Strategy update

Implementation update & upcoming strategy review

Prepared for: London Borough of Enfield Pension Fund
Prepared by: Aon
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Signatory of: STEWARDSHIP CODE | 2021

For professional clients only

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Implementation update

Strategy – implementation timeline

January 2023

Committee meeting - Committee agrees to invest in credit based on current pricing and underweight portfolio position. Based on Aon's recommendation, Committee agrees to invest £20m in Diversified Liquid Credit ('DLC') and Western corporate bond fund.

March 2023

CFM proceeds of c.£35m settle in bank account.

April 2023

Davidson Kempner proceeds of c.£35m settle in bank account.

May 2023

Investment of £20m in DLC and Western settle.

July 2023

Begin discussions on Triennial strategy review. **Plan for the strategy review to be discussed at this meeting.**

Dec '22

Mar '23

June '23

Infrastructure allocation

January 2023

Committee meeting - Aon provide recommendation on the Fund's Infrastructure allocation based on the higher allocation agreed at last strategy review.

March 2023

Committee meeting - Manager selection exercise to help determine Infrastructure managers based on Aon recommended allocation of LCIV, CIP, OSIM and AB Carval. Aon requested to provide further information, including OSIM's underlying exposure and view on property market.

June 2023

Investment Workgroup meeting - further discussion of Aon's proposed allocations. Agrees £75m investment in LCIV Renewables Infra Fund and £50m in CIP V, with ratification required by Committee in July.

July 2023

Committee meeting – Workgroup propose recommendation to Committee and discuss potential further action on allocation.

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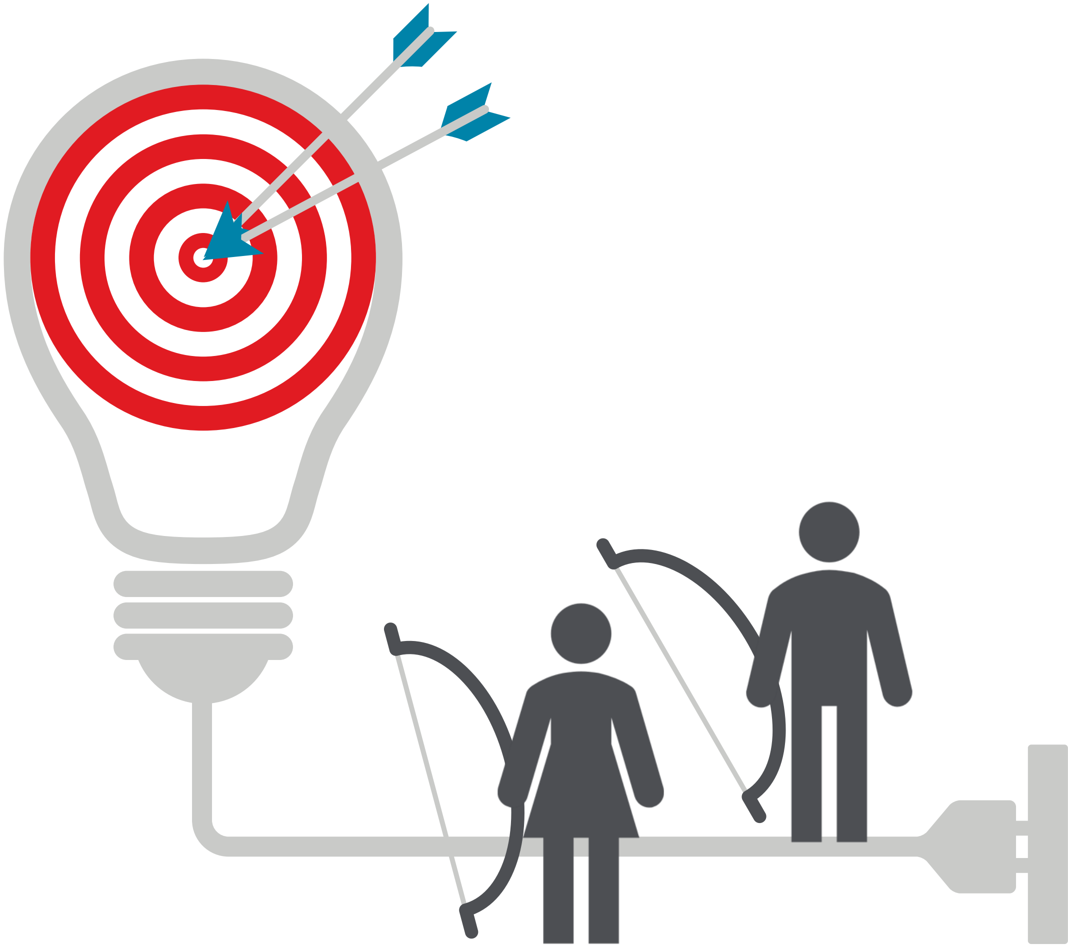
Upcoming strategy review

Investment strategy

Every three years, we revisit the Fund's investment strategy, in line with the Actuarial Valuation cycle. This document sets out our approach to undertaking strategy reviews and our plan for upcoming strategy work for the Fund.



The Aon Approach to Setting Investment Strategy

1. Discover
your beliefs, constraints and Fund specifics

Q3 2023

We will touch on this today.

2. Develop
a clearly defined return objective

N/A

We will not explicitly cover this – a long-term funding objective is less relevant for open-ended LGPS schemes with no finite maturity.

3. Deliver
a portfolio focused on your objective

Q3 2023

We propose a dedicated session in Q3 2023.

4. Review
against agreed metrics and evaluate new ideas

Ongoing

Interaction between investment risk and discount rate

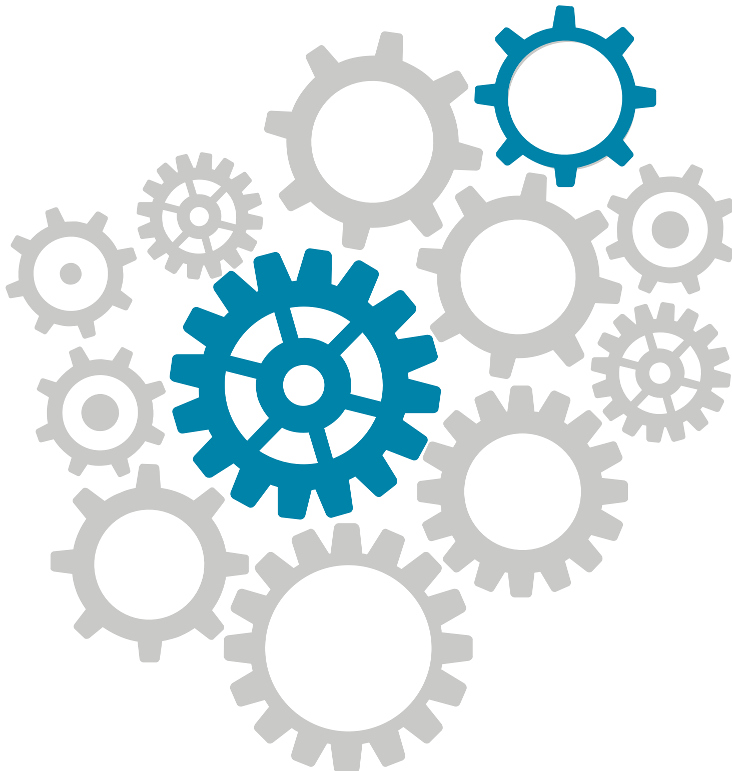
The discount rate for the Fund is set using a risk based approach, which considers many factors such as likelihood of meeting the funding objectives, and also **incorporates the risk of the investment strategy.**

Therefore, **if we change the Fund's asset allocation this can also impact the discount rate**, creating a circular effect.

The primary factor to consider is that **the investment return target should exceed the discount rate** in order to increase the likelihood that the discount rate is met.

As the liabilities are linked to CPI, risk can be illustrated as CPI+X% for comparison purposes.

It’s important to consider the **optimal level of risk above the liability discount rate**.



Discover: Your beliefs

We have included what we understand to be your high-level investment beliefs for the Fund below, based on your Investment Strategy Statement, prior Strategy Review and our understanding of the Fund.

We welcome thoughts from the Committee on these, so that we can update if necessary and work with the Officers to incorporate them into proposed portfolios.

Belief	Conclusion	Questions
ESG	Investments in companies that follow good ESG practices are likely to enhance returns	Does the Committee feel that ESG/Sustainable fund alternatives should always be used where possible?
Investment risk	Risk is only taken when the Fund believes a commensurate long term reward will be realised	The Fund is a long term investor, with equity assets the main driver of risk and return. Does the Committee want to diversify risk and return more, and seek opportunities with return premiums commensurate with the Fund's long time horizon?
Illiquidity	The investment strategy of the Fund should reflect the lifetime of the liabilities, which are very long	Does the Committee feel that as long as cashflows are managed sufficiently, the Fund should continue to invest in illiquid allocations? Does the Committee believe there should be a limit on these allocations?
Governance	A well-governed and well-managed pension fund will be rewarded by good investment performance in the long term	We believe the Fund's portfolio is well managed by the Officers Does the Committee believe that the LCIV could be further utilised within the Fund's portfolio?
Funding risk	Short-term volatility and decreases in funding level are acceptable in the context of the long-term time horizon	If the funding level dropped a large amount (e.g. 20%+) would the Committee have a desire to take action?

Deliver: Approach to Setting Long Term Investment Strategy

1

Strategic Allocation

Create an efficient proposed portfolio by setting the allocation across broad asset groups

Aon's economists produce long-term (10 year) risk / return statistics for asset classes (e.g. equities, bonds) on a quarterly basis.

These 'Capital Market Assumptions' can be used to construct proposed investment portfolios and determine which are both the most efficient over the long-term and also fit the Fund's requirements.

Aon will work with the Officers to produce these proposed portfolios in the strategy session in Q4 2023.

Key metrics:

- Expected return
- Expected volatility
- Value at Risk (1 in 20 downside)

Key constraints:

- Committee beliefs
- Transaction costs
- Liquidity / cashflow requirements

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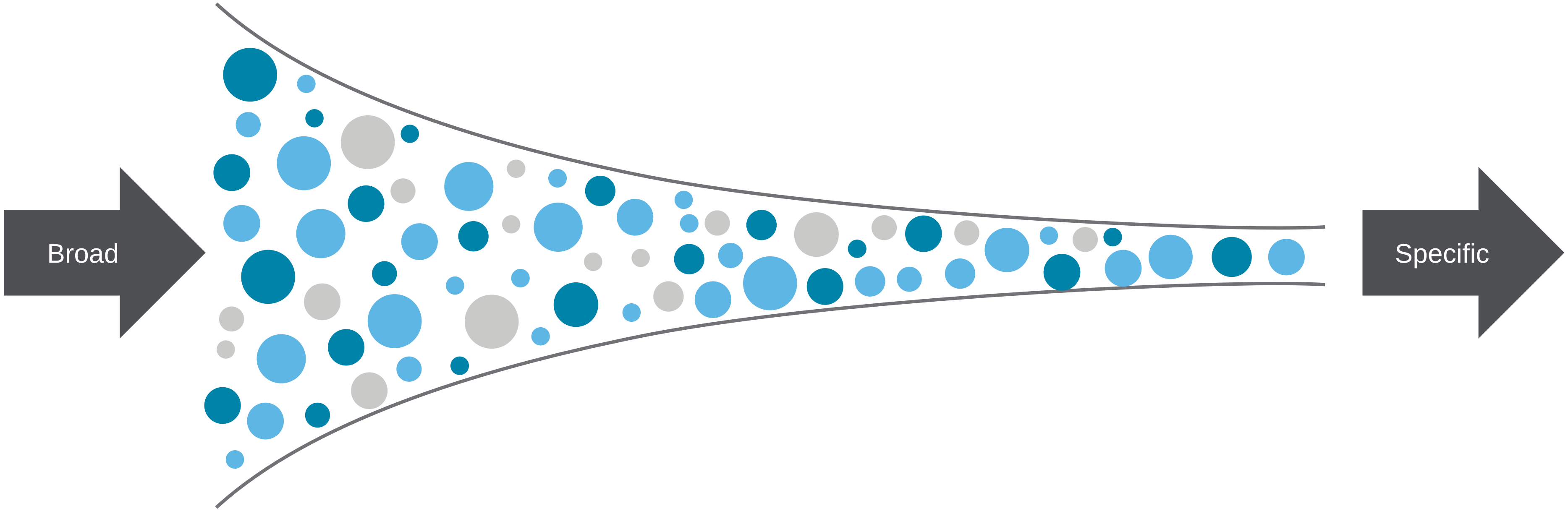
Why Use High Level / Broad Asset Groups?



Using broad groups allows more timely agreement to the most important principles

Strategic allocation is key to the risk / return characteristics of the strategy

Risk and return characteristics very similar in each group

e.g. "Equities" will be higher risk and return irrespective of active/passive and region

Specific asset classes and managers will be chosen once groups are decided on and strategy is refined.

Specific components can also be reviewed independently

Aon Asset Groups - Overview

1 Cash & LDI

2 Liquid Credit (Investment Grade)

3 Liquid Credit (Non-Investment Grade)

4 Cash Plus

5 Illiquid Credit

6 Equity

7 Illiquid Growth

8 Property

9 Diversified Growth

10 Absolute Return

Illustrative Interactive Model – Risk Return Frontier and Asset Groups

Each point on the chart shows the risk and return characteristics of a portfolio relative to the Fund's liabilities.

The points shown represent portfolios which invest entirely in each of the asset groups considered.

The model will attempt to find efficient portfolios which invest in these asset groups allowing for specified constraints (e.g. minimum and maximum amounts that can be invested in each asset group).

The blue frontier shows the collection of portfolios with the best risk and return characteristics relative to the liabilities when constructing portfolios from these constrained asset groups.

The Interactive Model seeks to improve risk and return efficiency

Deliver: Approach to Setting Long Term Investment Strategy

Only once the high-level asset class exposure within the portfolio is agreed, we can then work with the Officers to determine underlying assets within each asset class group and then finally recommend appropriate funds.

In this way, we look to create a portfolio that is not only efficient at a high-level asset class level but also within the asset class groups as well.

Key considerations

- Impact on portfolio diversification
- Aon views
- Liquidity / cashflow requirements
- Current holdings

2

Strategy Detail

Determine the underlying assets within each asset group

3

Manager Selection

Meet with and agree to appoint any new investment managers

Strategy themes

Infrastructure/illiquids

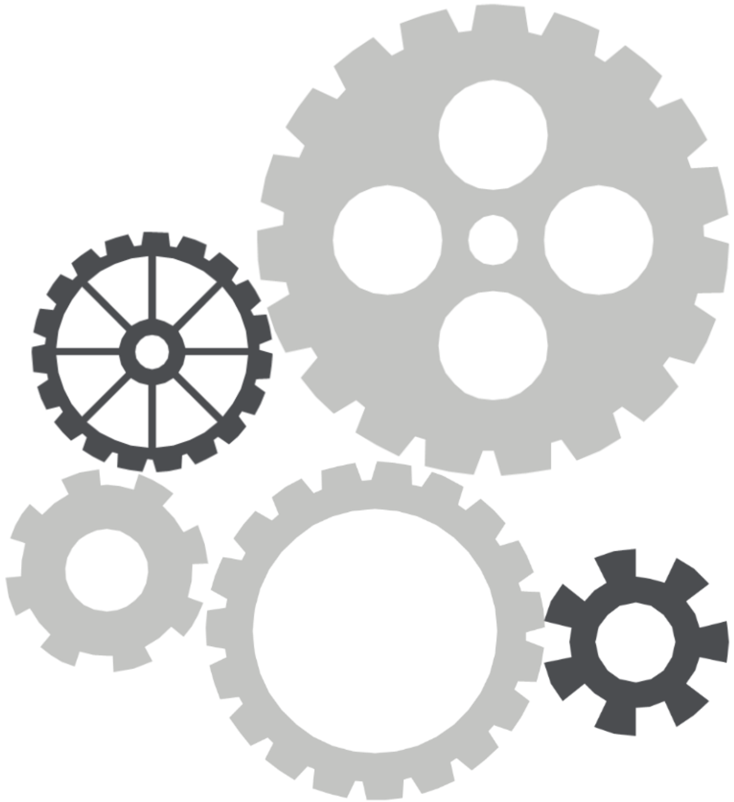
Consider impact of additional allocations to illiquid asset classes such as infrastructure to benefit from favourable characteristics.

Equities

Equity is a large proportion of overall portfolio risk. Explore alternative sources of risk and return to increase diversification.

Cashflow managements

What is the impact of various asset choices on the Fund's ability to meet pension payment obligations and other cashflow requirements (e.g. illiquid drawdowns)?



Fixed Income

Important source of diversification within the portfolio. Explore the effect of adding alternative fixed income investments to increase diversification.

Responsible Investment

Consider further integration of ESG during the portfolio implementation stage, using beliefs documented in the Investment Strategy Statement ('ISS') and Responsible Investment beliefs document.

Next steps

1

Strategic Allocation

Create an efficient proposed portfolio by setting the allocation across broad asset groups

Dedicated session in Q4 2023

2

Strategy Detail

Determine the underlying assets within each asset group

3

Manager Selection

Meet with and agree to appoint any new investment managers

Q1 2024 onwards… refine portfolio

Appendix

Discover: Investment Beliefs from Investment Strategy Statement (ISS)

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

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

Source: London Borough of Enfield Pension Fund Investment Strategy Statement as at 30/06/2020
https://governance.enfield.gov.uk/documents/s82750/item4%20Appendix%20Z%20-%20Enfield%20Pension%20Fund%20Investment%20Strategy%20Statement%20July%202020.pdf.

Discover: Responsible Investment Beliefs

The Pension Policy and Investment Committee of London Borough of Enfield believes that: -

1. Responsible investment is **supportive of long-term risk-adjusted returns**, across all asset classes. As a long-term investor, the Fund should invest in assets with sustainable business models in fulfilling its fiduciary duty to the scheme members.
2. Investee companies and asset managers with robust governance structures are better positioned to handle shocks and stresses. They capture opportunities by investing in companies which have weak but improving governance of financially material Environmental, Social and Governance (ESG) issues. [An opportunity is defined by its potential and intention to become aligned with the Fund's objectives and strategy].
3. The Fund Investment managers should include the Fund ESG considerations in their investment processes.
4. It is important to consider a range of ESG risks and opportunities. **Investible priorities should be based on the United Nations Sustainable Development Goals (UN SDGs).**
5. **Climate change** (SDG 13, Climate Action) represents a long term material financial risk for the Fund, and will impact our members, employers and our portfolio holdings, and is therefore one of these priorities.
6. It must prioritise the following SDGs in its investment strategy:
   a. SDG 7 – Affordable and Clean Energy
   b. SDG 9 – Industry, Innovation and Infrastructure
   c. SDG 11 - Sustainable Cities and Communities
   d. SDG 12 – Responsible Consumption and Production
   e. SDG 13 - Climate Action
7. The Fund's appointed Investment Managers are **accountable for implementing** appropriate responsible Investment policies, **tailored to these priorities**. The Investment managers should report back on these priorities.
8. **Divestment** mitigates ESG-related risk, when **collaborative engagement** with companies by investors and investment managers fails to produce positive responses, which meet its ESG-related priorities.
9. The exercise of **voting rights** is consistent with an asset owner's fiduciary duty: The Committee expects its managers to exercise this right fully and reserves the right to **direct votes**

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