# *LONDON BOROUGH OF HARROW PENSION FUND*

# *STATEMENT OF INVESTMENT PRINCIPLES*

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## Introduction

1.1 This is the Statement of Investment Principles (SIP) adopted by Harrow Council (the Council) in relation to the investment of assets of the Council's Pension Fund (the Fund). The Council is the Administering Authority of the Fund and, in that role it has responsibility to ensure the proper management of the Fund.

1.2 This SIP meets the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ("The Regulations") and has been prepared after taking appropriate advice.

1.3 The Council, as Administering Authority, decides on the investment policies most suitable to meet the liabilities of the Pension Fund and has ultimate responsibility for investment strategy. These powers are exercised on its behalf by the Council's Pension Fund Committee. The Committee monitors investments, including manager performance, on a quarterly basis. Advice is received as required from the officers, the professional investment adviser and the independent advisers. In addition, the Committee requires managers periodically to attend its meetings. The Committee is responsible for monitoring compliance with guidance given by the Secretary of State for Communities and Local Government.

1.4 The Council has delegated the management of the Fund's investments to professional investment managers, appointed in accordance with the Local Government Pension Scheme (LGPS) regulations, whose activities are specified in either detailed investment management agreements or subscription agreements and regularly monitored. The Committee is satisfied that the appointed fund managers have sufficient expertise and experience to carry out their role

1.5 The Statement is subject to review from time to time and, certainly, within six months of any material change in investment policy or other matters as required by law.

## Fund Objectives

2.1 The LGPS is established by statute. The Pension Fund is a legally distinct account with contributions made by employees (fixed percentage of earnings) and employers. The primary objective of the Fund is to optimise performance within risk parameters thereby minimising the level of employer contributions in order to meet the cost of pension benefits as required by statute.

2.2 A related objective is to minimise the volatility of employer contribution rates as investment returns vary from year to year.

## Investment Objectives

3.1 The investment objective of the Fund is to achieve a return that is sufficient to meet the funding objectives as set out above, subject to an appropriate level of risk (implicit in the target) and liquidity. Over the long-term, it is expected that the Fund's investment returns will be at least in line with the assumptions underlying the actuarial valuation.

**Investment style**

4.1 It is the Council's current policy that external fund managers are employed to administer the Fund's assets. The current structure, as set out in the table below, was agreed in principle in November 2013 and is being implemented during 2014-15. The majority of the Fund is invested in "growth assets" i.e. those expected to generate 'excess' returns over the long term. These include equities, and private equity. The structure also includes a small allocation to "cash flow matching" assets, mainly corporate bonds. Additionally, the investments in property and diversified growth funds provide both diversification and expected returns in excess of liabilities.

**The table below shows the asset allocation structure.**

| ASSET CLASS | MANAGEMENT APPROACH | ALLOCATION | RANGE |
|---|---|---|---|
| | | % | % |
| **Equities** | | | |
| Global | Passive | 31.0 | |
| Global | Active Unconstrained | 20.7 | |
| Emerging Markets | Active Unconstrained | 10.3 | |
| **TOTAL** | | 62.0 | 58-68 |
| **Bonds** | | | |
| Corporate | Active | 10.4 | |
| Index-linked gilts | Active | 2.6 | |
| **TOTAL** | | 13.0 | 11-15 |
| **Alternative Investments** | | | |
| Diversified Growth Funds | Active | 10.0 | |
| **TOTAL** | | 10.0 | 8-12 |
| **Property** | Active | 10.0 | 8-12 |
| **Private Equity** | Active | 5.0 | 4-6 |
| **TOTAL** | | 100.0 | |

4.2 The above allocations, ranges and the management structure comply with the limits set out in The Regulations with the exception that the limit on single insurance contracts has been increased from 25% to the upper limit of 35% to permit investment, prior to the re-structure being completed in a passive UK equities portfolio. This decision will apply until the completion of the re-structure. The decision to increase the limit complies with The Regulations.

4.3 The investment style is to appoint fund managers with clear performance benchmarks and place maximum accountability for performance against that benchmark with them. Multiple fund managers are appointed to give diversification of investment style and spread of risk. The fund managers appointed are mainly remunerated through fees based on the value of assets under management. Private equity managers are remunerated through fees based on commitments and also performance related fees.

4.4 The investment strategy is reviewed periodically.

4.5 Cash balances are held in either or both of the two Pension Fund bank accounts, current and call account.

4.6 Actual asset allocations are monitored against the above structure and rebalanced as appropriate. The Section 151 officer has delegated authority to undertake a quarterly rebalancing of the equity and bond portfolios should they breach the above ranges. Any rebalancing activity authorised by the Section 151 officer will be reported to the next meeting of the Pension Fund Committee. Rebalancing within the bond portfolio is delegated to the fund manager.

4.7 Where appropriate, custodians are appointed to provide trade settlement and processing and related services. Where investments are held through funds, the fund appoints its own custodian.

4.8 Stock lending is permitted in pooled funds where applicable. Details of investment managers' procedures and controls are available on request.

**Performance**

5.1 Performance targets are set on a three-year rolling basis in relation to the benchmark. The investment managers' performance is reviewed at quarterly and annual intervals by the WM Performance Services who provide independent performance statistics and reports.

5.2 The Council also monitors the qualitative performance of the Fund managers to ensure that they remain suitable for the Fund. These qualitative aspects include changes in ownership, changes in personnel, and investment administration

**Types of Investments**

6.1 A management agreement is in place for each fund manager, setting out where relevant, the benchmark, performance target and asset allocation ranges. The agreements also set out any statutory or other restrictions determined by the Council. Investment may be made in accordance with The Regulations in equities, fixed interest and other bonds and property, in the UK and overseas markets. The Regulations specify other investment instruments that may be used, for example, financial futures, traded options, insurance contracts, stock lending, sub-underwriting contracts.

6.2 The Regulations also specify certain limitations on investments. Principally, these place a limit of 10% of the whole fund in any single holding, or deposits with a single bank or institution, or investments in unlisted securities. The Council does however have discretion to adopt a higher statutory limit in respect of specific investments subject to formal agreement by the Council.

**Investment Risk**

7.1 Whilst the objective of the Council is to maximise the return on its investments, it recognises that this has to be within certain risk parameters and that no investment is without an element of risk. The Council acknowledges that the predominantly equity based investment strategy may entail risk to contribution stability, particularly due to the short term volatility that equity investments can involve. The long term nature of the Fund and the expectation that longer term returns from equity investments will exceed those from bonds mean, however, that a high equity allocation remains an appropriate strategy for the Fund.

7.2 A policy of diversification for its investments and investment managers helps the Council to mitigate overall risk. Benchmarks and targets against which investment managers are expected to perform are further measures put in place to manage the risks for the Fund. Manager performance is monitored quarterly with investigation of any significant deviations from intended strategy.

7.3 With investment returns included, the Fund has a positive cash flow that enables investment in illiquid asset classes e.g. private equity and property. More than 70% of the fund is invested in equities and bonds that are highly liquid.

7.4 The Council has established a currency hedge covering 50% of the global equity portfolio to dampen the effect of foreign currency fluctuations against sterling.

7.5 Demographic factors including the uncertainty around longevity / mortality projections (e.g. longer life expectancies) contribute to funding risk. There are limited options currently available to fully mitigate or hedge this risk. The Council monitors liabilities using a specialist service provided by Club Vita, a “sister” company of the Fund’s Actuary, Hymans Robertson. Club Vita carries out a comprehensive analysis of the Fund’s longevity data to facilitate an understanding which helps to manage this issue in the most effective way.

**The realisation of investments**

8.1 A realisable (liquid) investment is one that can be readily converted into cash, for example to satisfy payments out of the Fund. The majority of the Fund’s assets are highly liquid and the Council is satisfied that the Fund has sufficient liquid assets to meet all expected and unexpected demands for cash. Assets in the Fund that are considered to be illiquid include property and private equity. As a long term investor the Council considers it prudent to include illiquid assets in its strategic asset allocation in order to benefit from the additional diversification and extra return this should provide.

8.2 The Council has delegated to the fund managers responsibility for the selection, retention and realisation of assets.

## Investment advice

9.1 Professional advice on investment matters is taken from the investment practice of Aon Hewitt. Hymans Robertson provides actuarial services.

## Social, environmental or ethical considerations

10.1 The extent to which social, environmental and ethical considerations are taken into account in investment decisions is left to the discretion of the fund managers. However, the Council expects that investment return is seen as the priority and that the extent to which these considerations may have a financial impact on the portfolio will be taken into account by the fund managers in the exercise of their delegated duties. However, the Council expects the fund managers to engage positively and seek to influence companies in which the Fund invests to take account of key social, environmental and ethical considerations.

## Exercise of the rights (including voting rights) attaching to investments

11.1 The Council is an active shareholder and will exercise its rights (including voting rights) to promote and support good corporate governance principles which in turn will feed through into good investment performance.

11.2 In practice, the Fund's equity holdings are wholly invested through pooled funds in which voting and engagement decisions are made by fund managers. The Council encourages its fund managers to vote and engage with investee companies worldwide to ensure they comply with best practice in corporate governance in each locality. The fund managers provide reports on their voting and engagement activities.

## Additional Voluntary Contributions (AVC)

12.1 In line with statute, the Council has to appoint AVC providers and the current providers are Clerical Medical Equitable Life and Prudential.

## Compliance with "Myners" Principles

13.1 In Appendix 1 are set out the details of the extent to which the Fund complies with the six updated "Myners" principles set out in the Chartered Institute of Public Finance and Accountancy's publication "Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012." These principles codify best practice in investment decision making

**Appendix 1**

# Compliance with “Myners” Principles”

## 1. Effective decision-making

Administering authorities should ensure that:

- decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation.
- those persons or organisations should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Fund compliance – Full

- The Council has delegated decision making in respect of the Pension Fund to the Pension Fund Committee, comprising four Councillors with full voting rights with representatives from the trade unions invited.
- The Committee, with advice from its Investment Adviser and independent advisers has appropriate skills for, and is run in a way that facilitates, effective decision making.
- Members of the Committee are provided with training opportunities in line with the skills and knowledge framework produced by CIPFA and a training log is maintained.
- There are sufficient internal resources and access to external resources for the Pension Fund Committee to make effective decisions.

## 2 Clear objectives

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. These should be clearly communicated to advisers and investment managers.

Fund compliance - Full

- The Fund’s Statement of Investment Principles and Funding Strategy Statement set out its investment objectives which are agreed after consultation with the Fund actuary and take into account the Fund’s liabilities, the impact on employer contribution rates, future cashflows and the Fund’s attitude to risk.
- Asset allocation, benchmarks and risk parameters are set with the aim of achieving these objectives.
- Fund managers have clear written mandates with individual performance targets and benchmarks and their performance is measured and reviewed by the Committee on a quarterly basis.
- Full account is taken of the strength of the sponsor covenant for all non-local authority employers admitted to the fund and contribution rates set accordingly.

## 3 Risks and Liabilities

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.

Fund compliance – Full

- The Committee, in setting its investment strategy, has taken account of the form and structure of its liabilities following advice from the Fund's actuary. The strategy aims to achieve the return required to meet its liabilities whilst taking into account stability of contributions and affordability for employers.
- Consideration is given to the payment of a bond by prospective admitted bodies to the Fund to minimise the financial consequences of default.
- A risk assessment and suggestions as to how the risks can be managed is included in the triennial valuation.
- Longevity risk is built into the triennial actuarial and is therefore included when determining the investment strategy
- Investment risk, including that of underperformance is taken into account in the Statement of Investment Principles and the Fund's Annual Report.

## 4 Performance Assessment

Arrangements should be in place for the formal measurement of the performance of investments, investment managers and advisers. Administering authorities should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.

Fund compliance – Partial

- In addition to overall Fund performance, the Committee considers the performance of individual investment managers against their benchmarks on a quarterly basis; matters of poor performance are addressed through meetings with fund managers and, if necessary, the termination of contracts.
- An independent performance measurement company provides quarterly and annual reports detailing the performance of the Fund and its managers and identifying the achievements resulting from asset allocation and manager performance.
- The Committee also receives, annually, data measuring its performance against that of other administering authorities but in reviewing this is conscious of the need to set its own investment strategy based on its own Fund liabilities and other local conditions.
- The performance of actuaries and advisers is informally assessed on an ongoing basis.
- The performance of the Fund is reported annually to all scheme members and is included in the Annual report; the Committee will be considering ways of improving their accountability, particularly in the context of the imminent establishment of the local pension board.

## 5 Responsible Ownership

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 members on the discharge of such responsibilities.

Fund compliance – Partial

- The Fund's policy on the extent to which its investment managers take account of social, environmental and ethical considerations is stated in the Statement of Investment Principles.
- The Fund expects its managers to engage positively and seek to influence companies in which the Fund invests to take account of key social, environmental and ethical considerations.
- Where applicable, the Fund expects its managers to have adopted the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.
- Whilst the Fund's equity holdings are wholly invested through pooled funds in which voting and engagement decisions are made by fund managers the Council encourages its managers to vote and engage with investee companies worldwide to ensure they comply with best practice in corporate governance in each locality. The fund managers provide reports on their voting and engagement activities.

## 6 Transparency and Reporting

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 members in the form they consider most appropriate.

Fund compliance – Full

- The Fund publishes a Communications Policy Statement detailing its policy and detailed strategy for communicating information to members, prospective members and their employers, union representatives, elected Members, tax payers and other interested parties. The Fund makes available a range of documents including:
    - Annual Report including Statement of Accounts.
    - Governance Compliance Statement which includes level of compliance.
    - Communications Policy Statement.
    - Statement of Investment Principles.
    - Funding Strategy Statement.
    - Triennial Actuarial Valuation.
    - Agenda and Minutes of Pension Fund Committee.
    - Annual Statement of Benefits to all active and deferred members.
    - Newsletter to pensioners once a year.
    - Newsletters to active members at least once a year.

- The Communications Policy Statement details the methods of communication available for each "target" group which include:
    - The Council's website
    - Hard copy
    - Annual employers meeting
    - Quarterly employers focus groups
    - DVD