APPENDIX 1

Southwark Council
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Investment Strategy Statement

London Borough of Southwark Pension Fund

1. Introduction

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 Regulation 7 requires administering authorities to formulate and to publish a statement of their investment strategy (ISS), in accordance with guidance issued from time to time by the Secretary of State.

This ISS has been designed to be a living document and is an important governance tool for the London Borough of Southwark Pension Fund (the Fund). This document sets out the investment strategy of the Fund, provides transparency in relation to how the Fund investments are managed, outlines the Fund's approach to managing risk, how environmental, social and governance issues are taken into account and the approach with regard to pooling of investments. This document replaces the Fund's Statement of Investment Principles.

This statement will be reviewed by the Pensions Advisory Panel annually, or more frequently should any significant change occur, with any resulting recommendations made to the Strategic Director of Finance and Governance.

Southwark Council is the administering authority for the Southwark Local Government Pension Fund and bears ultimate responsibility for the funding of member pensions. The management and strategic direction of the Fund, whilst separate from the council, will always take into consideration the council's long term objectives.

In this regard the Fund's investment principles are aligned with the council's values as defined in the Borough Plan, in particular, the value of "spending money as if it were from our own pocket."

https://moderngov.southwark.gov.uk/documents/s92006/Appendix%20A%20Southwarks%20Borough%20Plan%202020.pdf

The pension fund has its own climate strategy and goals which are consistent with council targets to become carbon neutral by 2030. This is ahead of the UK government's commitment to achieve net zero by 2050.

The Fund is fully committed to collaboration with other local authority partners and in 2015 invested in the London Collective Investment Vehicle (CIV). The London CIV is a collaborative venture between local authorities to deliver benefits of investment scale and efficiency to the

participating Funds. The Fund will continue to support the development of the London CIV as an investment vehicle.

2. Investment objectives and principles

The Fund is an open, defined-benefit pension fund as part of the national Local Government Pension Scheme. The Scheme rules are determined at national level and cover many elements of the Fund, such as employee benefits and employee contributions. The nature of the Fund and scheme design means that payment of pensions will extend over the very long term.

In setting the investment strategy the Fund seeks to balance twin objectives: first, to achieve sufficient long-term returns for the Fund to be affordable and second, to keep the employers' contribution rate as stable as possible.

The Fund will seek to operate a long term, sustainable strategy; one which does not rely upon the pursuit of short term returns or adherence to asset management trends, but utilises a well-structured asset and fund manager investment allocation to target long term socially responsible investment performance. The Fund's uncomplicated investment structure provides significant flexibility and adaptability if required.

To achieve the twin objectives, the Fund needs to invest in a diverse range of assets which provide higher returns relative to the growth of pension liabilities whilst taking account of the volatility inherent in investment markets. The principles set out below provide high level guidance on how the Fund seeks to meet these objectives and manage the associated risks.

Governance

- The Fund seeks at all times to adopt best practice governance standards within a structured framework, compliant with regulatory requirements and with expert independent advice taken throughout the decision making process.
- The Fund will operate with transparency and be accountable for decision making to stakeholders and scrutiny bodies.
- The Fund will ensure that officers and members of the Pensions Advisory Panel and Local Pension Board have the necessary skills, expertise and resources to ensure effective and evidence based decision making regarding the Fund's investment strategy.

Investment structure and risk management

- The Fund is a long term investor and as such the Fund invests in a wide range of investment assets, which may be volatile (such as equity) or illiquid (such as property), but that over the long term can generate a sufficient return to at least meet the Fund's pension obligations.
- The Fund operates an evidence and research based approach to investment; continually utilising research and guidance from investment professionals and peers, and seeking continual development in the understanding of investment.
- The Fund recognises the importance of having the right asset allocation, but also the value of developing the most appropriate structure and appointing suitable investment managers. The Fund will take account of market movements, cycles and the economic

background in decision making, but will avoid making decisions on a purely short term basis.

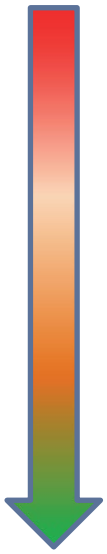
- The Fund will be comprehensive in the consideration of risks; the Fund will base assessments of risk on future pension liabilities and contributions, will consider financial and non-financial risks, diversify investment assets in an appropriate manner, but also recognise the limits of that diversification. As a long term investor the Fund understands that investment success depends significantly on the sustainable growth of the economy.
- The Fund will seek the most efficient and cost-effective solutions to achieving the Fund's objectives. This may involve active management and other services where additional costs are justified. Fees will always be considered in the context of overall performance and it is recognised that higher performance may be associated with higher fees.
- The Fund is a shareholder in the London CIV, with the Fund making regular contributions to the London CIV to assist in the development and expansion of the collaborative venture. Any future investments within the London CIV will be dependent upon the satisfactory completion of detailed due diligence and review to the same high standard that would be undertaken outside the investment pool.

Responsible investment and stewardship

- The Fund is a responsible investor; holding the belief that integrating responsible investment factors such as ESG in the investment process will protect, if not generate better returns over the long term.
- The Fund seeks to integrate responsible investment factors into the investment process across all asset classes.
- The Fund is prepared to be innovative in its investment strategy in order to cultivate positive social impact, within a framework of prudence and fiduciary duty.
- The Fund will proactively exercise responsible stewardship of assets held and act as a responsible voice in the broader investment community through platforms such as the Local Authority Pension Fund Forum.
- The Fund will collaborate with others whenever possible to share ideas and best practice, and to improve effectiveness and to reduce costs.
- The Fund considers the impacts and opportunities provided by climate change on both a Fund and wider social level, and so holds a commitment to meeting net zero carbon emissions from pension fund investment by 2030 with no direct investment in companies exposed to fossil fuels.

Categorisation of Investments

There is currently no standardised way of measuring the relative performance of different funds' carbon profiles; however, Southwark continues to work on its carbon footprint and investment classifications (see key below) to illustrate the progress being made.



NON LOW CARBON: Investment products that are not actively targeting reduced carbon emissions. Some of these may potentially have exposure to fossil fuels; however we are working to understand the extent of this and will address this in our strategy going forwards. The Fund intends to make no new investments in such products.

REDUCED CARBON: Investments either in property or in funds with specific oil and gas exclusions.

LOW CARBON: Funds specifically set up as 'low carbon' funds.

ZERO CARBON: Investments in vehicles that produce zero carbon or in some cases have a measurable offsetting impact on carbon emissions. Currently this category contains sustainable infrastructure and timberland products.

CASH: Held in the pension fund, usually pending anticipated drawdown requests or in advance of an acquisition.

The Fund will at all times monitor investments that are specifically reduced, low and zero carbon to ensure the Fund progresses towards the stated objectives of this strategy.

Within the context of achieving sustainable long-term returns, the Fund will always seek, as part of any reallocation of assets, to achieve a lower carbon footprint following the reallocation. Every new investment made will endeavour to be lower carbon than the one it is replacing.

The chart in Appendix C shows how the investment strategy has been implemented to date, with progressively greater proportions of the overall Fund invested in "greener" funds.

3. Investment strategy and the process for ensuring suitability of investments

The Fund's asset strategy, along with an overview of the role each asset plays is set out in the table below:

Asset class	Target Allocation %	Investment Style %	Maximum Allocation %	Role (s) within the strategy	Carbon Classification
Equity	50.0	Passive 35.0	60.0	Expected long term growth in capital and income in excess of inflation over the long term.	Low Carbon
		Active - Direct 10.0			Reduced Carbon
		Active – Indirect 5.0			Low Carbon
Multi-Asset Credit	10.0	Active 10.0	20.0	Diversified approach to fixed income investing which aims to deliver equity like returns over time with a lower level of risk.	Low Carbon
Index Linked Gilts	10.0	Passive 10.0	20.0	Low risk (relative to the liabilities) asset that provides inflation linked income and protection from falling interest rates.	Non-low Carbon
Property	20.0	Direct 14.0	30.0	Provides diversification from equities and fixed income.	Reduced Carbon
		Pooled Fund 6.0		Generates investment income and provides some inflation protection.	Reduced Carbon

Sustainable Infrastructure	5.0	Limited Partnership 5.0	10.0	Asset class provides additional diversification from traditional asset classes. Generates sustainable, reliable income with significant linkage to inflation. Provides risk mitigation from declining fossil fuel usage.	Zero Carbon
Bereavement Services	5.0	Limited partnership 5.0	10.0	ESG priority allocation. Focus on investments with strong ESG and, nparticular, low carbon credentials.	Low Carbon
Timberland					Zero Carbon
Private Equity					Reduced Carbon

The above table sets out the Fund's asset allocation strategy with a target allocation to each asset class. If the actual asset allocation as at a reporting quarter end moves outside a target range for a particular asset class, (plus or minus 5% of total investment assets) the Strategic Director of Finance and Governance will review the portfolio(s) and prevailing market conditions to determine if a corrective rebalancing action is required. A breach of the target range will not automatically trigger a portfolio rebalance.

Under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, the Fund is required to set maximum investment limits pertaining to different asset classes so that actual allocation to those asset classes will not breach this maximum limit. The limits as applied to the Fund are set out in the above table.

Appendix A shows the Fund's current investment manager appointments and mandates.

The Fund's asset allocation is reviewed on an ongoing basis and undergoes a triennial strategy review as part of the actuarial valuation process. The triennial review, which reflects updated actuarial and capital market assumptions, looks at both qualitative and quantitative analysis, covering:

- The required level of return that will mean the Fund is able to meet its future benefit obligations as they fall due.
- The level of risk that the Fund can tolerate in absolute terms, and in relation to its funding level and associated surplus/deficit.
- An analysis of the order of magnitude of the various risks facing the Fund, so that the Fund can focus upon the most significant risks.
- The desire for diversification across asset class, region, sector, and type of security.

4. Risk measurement and management

The risks inherent within the Fund are assessed both qualitatively and quantitatively as part of regular investment strategy reviews by the Strategic Director of Finance and Governance and the Pensions Advisory Panel. The Fund uses specialist external investment advisers under contract, to support these reviews and on an ongoing basis. The Fund highly values the use of specialist support in the management of performance and risk.

The table below, based on the 31 March 2022 Actuarial Valuation results and estimates, shows how a range of events could impact on the Fund:

Event	Event movement	Impact on the Fund
Fall in equity markets	25% fall in equities	£275m
Rise in inflation	1% increase in inflation	£413m
Fall in interest rates	1% fall in interest rates	£413m
Underperformance by the active managers	3% collective underperformance	£33m

The Fund's overall investment strategy is designed to mitigate much of the underlying risk through the holding of a variety of different, diverse asset classes (e.g. long term directly held property investments).

Equity risk

The largest asset risk to the Fund is in relation to its equity holdings. Should equity markets deteriorate significantly this will have a large negative impact on the Fund's assets. The Fund invests in equities in order to provide the necessary long term expected returns to help ensure that the Fund remains affordable. The Fund believes that the extra returns that are expected to be generated by equities compensate for the level of risk equities bring to the Fund. However,the Fund is aware of the need for diversification in growth assets, and the Fund's strategy reflects this via allocations to absolute return investment mandates (with an asymmetric profile)and property (with a lower correlation to equity).

Inflation

CPI inflation will increase the value of pension benefits accrued by active and deferred members of the Fund as well as increasing the value of pensions in payment. The Fund has an allocation to index linked gilts for explicit inflation protection and other investment assets, such as property and equities, in the expectation that these will achieve returns in excess of inflation over time.

Active manager risk

Active investment managers are appointed to manage a portion of the Fund's assets. This brings with it the risk of underperformance relative to the market but also brings the chance of additional returns and diversification. The additional risk is small relative to other risks. Extensive due diligence is undertaken before managers are selected and investment managers are also monitored regularly by Fund officers, the Pensions Advisory Panel, and by the Fund's investment advisors.

Liquidity risk

The Fund recognises that there is liquidity risk in holding assets that are not readily marketable and realisable. Given the long term investment horizon and the potential for an illiquidity premium in investment returns, the degree of liquidity risk within the portfolio is considered as acceptable. The Fund has a large allocation to property and is building an exposure to sustainable infrastructure, but the majority of the Fund's assets are realisable at short notice.

The table below sets out a summarised cash flow position of the Fund over the last five financial years.

	2017-18 £000	2018-19 £000	2019-20 £000	2020-21 £000	2021-22 £000
Contributions and Transfers In	54,711	58,891	65,787	69,712	71,270
Benefits and Transfers Out	-63,406	-71,384	-71,384	-67,580	-72,050
Investment Income	15,432	15,287	15,287	10,036	7,425
Net Position	6,737	2,794	9,690	12,168	6,645

The Fund is currently cash flow positive; in that the sum of contributions received and investment income is greater than the benefits paid out to pensioners. During 2021-22, the Fund received £6.6m more in contributions and investment income than was paid out in benefits. As such the Fund is not currently exposed to unplanned and inefficient divestment of assets.

As a result of the Fund's increased exposure to illiquid funds, there is an increased level of liquidity risk due to contractual obligations to meet capital drawdowns at the request of fund managers. The balance of unfunded commitments and available liquid assets is regularly monitored by officers of the fund to ensure a negative cash balance is avoided. This is continuously monitored in order to prevent the need for sale of assets in order to fund capital drawdowns.

Exchange rate risk

This risk arises from investing in unhedged overseas (non GBP denominated) assets, with all pension benefits due to be paid in sterling. As a long term investor the Fund takes the view that currency volatility can be tolerated. Sterling has for many years been a depreciating currency and the Fund has benefitted significantly in return terms from not hedging this risk. The Fund's portfolio is well diversified across asset classes, geography and investment managers.

Demographic risks

The Fund is subject to a range of demographic risks, but with particular importance to the investment strategy is the possibility of a maturing Fund membership profile. This would involve a change in the ratio between active members contributing into the Fund and pensioner members drawing pension benefits from the Fund. The more mature a pension fund, the more likely it is that disinvestments would need to be made to pay benefits. The Fund is not in that situation at present as income from contributions and investments is greater than benefit

payments. However, this situation is monitored regularly and formally as part of the actuarial valuation and strategy review.

Environmental, social and corporate governance policy

The Fund is a long term investor that aims to deliver a truly sustainable pension fund; ensuring that it is affordable, delivers financially to meet the objectives of the Fund employers, and is invested responsibly.

The fiduciary duty of the Fund is to act in the best long term interests of Fund members. To do so properly requires the Fund to recognise that environmental, social and governance issues can impact on the Fund's financial performance and that they should be taken into account in funding and investment strategies, and throughout the funding and investment decision making process.

The Fund will seek to incorporate ESG considerations at all stages in the investment process; from the overall asset allocation, to individual investment selections, and continued engagement and responsible stewardship of Fund assets.

The responsible investment objectives of the Fund are promoted through membership of the Local Authority Pension Fund Forum (LAPFF). As a LAPFF member the Fund allies itself with 83 other shareholders with combined assets of over £300 billion to influence key areas of responsible investment interest.

Fund engagement is crucial in relation to improving standards of corporate governance, which over the long term is expected to enhance investment returns. Details of the Fund's approach are set out in section 6 as well as the approach for the implementation of moving towards a zero carbon commitment as Appendix E.

The Fund's key responsible investment principles are set out below:

- Apply long term thinking to deliver long term sustainable returns.
- Seek sustainable returns from well governed and sustainable assets.
- Apply a robust approach to effective stewardship.
- Engagement through voting, meetings, and the LAPFF is a valuable tool to influence organisations in areas of responsible investment interest.
- Ensure that responsible investment is a core competency and skill to support decision making.
- Seek to innovate, demonstrate and promote responsible investment leadership and ESG best practice.
- Apply evidence based decision making in the implementation of responsible investment.
- Achieve improvements in ESG through effective partnerships with the London CIV and LAPFF.
- Share ideas and best practice to achieve wider and more valuable responsible investment outcomes.
- Be transparent and accountable in all Fund activities.
- Consider the costs of responsible investment decisions alongside fiduciary responsibilities.
- To continue with a structured, measured process of reducing with an aim of eliminating investments in fossil fuels.

Environmental, social and governance risks

The Fund may consider investments that have an explicit focus on delivering wider social and environmental impacts provided there is no risk of significant financial detriment to the Fund.

The Fund recognises the growing financial risks associated with investment in traditional energy sources and is fully committed to the achievement of carbon neutrality. The Fund commits to transferring any current investments in these traditional energy sources in a way that is both structured and affordable and also meets the Fund's fiduciary duties.

The Fund is committed to a process to achieve a neutral carbon footprint by 2030. This will be accomplished through a phased divestment and transfer of assets into reduced, low and zero carbon products.

Appendix E outlines the approach by which the Fund will achieve this objective, how the risks and other considerations associated with such a commitment will be managed and how the divestment will be incorporated into the asset allocation strategy for the Fund.

5. Approach to asset pooling

The Fund is a shareholder of the London Collective Investment Vehicle (CIV). The London CIV was created in 2015 and continues to progress the opening of a range of sub-funds for potential investment. As part of any future changes to investment strategy, the Fund will look first to the availability of appropriate investment products within the London CIV.

The transition of any assets into the pool will follow the normal due diligence process with consideration of: transition costs, fit with overall strategy, fees (direct and indirect), reporting arrangements, ESG requirements and, most importantly, expectations for future performance.

The Fund currently pays a contribution to London CIV for passive investments. This amounts to approximately £50,000 per annum. This fee arose from collective fee arrangements with the CIV, although these are not assets under management of the London CIV (value as at 31 March 2022 £0.9 billion, approximately 42.5% of the Fund).

The Fund has a target allocation of 20% of the assets to illiquid property and the cost of exiting these strategies early in favour of a CIV alternative would have a significant negative financial impact on the Fund.

6. Policy of the exercise of rights (including voting rights) attaching to investments

The Fund follows the principles of the UK Stewardship Code and exercises the voting rights attached to its investments wherever it is possible and cost effective to do so.

The aim is to promote and support good corporate governance principles and best practice. Voting rights should be exercised in accordance with the best financial interests of both the beneficiaries and contributors to the Fund. Environmental, social and ethical considerations may be taken into account when exercising votes where this acts in these parties' best interests.

Fund managers have been instructed to vote in accordance with their house policies and practices, whilst also taking into account the Combined Code on Corporate Governance.

Where practical, managers should vote in line with the council's priority themes.

Fund managers report in advance of all voting rights they intend to exercise on behalf of the Fund. They provide details of their house view and on how they intend to vote. They ensure that this is consistent with the council's key themes and also with the LAPFF principles.
Fund managers' views are compared with the voting recommendations of LAPFF. Where the fund managers' house views are not consistent with those of LAPFF, the fund manager is instructed by the Fund to vote in line with the recommendations of the LAPFF.

Fund managers provide a quarterly report on corporate governance activity. This lists all votes which have been exercised and all engagement with companies which has taken place. It allows for checks to be carried out in order to ensure all the Fund's voting rights have been exercised in accordance with policy

Myners Principles

The Government introduced a code in October 2001 based on the results of HM Treasury's review of institutional investment in the UK, carried out by Paul Myners. This code set out ten principles that were intended to improve the investment management of pension funds. These were updated in October 2008 and previously LGPS administering authorities were required to prepare, publish and maintain statements of compliance against a set of six principles within the Statement of Investment Principles. Although not specifically required by the Regulations the Fund sees the Myners Principles as a relevant governance tool and will continue to report on compliance.

The Fund is fully compliant with the six principles and Appendix D sets out the compliance statement.

Advice Taken

In creating this statement, the Fund has taken advice from its investment consultant, independent adviser and has sought the views of the Local Pension Board. Also, in relation to each of the constituent parts, such as the asset allocation and risk mitigation, advice has been taken from its investment consultant and scheme actuary Aon.

Appendix A – Current investment managers and mandates.

Manager	Mandate	Benchmark	Benchmark Weight (%)	Outperformance target (% p.a.)	Carbon Classification
BlackRock	Low carbon passive Global Equities	MSCI World Low Carbon Target Reduced Fossil Fuel Select Net Index	17.5	-	Low Carbon
BlackRock	Index Linked Gilts	FTSE UK Gilts Index-Linked over 5 Years Index	5.0	-	Non low carbon
BlackRock	Dynamic Diversified Growth Fund	3M SONIA	10.0	+3.0% net of fees	Non low carbon
BlackRock	Absolute Return Bonds	3M SONIA	-	+4.0% net of fees	Non low carbon
BlackRock	Sustainable Infrastructure	10% p.a. absolute return	1.5	-	Zero carbon
Legal & General	Low carbon passive Global Equities	MSCI World Low Carbon Target	8.5	-	Low carbon
Legal & General	Low carbon passive Global Equities	Low Carbon Transition Fund	9.0	-	Low Carbon
Legal & General	Index Linked Gilts	FTSE Index-Linked Over 5 Years	5.0	-	Non low carbon
Newton	Global Equity	FTSE All World	10.0	+3.0% net of fees	Reduced carbon
Comgest	Active Emerging Market Equities	MSCI Emerging Markets – Net Return	5.0	-	Low carbon
Nuveen	Core Property	7.0% p.a. absolute return	14.0		Reduced carbon
Frogmore	Opportunistic Property	16.5% p.a. absolute return	1.5	-	Reduced carbon

Brockton	Opportunistic Property	15.0% p.a. absolute return	1.5	-	Reduced carbon
Invesco	PRS Property	8.5% p.a. absolute return	1.5	-	Reduced carbon
M&G	PRS Property	8.0% p.a. absolute return	1.5	-	Reduced carbon
Glennmont	Sustainable Infrastructure	10% p.a. absolute return	2.0	-	Zero carbon
Temporis	Sustainable Infrastructure	10% p.a. absolute return	1.5	-	Zero carbon
Temporis	Sustainable Infrastructure	11-12% p.a. absolute return	1.0	-	Zero carbon
Temporis	Sustainable Infrastructure	7% p.a. absolute return	-	-	Zero carbon
Blackstone	Private Equity	12-14% p.a. absolute return	2.5	-	Reduced carbon
Darwin	Bereavement Services	6-8% p.a. absolute return	1.0	-	Reduced carbon
BTG Pactual	Timberland	12-14% p.a. absolute return	1.5	-	Zero carbon

Appendix B – Framework for new illiquid investments

This section outlines the Fund's framework for making investments in illiquid investments. Examples of illiquid investments include property, infrastructure, renewables, private equity, and any other alternative assets within the investment universe. Any potential investment opportunity should be assessed against the following criteria:

1) Return
   - The investment should aim to generate an expected return that contributes to an overall return of at least 8% of the illiquid portfolio.
   - This should be supported by independent analysis and monitored on a regular basis ex-post an investment is made.

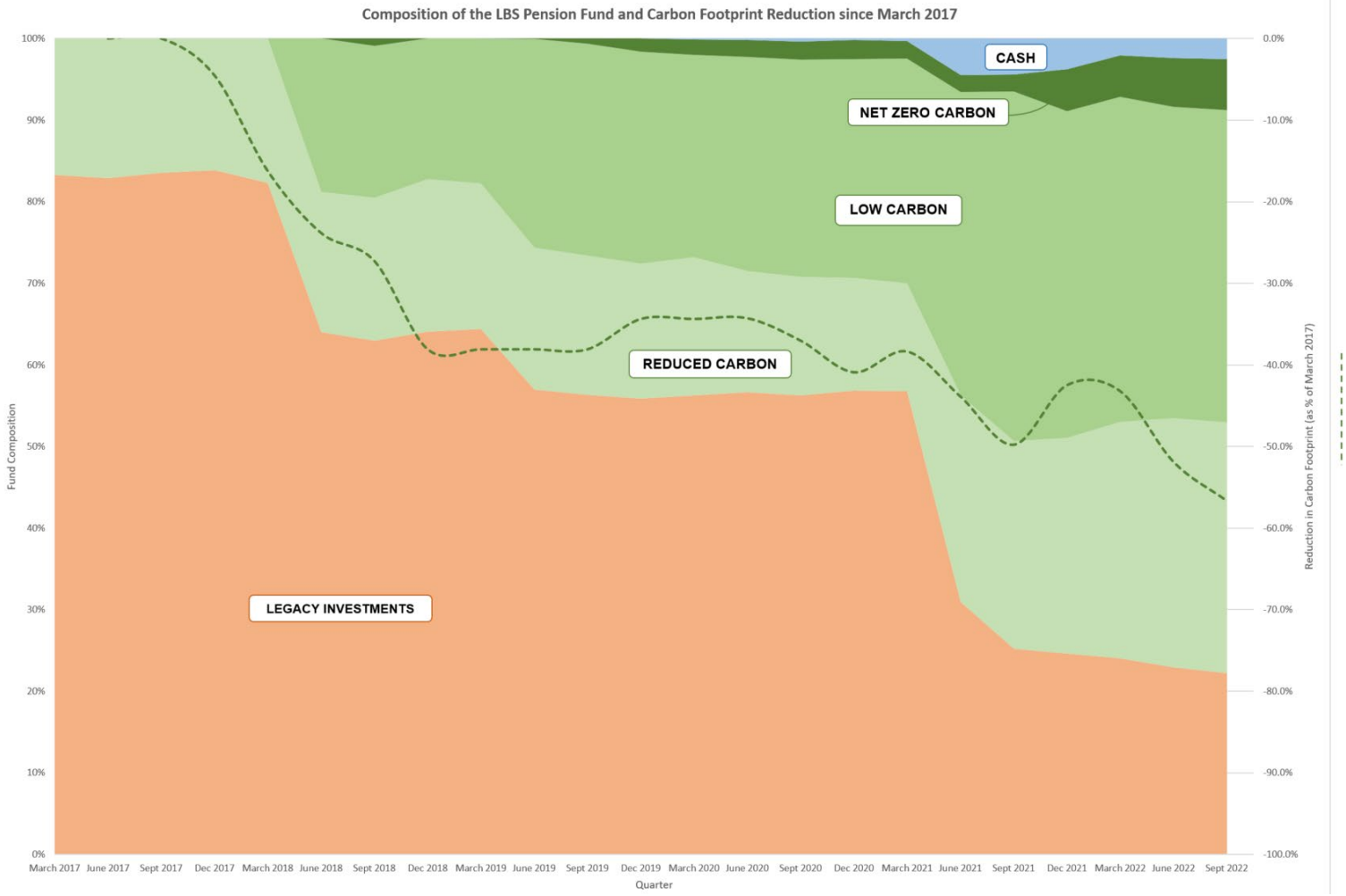
2) Risk
   - Concentration of the portfolio (the Fund should seek to make investments in such a way that does not expose the portfolio to manager, asset class, sector or geographical concentration and the risks that they bring).
   - Volatility of returns (tracking error) should be in line with or lower than the wider equity market. This should be supported by independent analysis and monitored on a regular basis ex-post an investment is made.
   - Wider risks such as political/reputational risk should be considered when looking at specific underlying investments.

3) A move to any new investment must demonstrate evidence that the new one will be lower in carbon than the legacy investment holding it is replacing. Managers must be able to provide evidence to confirm this.

4) Seek opportunities where possible to obtain new mandates with existing fund managers.

5) Consideration of the fees imposed by the manager on the Fund and whether this is justified.

Appendix C – Carbon Profile Allocation over Time



Appendix D

Myners Principles – Assessment of Compliance

1. Effective Decision-Making

Principle

Administering authorities should ensure that:

- Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and

- Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive and manage conflicts of interest.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The Pensions Advisory Panel is supported by suitably qualified officers and external advisors. All members of the Panel are offered training on appropriate topics.

2. Clear Objectives

Principle

An overall investment objective(s) should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers and the attitude to risk of both the administering authority and scheme employers and these should be clearly communicated to advisors and investment managers.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The Fund's objectives are set out in the Investment Strategy Statement and the Funding Strategy Statement. The objective, benchmark and risk parameters are clearly stated in the Investment Management Agreements with each investment manager.

- Covenants of all scheme employers are reviewed on an ongoing basis.

3. Risk and Liabilities

Principle

- In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.

- These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The asset allocation strategy is reviewed every three years. Aon is commissioned to carry out an asset liability study which models the risk/reward characteristics of different investment strategies.

- The study follows the triennial actuarial valuation and the form and structure of liabilities are fully taken into account.

4. Performance Assessment

Principle

- Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors.

- Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision making body and report on this to scheme members.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The Pensions Advisory Panel monitors the performance of the investment managers and the suitability of the investment strategy on a regular basis.

- Performance measurement is provided by JP Morgan and Aon.

- Assessment of the effectiveness of the administering authority is reflected through the effectiveness of the decision making in the investment returns achieved. Further, with the establishment of the Local Pensions Board, scrutiny of the Pensions Advisory Panel is now being undertaken.

- A procurement exercise was carried out in 2020-21 which resulted in the appointment of Aon as the fund's investment advisors. They were appointed through the National

LGPS Frameworks and as such are subject to ongoing review at the framework level. Feedback is provided to the framework on an annual basis.

5. Responsible Ownership

Principle

Administering authorities should:

- Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.
- Include a statement of their policy on responsible ownership in the statement of investment principles.
- Report periodically to scheme members on the discharge of such responsibilities.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The Fund has adopted the investment managers' policies on activism and each has adopted the Institutional Shareholders' Committee Statement of Principles. All investment managers adopt a policy of engagement with companies.
- The Fund's policy on responsible ownership is set out in its Investment Strategy Statement.
- Investment managers report on the exercise of voting rights and this is monitored by officers and the Pensions Advisory Panel to ensure consistency with the Fund's policy.
- The pension fund is a member of the LAPFF, the UK's leading collaborative shareholder engagement group.
- Responsible ownership is periodically reported to the Pensions Advisory Panel and states how active fund managers are discharging these responsibilities.
- A section on responsible ownership is included in the Pension Fund Annual Report and a member survey has been completed. These ensure that members are both provided with the relevant information and are able to input their views into the responsible ownership process going forward.

6. Transparency and Reporting

Principle

Administering authorities should:

- Act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives.

- Provide regular communication to scheme members in the form they consider most appropriate.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- Documents relating to the Pension Fund are published on the pension fund website.

- The annual report sets out the arrangements during the year for the management of investment, governance and risks and other relevant information.

- Members can also request information directly from the council.

- The Pension Advisory Panel meeting papers are published on the council's website.

Investment Strategy Statement: Appendix E

Southwark Pension Fund Investment Strategy to Achieve Net Zero Carbon Exposure by 2030

Introduction

The London Borough of Southwark Pension Fund is an open, defined-benefit pension fund as part of the national Local Government Pension Scheme. The nature of the Fund and scheme design means that payment of pensions will extend over the very long term.

In setting the investment strategy, the Fund seeks to balance twin objectives: first, to achieve sufficient long-term returns for the Fund to be affordable and second, to keep the employer contribution rate as stable as possible. These objectives must now be considered in the context of the global climate emergency and the need to reduce exposure to carbon investments, a key thrust to this strategy.

In this respect, the Fund seeks to operate a long term, sustainable strategy; one which does not rely upon the pursuit of short term returns but utilises a well-structured asset and fund manager investment allocation to target long term socially responsible, sustainable investment performance. The Fund avoids unnecessary complexity within its investment structure, appointing best in class managers within an asset class to achieve the strategic asset allocation. Having stronger relationships with a smaller number of managers provides significant flexibility and adaptability if required, but this will be challenged as the fund strives to reduce exposure to fossil fuels.

To achieve the twin objectives while reducing carbon exposure, the Fund needs to invest in a diverse range of assets, which provide higher returns relative to the growth of pension liabilities whilst taking account of the volatility inherent in investment markets. This will require additional resources, support and advice in order to deliver the positive outcomes being targeted. It will also require increasingly sophisticated management reporting for control and monitoring of performance.

As a long-term investor, with significant investment assets and pension liabilities the Fund must be comprehensive in the consideration and mitigation of risks that the portfolio faces. The Fund will base assessments of risk on future pension liabilities and contributions, will consider financial and non-financial risks, diversify investment assets in an appropriate manner, but also recognise the limits of that diversification.

The Net Zero Challenge

A developing risk to investment and to the Southwark fund is from exposure to fossil fuels. Extraction and combustion of fossil fuels generate significant carbon dioxide (CO_2) output. There is a growing scientific consensus[1] that continued CO_2 production will have a detrimental impact upon the earth's climate.

The Fund, through its diversified portfolio of investments, is exposed to assets where a portion of the market value is derived from current or future extraction and production of fossil fuels. Global and local regulatory restrictions on fossil fuel extraction and usage, in addition to changing consumer trends, may degrade the viability of fossil fuel extraction and usage. The value of investments in companies that derive much of their revenue or value from these resources would be at risk.

Recent Background

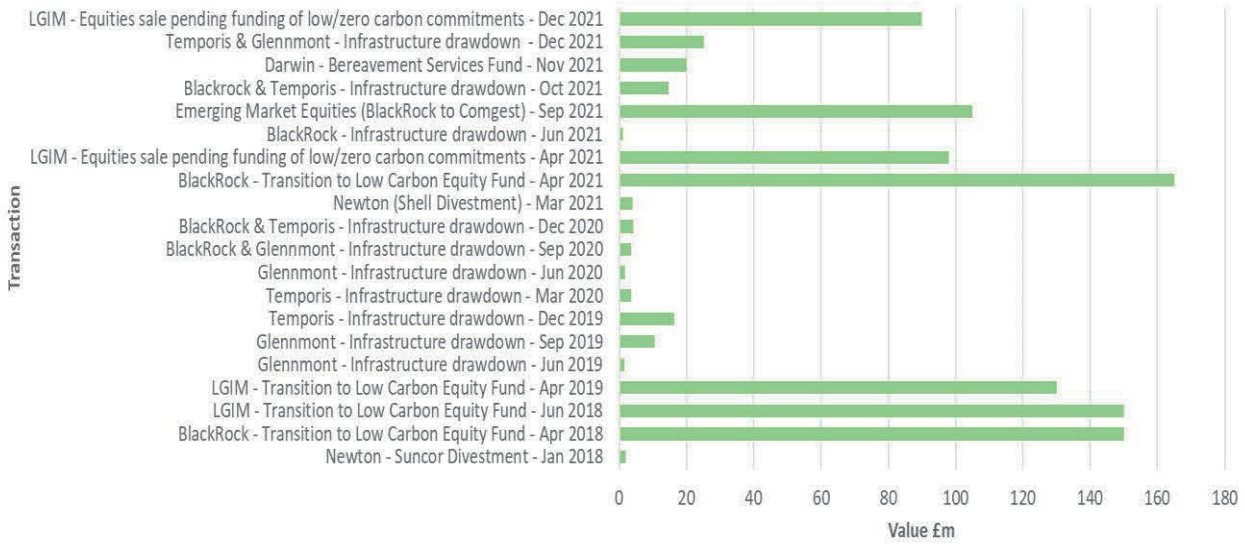
On 13 December 2016, after due consideration of the long term risk to the Fund; the Fund announced that investments in fossil fuel companies would be cut over the long term. This commitment was incorporated into the Investment Strategy Statement for the Fund published in March 2017 and updated in December 2021. Southwark is one of the first LGPS Funds to

[1] IPCC report, 'code red' for human driven global heating, warns UN chief / / UN News

make such a commitment and places the Fund at the forefront of sustainable fossil fuel aware investment.

The Fund recognises the growing financial risks associated with investment in traditional energy sources and is fully committed to transferring any current investments in these traditional energy sources in a way that is both structured and affordable and also meets the Fund's fiduciary duties.

The previous investment strategy committed to a reduction in exposure to fossil fuel generated significant CO_2 output. It was adopted in 2017 and has acted to counteract the risk to the Fund of investment exposure to fossil fuels, in line with other Fund responsibilities. In the period between 2017 and the adoption of the new strategy, the Fund's carbon exposure has reduced by 50%. When the previous strategy was agreed we set out a short, medium and long-term plan. Over the last four years significant progress has been made in transitioning investments exposed to fossil fuels to products with lower carbon exposure, as set out in the chart below:



Progress by Asset Class

The availability of suitable investment products, which meet the Fund's requirements, has influenced progress made within each asset class the Fund is invested in. This can be demonstrated by the fact that 100% of the Fund's holdings in equities had been transferred to low or reduced carbon investments by September 2021. In comparison, the Fund's defensive allocation, (15%) which includes investments in absolute return bonds and index linked gilts, remains in non-low carbon investments due to the lack of availability of suitable replacements. The progress to date by asset class is set out in detail below.

Equities

The Fund's holdings in passive developed market equities have been transitioned to passive low carbon equity funds. Emerging market passive equities have been switched to a new emerging market active equity strategic asset allocation. Investment has been made in the Comgest Global Emerging Markets Plus Fund, which demonstrates strong ESG credentials whilst maintaining performance targets. The Fund's active equities portfolio has divested from

fossil fuel investments and a restriction has been placed on the portfolio preventing further investments in these companies or their industry peers.

The above changes have resulted in the Fund's 45% strategic allocation to equities now being entirely in low or reduced carbon holdings, whilst maintaining exposure to this asset class in a manner that continues to achieve the required level of risk and return.

New ESG Priority Allocation

A strategic allocation of 5% to alternative investments has been agreed. This allocation has both low carbon and strong ESG credentials. Commitments to three new investments have been approved within this allocation, with the majority expected to be invested by the end of March 2022. Commitments have been made with Blackstone Capital Holdings (private equity); Darwin Alternative Investment Management (bereavement services); and BTG Pactual Timberland Investment Group.

New Allocation to Sustainable Infrastructure

Following the agreement to allocate 5% of the Fund to this asset class, commitments have been made to investments in four funds that specifically include investments in solar and wind power technologies identified by the fund managers.

Measurement of Progress

During this time, it has been possible to test performance against our commitment through the use of carbon foot printing. We have developed our approach and made ongoing improvements. Further work is required as the market develops and there are improvements in the availability and accuracy of the measurement of carbon intensity data.

The Fund has increased in value from £1.5bn in September 2017 to over £1.9bn in March 2021. Performance has remained strong in the short to medium term with returns at March 2021 as follows: 1 year 24.4%, 3 years 9.6%, and 5 years 10.4%. The one-year return out-performed the average local authority return of 22.8% and the Fund has achieved top quartile performance in the longer term when compared to other local authorities.

These strong performance results give confidence in moving forward with a more definite plan to take the Fund to 2030. The Fund has reduced its carbon footprint by 50% during this time whilst maintaining investment performance. Looking forward there remains a conviction that strong investment performance can be delivered alongside reducing carbon exposure, and it is appropriate to move to the next stage of making further progress towards a net zero carbon commitment by 2030.

This document outlines how the Fund will approach this divestment, how the risks and other considerations associated with such a commitment will be managed and how the divestment will be incorporated into the asset allocation strategy for the Fund.

Transition to Net Zero Carbon Principles:

The overall approach of the Fund to incorporating wider environmental, social and governance issues (ESG) is set out in more detail within the Investment Strategy Statement.

This applies throughout the investment process from the initial investment to ongoing engagement and responsible stewardship of Fund assets.

This document will specifically address the Fund's principles for the transition to net zero carbon: The four key principles for divestment are set out below:

- Climate related risks and opportunities will be incorporated into the overall asset allocation strategy
- The commitment to reduction in fossil fuel investment is more than a long-term risk mitigation strategy.
- Divestment is not risk free.
- Engagement and local authority partnerships - LCIV

Principle 1: Incorporation into asset allocation strategy

The primary purpose of the Fund is to meet the pension benefits for the members of the Fund. Every three years the Fund undergoes an actuarial valuation, which estimates the value of pensions due to be paid to members. The result of which allows the Fund to review the asset and investment strategy in order to establish the most appropriate mix of assets to best achieve the required level of net of fees investment return on an appropriate risk adjusted basis, whilst ensuring diversity of assets, sufficient liquidity and appropriate governance of the investments.

The Fund will seek to fully integrate fossil fuel risk and opportunities into the investment strategy review process, from overarching asset allocation to individual investment choices. All investments will be considered through the lens of fossil fuel risk, but that any investment cannot be separated from the overall investment objectives for the Fund and must be subject to a full business case in consideration of the overall portfolio as well as fees and transition costs.

Principle 2: More than a long-term risk mitigation strategy

The Fund has a fiduciary duty to all the employers within the Fund and to the scheme members, and as such must manage the investment assets effectively with an investment time horizon in line with the liabilities for the Fund and have due regard to the investment risk inherent within the portfolio.

The Fund recognises the risk that fossil fuel investment places upon the Fund for future investment and as such, this document largely involves the desire to mitigate risk.

However, purely focusing upon those investments that are negatively exposed to the decline in profitability and viability of fossil fuel extraction and usage excludes a key consideration forthe Fund; identifying those investments that are positioned to gain from such a transition.

The Fund therefore will proactively seek to identify suitable investments that fit within the overall asset allocation strategy and will be the beneficiaries from a low carbon regulatory and investment environment. The Fund will target both a downside risk mitigation strategy and a desire to invest in positive ‘green’ focused assets.

Principle 3: Divestment is not risk free – Potential for negative implications

It is imperative that, as set out in Principle 2, the Fund must seek to incorporate fossil fuel considerations into the overarching investment strategy rather than seeking to separately implement fossil fuel risk mitigation approaches.

The Fund has long held a large portion of equity investments as passive (investments that are held in the same proportion as that of the market as a whole) with a current target allocation of 30%. This approach acknowledges the challenges and typically higher costs involved in seeking to predict future investment winners and losers. The inclusion of a fossil fuel risk mitigation strategy within this leads to a risk that in the short term the Fund may be negatively exposed to overall market returns if fossil fuel based investments outperform the wider market. Global usage of fossil fuels is still predicted to comprise a significant portion of global energy

usage in years to come and as such, the Fund must be cognisant of the potential investment returns forgone should fossil fuel usage decline at a rate slower than the market has priced in.

There are additional management expenses within equity investment mandates that have some element of fossil fuel exclusion. As such the Fund must be confident that the additional risk from holding a portion of the Fund that is exposed to fossil fuels must be considered to be greater than the additional burden of higher management fees and any associated costs of transitioning assets from one mandate to another. The Fund works with its advisers and asset managers to ensure that there is no expected financial detriment associated with asset allocation shifts made to low carbon alternatives.

The measurement and assessment of which investments are most exposed to fossil fuels is not straightforward. Some companies may hold fossil fuel reserves or operations which are more damaging to the environment as a result of greater CO_2 output but that might be paradoxically less exposed to changing regulatory environment due to lower extraction costs. Companies not directly involved in the production or extraction of fossil fuel may derive significant portions of their revenue from fossil fuel companies. The Fund must ensure that any assessment of exposure to fossil fuels risk is sophisticated, and that investments are not distorted by inaccurate data.

Principle 4: Engagement and Local Authority Partnerships - LCIV

There is growing appreciation of the growing risks and opportunities that pension funds face from the transition away from traditional fossil fuel usage, including among Local Government Pension Funds. Where appropriate, it is important that the Fund works with other Local Authority partners to share knowledge and best practice as well as utilising collective assets to push for the most effective and efficient implementation of reduced fossil fuel strategies.

The Fund will work with local authority partners as well as the LCIV, the pooled investment vehicle of which the Fund is a shareholder and active supporter, in the application of this commitment. The Fund will also seek to be an active voice in the investment community for the advancement of investment outside of fossil fuels.

Timeline:

The Fund's implementation period to achieve net zero carbon is split into three main time horizons, encompassing short, medium and long-term objectives.

- The short term: one-four years (2022-2026)
- The medium term: five-seven years (2027-2029)
- The long term: year eight (2030)

Given the difficulty in predicting the global investment and technological environment in addition to Fund specific liability and investment requirements, longer-term periods will likely be subject to significant variability and uncertainty.

Short Term – From 2022 to 2026

Triennial Actuarial Valuation and Investment Strategy Review

- The short term will incorporate the results of the 2022 and 2025 triennial actuarial valuations. The Fund will publish the results of the 2022 actuarial valuation in March 2023, the results of which will be the foundation for the subsequent investment strategy review. The asset allocation review aims to ensure that the current investment allocation is appropriate to meet the required investment return to fund future pensions within a suitable risk profile. Where investment underperformance is identified or risk profile changes, either across an asset class or manager specific, any subsequent reallocation will be considered with regard to overall fossil fuel exposure.

Local Authority Collaboration and Pooling

- It is important that the Fund works together with other likeminded local authority partners, in order to develop suitable fossil fuel reduction opportunities. Collaboration will also seek to mitigate some of the fee and transition cost implications of changing investment allocation.
- The Fund will engage with the LCIV through representation by officers and members on key LCIV governance panels to push for the availability of reduced fossil fuel investment mandates within the LCIV.

Fund Managers

- Re-allocation of investments from opportunistic property as these funds reach the end of their life cycles.
- Initial review of direct property holdings, with any necessary action being taken in the medium term.
- Low carbon passive equity investments will be moved to zero carbon alternatives, subject to the availability of products. The transition of these assets will take place in a phased manner with up to 50% being transferred in the short term and the remainder in the medium term once performance of these new investments has been reviewed.
- Active equity mandate to be assessed against zero carbon target and if not achieved move to new zero carbon mandate.
- Seek alternatives to replace the holdings in the defensive allocation which currently includes index linked gilts and absolute return bonds. Replacements will be required to either be low or zero carbon, whilst providing an equivalent level of risk and serving the same purpose within the asset allocation. It is recognised that if suitable products are not available in the short term, further review of this allocation may be required in the medium to long term.
- Initial review of the Fund's diversified growth holding in terms of its continuing suitability within the strategic asset allocation, whilst also identifying suitable low or zero carbon replacements.
- Review performance of holding in the Comgest Global Emerging Markets Plus Fund in terms of both performance against benchmark and carbon emissions.

- Consolidate new mandates allocated in 2021-22. (These include Comgest Global Emerging Markets Plus Fund, Blackstone Strategic Capital Holdings II, Temporis Impact V Fund, Darwin Bereavement Services Fund; and BTG Pactual Timberland Fund).
- Assess carbon objectives in the context of the results of the 2022 and 2025 triennial actuarial valuations.
- The Fund will use this period to identify developments in low and zero carbon equity investments being brought to the market and the opportunities they present to the Fund in its journey to achieving net zero carbon.
- A formal update and refresh of the investment strategy will take place in 2026.

General

- The Fund will continue to develop and improve its approach to the measurement of its carbon footprint to ensure it is kept current and accurate. This will be a key metric in monitoring progress towards achieving net zero carbon. We will work with fund managers and data providers to establish actual data which will replace proxies. All new investment products that the Fund invests in will be required to provide the Fund with regular data on their carbon intensity.
- Develop enhanced carbon measurement for property investments and review the management and monitoring of carbon in the property allocation.
- The Fund will lobby the fund management industry for the introduction of new products that meet our objectives.
- The Fund will continue to support the work of the Local Authority Pension Fund Forum (LAPFF) as representing 90 local authority pension funds in their engagement with companies to promote best practice climate aware business activities
- Any changes to investment allocations will need to be communicated with key advisers, such as the Fund actuary, as well as the Fund's external auditors.
- The Fund will engage with the investment advisers who support the Fund in monitoring and engaging with buy-rated investment strategies held outside of the LCIV.

Medium Term – From 2027 to 2029

Triennial Actuarial Valuation and Investment Strategy Review

- The medium term will incorporate the results of the 2028 triennial actuarial valuation and will constitute a key point for major review of assets and investments to ensure that these are best placed to meet the payment of benefits to members of the scheme. Fossil fuel risks and opportunities will be incorporated in the consideration for any amendments to the asset allocation strategy.
- The carbon footprint will be re-calculated quarterly and incorporated into the overall portfolio risk assessment.

Local Authority Collaboration and Pooling

- The Fund is committed to working with the LCIV and will seek to comply with the government requirements for pooled investments. The Fund will continue to seek to exert influence over the strategic direction of the available investments within the LCIV, alongside other local authority partners, to ensure that these are appropriate for the sustainable strategy that the Fund wishes to implement. The opportunity for reduced fossil fuel or sustainable investment in multi asset mandates will likely develop as part of continued engagement between the Fund and other likeminded members of the LCIV.

Fund Managers

- Continued engagement with fund managers to ensure that fossil fuel risks and opportunities are consistently and appropriately taken into consideration throughout the decision making process.
- Review of private residential holdings within the Fund in terms of their continuing suitability within the investment strategy and their contribution to the Fund's zero carbon targets.
- Review of direct property investments to seek zero carbon options. This will be subject to availability of zero carbon investments in the commercial property sector and also the satisfactory performance of markets to avoid crystallisation of losses, thereby protecting the value of the Fund. If it is not possible to achieve zero carbon within this asset class suitable alternative asset classes, which meetthe Fund's strategic requirements, will be identified as a replacement.
- Balance of low carbon passive equities will be moved to zero carbon equivalents. This will be subject to satisfactory performance of assets transferred in the short term and the availability of suitable investment products in this asset class.
- Complete the migration of the current diversified growth, index linked gilts and absolute return bond holdings into reduced and zero carbon products.
- Further review of holding in the Comgest Emerging Markets Plus Fund, with action being taken if investment performance or zero carbon targets are not being achieved.

- Formal review of the performance of the zero carbon sustainable infrastructure investments and maintenance of the pipeline of commitments to maintain the strategic allocation to this asset class. Make adjustments to holdings in this asset class if necessary.
- Review the performance and carbon emissions of the reduced carbon private equity holding with Blackstone. Make adjustments if required, subject to the availability of alternatives.
- Review the holding in the Darwin Bereavement Services Fund and consider suitable replacements if performance and carbon targets are not being achieved.

General

- The Fund will continue a policy of engaging with companies through membership of the LAPFF and the LCIV to encourage companies to adopt the highest of standards with regard to fossil fuels and energy efficiency.
- The measurement of the Fund's carbon footprint will include advanced metrics which will measure progress towards the Fund's net zero carbon targets. The use of scenario analysis will facilitate the Fund to understand where it could be by 2030 based on its current investment strategy, planned changes, and alternative investment strategies and asset allocations. This will enable action to be taken in the medium to long term, to identify holdings which cannot continue to be held in the strategic asset allocation, ensuring that the 2030 target is achieved. An assessment of the Fund's alignment with the Paris Agreement will be conducted providing temperature scores of the portfolio. This will also provide useful information for decision-making.
- The Fund will continue to lobby the fund management industry to encourage the development of new zero carbon investment products.
- A survey of scheme members will be conducted which will include scheme governance, administration and investments. The results will be considered when assessing actions to be taken over the long term.

<u>Long Term: 2030</u>

Triennial Actuarial Valuation and Investment Strategy Review

- The Fund will continue to assess the overall investment strategy as required to meet the pension benefits for members. As and when asset and manager allocations require amending, the risk of fossil fuel exposure will be incorporated into any due diligence regarding risk and reward decision making.

Local Authority Collaboration and Pooling

- In the long term, the Fund may be required to invest the majority of its assets through the LCIV, depending on government requirements for pooling of assets. The availability of suitable opportunities within the LCIV will be key for the continued reduction in fossil fuel investments as well as positioning the Fund to benefit from clean technology and low carbon industries. This will allow the Fund to invest across a variety of disparate asset classes without compromising the ambition to be a long-term sustainable investor.

Fund Managers

- All investments in the Fund will be reviewed to identify any remaining allocations which are not at least low carbon, with the majority now being zero or negative carbon. Investments that do not meet this criterion will be transitioned to suitable alternative products. As with the short and medium term, this will be subject to the ongoing availability of investment products that meet the Fund's risk and return requirements.
- Final tuning to complete carbon neutral objectives.
- Final application of negative carbon offsets from the Fund's sustainable infrastructure holdings.
- Review carbon emissions performance of private equity holding.
- The activity required at this stage will depend on progress made in earlier years towards ensuring the majority of the Fund's investments are, as a minimum, low carbon.

General

- The Fund will have fully incorporated fossil fuel risk, through regular and sophisticated monitoring and portfolio analysis into the investment decision-making process. Carbon reduction targets as part of the overall portfolio will play a key role in achieving the net zero carbon target by 2030.