overseas Equity	30.0	15-40	6.2%	18.0%
Emerging Market Equity	10.0	0-20	7.1%	25.6%
Diversified Growth	10.0	0-20	5.9%	12.4%
Property	5.0	0-10	6.0%	3.7%
Infrastructure	7.5	0-15	7.3%	14.7%
Private Credit	7.5	0-10	7.0%	7.8%
Stabilising Assets				
Corporate Bonds	0.0	0-10	n/a	n/a
Long Dated UK Gilts	0.0	0-5	n/a	n/a
Multi-Asset Credit	10.0	0-20	5.0%	1.2%
Index Linked Gilts	10.0	0-30	1.3%	9.1%

Notes:

- Expected Returns are JLT's forecasts as at the time of modelling, and expected Risk figures are taken from JLT's partner RiskFirst.
- The strategic allocation to Corporate Bonds, and Long Dated UK Gilts are set at 0%; these will be transitioned from the current position over time, and are included for completion.

The inclusion of a diversified range of assets in the strategy is expected to reduce the overall volatility of returns without significantly altering the Fund's expected long term return. This was the case when modelling the revised investment strategy in 2016/17.

4. Approach to risk, including the ways in which risks are to be measured and managed

Regulation 7(2) (c) requires that funds describe their approach to risk within their investment portfolio, including summarising the key risks and detailing the approach to mitigate the risk (where possible or appropriate). It also requires that funds ensure that the approach is complicit with that in their Funding Strategy Statement.

Approach to risk

The Fund recognises that there are a number of risks that need to be factored into the Investment Strategy, and the expected estimates of volatility are reflected in the table above. The financial, demographic and regulatory risks are addressed in the Funding Strategy Statement, and so are not repeated here. This statement looks to address the financial risks for the Fund, in particular the risk of the performance of the Fund's assets not achieving the actuary's expected rate of return. The following paragraphs explain Merton's approach to addressing this risk.

Investing heavily in higher risk assets (e.g. equities) would be expected to increase the long term returns achievable from the assets, and thus to reduce the contributions required to Fund the liabilities over time. However, this type of strategy would be expected to lead to volatile short to medium term results, both in absolute terms and, particularly, relative to the Fund's liabilities.

Equally, whilst investing in lower risk assets (e.g., bonds) would be expected to reduce risk within the Fund (in terms of the volatility of returns, the Funding level and contribution rates), this may not be desirable as it would lead to a lower expected return and hence higher contribution rates over the long term.

In considering the Fund's investment strategy, one must therefore bear in mind this balance between risk and return. In practice, the investment strategy objective will be to achieve the highest possible return whilst minimising downside risk, within agreed parameters.

Investment, by its very nature, is a risk based activity where the returns achieved will reflect differing levels of risk. There are a number of investment risks to consider within an investment fund, a number of these are considered below:

Solvency Risk and Mismatching Risk

- These are measured through a qualitative and quantitative assessment of the expected development of the assets relative to the liabilities.
- These are managed by setting a Fund-specific strategic asset allocation with an appropriate level of risk.

Manager Risk including the London CIV

- This is assessed as the expected deviation of the prospective risk and return, as set out in the managers' objectives, relative to the investment policy.
- It is measured by monitoring the actual deviation of returns relative to the objective and factors supporting the managers' investment process, and by monitoring and replacing any managers where concerns exist over their continued ability to deliver the investment mandate.
- The aim of the investment strategy and management structure is to manage the appropriate level of risk for the return target which reflects the funding strategy. The Fund's external investment managers are required to invest in line with the investment guidelines set by the Fund. Independent custodians safe keep the assets on behalf of the Fund.

Liquidity Risk

- This is monitored according to the level of cash flows required by the Fund over a specified period.
- It is managed by holding an appropriate amount of readily realisable investments. The Fund's assets are invested in pooled funds which are readily realisable. As a result the investments in less liquid asset classes such as property, hedge funds, private equity and infrastructure are limited.

Political Risk

- This is measured by the level of concentration in any one market leading to the risk of adverse influence on investment values arising from political intervention.
- The Fund manages this by regular reviews of the investments and through investing in funds which give a wide degree of diversification.

Corporate Governance Risk

- This is assessed by reviewing the Fund's investment managers' policies regarding corporate governance.
- It is managed by delegating the exercise of voting rights to the managers, who exercise this right in accordance with their published corporate governance policies. Summaries of these policies are provided to the Committee from time to time and take into account the financial interests of the shareholders, which should ultimately be to the Fund's advantage.

Legislative Risk

- This is the risk that legislative changes will require action from the Committee so as to comply with any such changes in legislation.
- The Committee acknowledge that this risk is unavoidable but will seek to address any required changes so as to comply with changes in legislation.

Market Risk

- This is the risk the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices.
- The Fund seeks to manage this risk through the strategic policy which ensures diversification of investments across a range of asset classes and markets that have low correlations with each other and across a selection of managers.
- As most of the portfolio is exposed to market risk, the main risk to the Fund is a fall in market prices. Although market movements cannot be completely avoided, and indeed there are periods when all assets become more highly correlated, the impact can be mitigated through diversifying across asset classes and approaches to investing.
- Market risk comprises of the following three types of risk:

Currency Risk

- This is the risk that occurs when the price of one currency moves relative to another (reference) currency. In this context, the Fund may be invested in overseas stocks or assets, which are either directly or indirectly linked to a currency other than Sterling. There is a risk that the price of that overseas currency will move in such a way that devalues that currency relative to Sterling, thus negatively impacting the overall investment return.

Interest rate risk

- This is the risk that an investment's value will change due to a change in the level of interest rates. This affects debt instruments more directly than growth instruments.

- The Committee acknowledge that the interest rate risk related to individual debt instruments is managed by the underlying investment managers through a combination of strategies, such as diversification, duration and yield curve management.

Inflation risk

- This is the risk that the value of the Fund's liabilities which are inextricably linked to Consumer Price Index (CPI) inflation, increase at greater rate than the assets.
- The Committee acknowledge that inflation risk relating to the Fund's liabilities is managed by the underlying investment managers through a combination of strategies, such as diversification, investing in assets that move in line with inflation, such as Infrastructure and Index Linked Gilts.

Proper advice

In assessing the Fund's strategy, including an assessment of the implicit risks, and setting the maximum limits the London Borough of Merton has taken proper advice from JLT (Investment Consultants), with input from the Fund's Officers and Barnett Waddingham, the Fund's actuaries.

5. Approach to pooling

Regulation 7(2) (d) requires that all authorities commit to a suitable pool to achieve benefits of scale. It also requires that administering authorities confirm the chosen investment pool meets Government's investment reform criteria, or to the extent that it does not, that Government is content for it to continue.

Pool Characteristics

The Merton 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.

(a) The Fund will transition liquid assets into the London CIV when there are suitable investment strategies that meet the asset allocation and investment strategy available on the London CIV platform.

(b) The Fund is monitoring developments and the opening of investment strategy fund openings on the London CIV platform with a view to transitioning liquid assets across to the London CIV as soon as there are suitable sub-funds to meet the Fund's investment strategy requirements.

The Fund holds assets in life funds. If in the future should it hold life funds within its strategy it intends to retain these outside of the London CIV in accordance with government guidance on the retention of life funds outside pools for the time being. The Fund agrees for the London CIV to monitor the passive funds as part of the broader pool.

The Fund holds some illiquid assets 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 dis-invest.

The Merton Fund intends to invest most of its assets through the London CIV, however it is recognised that this will take a number of years before this can be fully implemented. The London CIV has a road-map for assets to move into the pool, and the Merton Fund intends to transition assets in line with this plan. The transition plan is shown below:

Indicative Sub-Funds Available on London CIV	2015	2016	2017	2018	2019	2020	2021	2022	2033
Global Equities (Active)	1	3	6	6	6	6	6	6	6
Global Equities (Passive)		4	5	4	3	3	3	3	3
UK Equities (Active)			2	2	2	2	2	2	2
UK Equities (Passive)		2	2	1	1	1	1	1	1
Multi Asset / DGFs		4	4	4	4	4	4	4	4
Fixed Interest & income/cashflow generating		1	3	4	5	5	5	5	5
Property				2	3	4	4	4	4
Alternative products				2	2	4	5	5	5
Private Equity					2	3	3	3	3
Real Assets				2	2	3	3	4	4
Infrastructure			1	2	2	3	4	5	6
Total Sub-Funds open	**1**	**14**	**23**	**29**	**32**	**38**	**40**	**42**	**43**

6. Approach to Environmental, Social and Governance issues

Regulation 7(2)(e) requires administering authorities to demonstrate that it considers any factors that are financially material to the performance of the Fund's investments, including social, environmental and corporate governance factors, and over the long term, dependent on the time horizon over which their liabilities arise.

The Committee's primary, statutory responsibility for the Fund is fiduciary; that is, to ensure that the Fund's investments produce the required return within the policy regarding risk. Good practice in terms of socially responsible, environmental and ethical issues is secondary.

The Committee do however, believe that good stewardship can enhance long -term portfolio performance, and is therefore in the best interests of its members.

The Committee believe that environmental social and corporate governance ("ESG") and ethical issues can affect the performance of investment portfolios and should therefore be considered as part of the Fund's investment process.

The London Borough of Merton Pension Fund is a long-term active investor that takes seriously its role in fostering stewardship. We believe that sound corporate governance contributes to long-term value for our clients. These high-level Policies set out the Funds' philosophy on corporate governance and its approach to voting on behalf of clients.

Voting rights give shareholders both the opportunity and responsibility to participate in the stewardship of companies, and the Fund's policy on exercising voting rights is explained in section 7 below.

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.

The Fund expects its external investment managers (and specifically the London CIV 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.

Effective monitoring and identification of these issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the Fund expects its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes.

The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.

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.

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.

Social investments

The Government guidance also addresses the issue of "social investments"; meaning those that deliver a social impact as well as a financial return. The Government considers that social investments are appropriate for LGPS funds where either the social impact is simply in addition to the financial return. It also considers that investments where some part of the financial return is forgone in order to generate the social impact are also appropriate, where the administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund.

To date the Merton Fund has not made any social investments.

7. Policy on exercising voting rights

Regulation 7(2) (f) requires administering authorities to explain their policy on exercising rights (including voting rights) attaching to investments. The guidance refers to the Financial Reporting Council's UK Stewardship Code and requires that funds explain, where appropriate their policy on stewardship with reference to the Stewardship Code.

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.

Voting Policy

It is the Fund's policy to be an active shareholder and to exercise voting rights to promote and affect good corporate governance.

Voting is normally delegated to the investment manager on a discretionary basis, subject to the investment manager being guided by the UK Corporate Governance Code appended to the Stock Exchange Listing Rules and the UK Stewardship Code.

Investment managers are to discuss high profile/contentious issues with representatives of the Committee and report such issues to the Chair of the Committee. Where feasible, these issues are to be discussed by the Committee as a whole, before action. Voting actions are to be recorded in quarterly reports, which will be available to the Committee.

Where required, voting on contentious issues should be explained to the Committee by investment managers at meetings of the full Committee. This will serve to strengthen the Fund's compliance with the UK Stewardship Code with regard to monitoring and disclosure of voting activity. In addition the Fund is a member of the Local Authority Pension Fund Forum, a collaborative body which exists to serve the investment interests of local authority pension funds.

Unless the Committee has made independent arrangements and advised the investment managers accordingly, the investment managers have discretion to make (and are expected to make and implement) corporate governance and voting judgments. For operational purposes, investment managers will work within their own internal operational guidelines, which are to be explained to and agreed with the Committee.

In the case of pooled investments, the fund manager will act within the terms of the relevant pooled fund agreement, but any high profile or contentious cases should nonetheless be reported to the Committee. The Committee will review corporate governance issues in respect of pooled funds and consider and take action as appropriate.

The Committee may subscribe to a voting issues service to provide information on governance issues independently of investment managers.

In support of responsible ownership, investment managers are expected to engage with the directorates of investee and potential investee companies to investigate business plans and practices and question performance and compliance-related issues, wherever appropriate and feasible.

The Committee may (should it consider it appropriate to act independently of investment managers) appoint a corporate governance, proxy voting, and/or engagement manager(s) to provide voting and engagement services to it.

The investment managers will be issued with copies of this ISS, which is compliant with the UK Stewardship Code, and publication of the ISS affects compliance with the disclosure requirement of the UK Stewardship Code.

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.

UK Stewardship Code

The Financial Reporting Council (FRC) first published the UK Stewardship Code in 2010, and revised it in 2012. The Code aims to enhance the quality of engagement between asset managers and companies to help improve long-term risk-adjusted returns to shareholders. The Code sets out a number of areas of good practice to which the FRC believes institutional investors should aspire. Since December 2010 all UK-authorised Asset Managers are required by the Financial Conduct Authority to produce a statement of commitment to the Stewardship Code or explain why it is not appropriate to their business model.

The Stewardship Code has seven principles, and the ISS statutory guidance requires that administering authorities become signatories to the Code, and state how they implement the principles on a "comply or explain" basis.

The London Borough of Merton as administering authority for the Merton Pension Fund is not currently a signatory to the Stewardship Code. However, the Fund attempts to follow the principles, and plans to become a signatory in time.

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.

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.

The London CIV's draft Stewardship Code Statement of Compliance is attached at Appendix 2.

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Appendix

LONDON CIV

STEWARDSHIP CODE

STATEMENT OF COMPLIANCE

LONDON CIV

UK STEWARDSHIP CODE STATEMENT

The London Collective Investment Vehicle (CIV) was formed as a voluntary collaborative venture by the London Local Authorities in 2014 to invest the assets of London Local Government Pension Scheme (LGPS). The London CIV and its London Local Authority investors recognise the importance of being long term stewards of capital and in so doing supports the UK Stewardship Code, which it recognises as best practice.

The London LGPS CIV Limited ("London CIV") is fully authorised by the FCA as an Alternative Investment Fund Manager (AIFM) with permission to operate a UK based Authorised Contractual Scheme fund (ACS Fund). The London CIV in the management of its investments has appointed a number of external investment managers. We therefore see our role as setting the tone for the effective delivery of stewardship managers on our behalf and on behalf of our investing Funds. We are clear that we retain responsibility for this being done properly and fully in the interests of our own shareholders.

This Statement sets out how the London CIV implements the seven principles of the Code.

Principle 1
Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

The London CIV on behalf of its London Local Authority Shareholders recognises its position as an investor on their behalf with ultimate responsibility to members and beneficiaries and recognises that effective stewardship can help protect and enhance the long-term value of its investments to the ultimate benefit of all stakeholders in the LGPS.

As we do not invest directly in companies, we hold our fund managers accountable for the delivery of stewardship on our behalf in terms of day-to-day implementation of its stewardship activity. We require the appointed fund management teams to be responsible for holding to account the management and boards of companies in which they invest. The London CIV believes that this approach is compatible with its stewardship responsibilities as it is the most effective and efficient manner in which it can promote and carry out stewardship activities in respect of its investments, and ensure the widest reach of these activities given the CIV's investment arrangements.

A key related area where stewardship is integrated into the wider process is in the selection and monitoring of external investment managers. When considering the appointment of external investment managers the consideration of Environmental Social and Governance (ESG) integration and stewardship activity of each investment manager is part of the selection process.

The London CIV expects its equity investment managers to adhere to the principles within the UK Stewardship Code. This position is communicated to the Fund's investment managers and forms the basis of the approach to monitoring the investment managers as outlined in this document. Whilst the Stewardship Code is primarily directed at UK equity investments, the CIV encourages its investment managers to apply the principles of the Code to overseas equity holdings where possible.

The primary mechanisms for the application of effective stewardship for the CIV are exercise of voting rights and engagement with investee companies. The CIV expects its external equity investment managers that invest directly in companies, to pursue both these mechanisms. We receive quarterly reporting from managers which includes their stewardship and voting activities where appropriate. We seek consistently to ensure that these stewardship activities are carried out actively and effectively in the furtherance of good long-term investment returns.

We expect all of the CIV's equity managers to be signatories to the Code and have publicly disclosed their policy via their Statements on how they will discharge their stewardship responsibilities. We expect managers that invest in companies directly to discharge their responsibilities by:

- having extensive dialogue with the company's management throughout the year on a range of topics such as governance, financial performance and strategy; and
- voting, either directly or via the services of voting agencies.

Principle 2
Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Day-to-day implementation of the Fund's stewardship activity has been delegated to external investment managers. The CIV expects its investment managers to document their approach to stewardship, which should include how they manage any conflicts of interest that arise to ensure that the interests of the CIV's Investors are prioritised. The CIV will review annually the conflicts of interest policy of its managers and how any conflicts have been managed during the year.

The London CIV has policies in place to manage conflicts of interest that may arise for the Board and its officers when making decisions on its behalf. The Conflicts of Interest policy is reviewed by the CIV board on a regular basis. A Conflicts of Interest Register is maintained.

Shareholders of the CIV attending the Pensions Sectoral Joint Committee are required to declare any conflicts of interest at the start of any meeting.

Principle 3
Institutional investors should monitor their investee companies.

We recognise that active and ongoing monitoring of companies is the foundation of good stewardship, reminding companies in which we invest that they have obligations to their shareholders to deliver returns over the appropriate long-term investment timeframe and, consistent with this, to manage any related environmental and social risks responsibly.

The CIV requires its external investment managers to monitor investee companies. Issues to be monitored are likely to vary, however typically these might include a company's corporate strategy, financial performance, risk (including those from environmental and social factors), capital structure, leadership team and corporate governance. The CIV encourages its investment managers to satisfy themselves that investee companies adhere to the spirit of the UK Corporate Governance Code.

The CIV reviews investment managers in this area as part of their regular meetings. For equity investment managers this includes consideration of:

- who has overall responsibility for ESG risk analysis and integration;
- resources and experience of the team;
- at what stages of the process ESG risks are considered;
- exposures to environmental, social or governance risk within the portfolio; and
- the investment manager's willingness to become an insider and, if so, whether the manager has a policy setting out the mechanisms through which this is done.

Principle 4
Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

The CIV recognises that constructive engagement with company management can help protect and enhance shareholder value. Typically, the CIV expects its investment managers to intervene with investee companies when they view that there are material risks or issues that are not currently being adequately addressed.

The CIV reviews investment managers in this area as part of their regular meeting. For equity investment managers that invest directly in Companies, this includes consideration of:

- whether voting activity has led to any changes in company practice;
- whether the investment manager's policy specifies when and how they will escalate engagement activities;
- overall engagement statistics (volume and areas of focus);
- example of most intensive engagement activity discussed as part of the manager's annual review meeting; and
- the estimated performance impact of engagement on the strategy in question.

Given the range of fund managers and Fund investments, the CIV carries out its monitoring at the manager level to identify:

- trends to ensure progress is being made in stewardship activities;
- specific managers where progress or the rate of progress is not adequate; and
- appropriate specific actions necessary.

Principle 5
Institutional investors should be willing to act collectively with other investors where appropriate.

As day-to-day management of the Fund's assets has been delegated to external investment managers, the CIV expects its investment managers to get involved in collective engagement where this is an efficient means to protect and enhance long-term shareholder value.

In addition the London CIV will work collectively with other investors including other LGPS Asset pools and the Local Authority Pension Fund Forum (LAPFF) to enhance the impact of their engagement activities.

Principle 6
Institutional investors should have a clear policy on voting and disclosure of voting activity.

The CIV has delegated its voting rights to the Fund's investment managers and requires them to vote, except where it is impractical to do so. The CIV also monitors the voting alerts of the LAPFF and where these are issued, requires the investment managers to take account of these alerts as far as practical to do so. Where the investment manager does not vote in line with the LAPFF voting alerts, the CIV will require detailed justification for non compliance.

The CIV reviews and monitors the voting policies and activities of its investment managers, this includes consideration of:

- the manager's voting policy and, what areas are covered;
- the level of voting activity
- whether the investment manager typically informs companies of their rationale when voting against or abstaining (and whether this is typically in advance of the vote or not);
- if securities lending takes place within a pooled fund for the strategy, whether the stock is recalled for all key votes for all stocks held in the portfolio; and
- whether a third party proxy voting service provider is used and, if so, how.

Principle 7
Institutional investors should report periodically on their stewardship and voting activities.

The London CIV encourages transparency from its investment managers and expects its managers to report publicly on their voting in an appropriate manner. In addition the

London CIV receives reviews and monitors quarterly the voting and stewardship engagement activities of its investment managers.
The CIV reports quarterly to its investors and will include information on voting and engagement activities from investment managers where appropriate including updates as required on updated stewardship and voting policies of managers. The CIV also requires its managers to provide it with annual assurances on internal controls and compliance through recognised framework such as the AAF01/06 or equivalent.

This statement will be reviewed regularly and updated as necessary.

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