

## HAMPSHIRE COUNTY COUNCIL

## Decision Report

<b>Decision Maker:</b>	Pension Fund Panel
<b>Date of Decision:</b>	18 June 2010
<b>Decision Title:</b>	Statement of Investment Principles - update
<b>Decision Reference:</b>	1758
<b>Report From:</b>	County Treasurer

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## 1. Executive Summary

1.1. The purpose of this paper is to review Hampshire Pension Fund's Statement of Investment Principles (SIP), which should be reviewed and updated by the Pension Fund Panel each year. Whilst this has historically been done at one of the Panel meetings in November, the recently issued Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 requires the SIP to now include the Fund's policy on stock lending.

## 2. The Statement of Investment Principles

2.1. For transparency and as good practice, the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 require Pension funds to revise their SIP to now include information on any stock lending activity and to publish this revised SIP by 1 July 2010. In practical terms, this will be posted on the Pensions website as a one off until the 2009/10 Annual Report is published.

2.2. The SIP includes the Pension Fund's social, environmental and ethical policy. That policy is currently under review following the discussion at the last Panel meeting and may be revised when that review has been completed.

2.3. A revised draft of the SIP is attached as Appendix 1 for approval. The proposed changes are highlighted in Appendix 1.

## 3. Recommendation

3.1. That, subject to any amendments the Panel may wish to make, the updated Statement of Investment Principles be approved.

**CORPORATE OR LEGAL INFORMATION:****Links to the Corporate Strategy**

<b>Hampshire safer and more secure for all:</b>	yes/no
Corporate Business plan link number (if appropriate):	
<b>Maximising well-being:</b>	yes/no
Corporate Business plan link number (if appropriate):	
<b>Enhancing our quality of place:</b>	yes/no
Corporate Business plan link number (if appropriate):	
<b>OR</b>	
<b>This proposal does not link to the Corporate Strategy but, nevertheless, requires a decision because it requires approval of the Pension Fund's Statement of Investment Principles.</b>	

**Other Significant Links**

<b>Links to previous Member decisions:</b>		
<u>Title</u>	<u>Reference</u>	<u>Date</u>
<b>Direct links to specific legislation or Government Directives</b>		
<u>Title</u>	<u>Date</u>	

**Section 100 D - Local Government Act 1972 – background documents**

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

DocumentLocation

None

## **IMPACT ASSESSMENTS:**

### **1. Equalities Impact Assessment:**

- 1.1. Equality objectives are not considered to be adversely affected by the proposals in this report.

### **2. Impact on Crime and Disorder:**

- 2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime.

### **3. Climate Change:**

- a) How does what is being proposed impact on our carbon footprint / energy consumption?

No specific impact.

- b) How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific impact.

## STATEMENT OF INVESTMENT PRINCIPLES

### Introduction

Hampshire County Council is the administering authority for the Hampshire Pension Fund, which covers employees of the County Council, two city (unitary) councils, 11 district councils, and 194 other scheduled and admitted bodies. The total number of contributors is around 47,000 and there are approximately 29,000 pensioners.

The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2009 require administering authorities of pension funds to prepare and review, from time to time, a written statement setting out the investment policy for their Fund.

This SIP has been drafted to comply with these regulations.

### Types of investments to be held

The Fund can be invested in shares, bonds and other investments to limits defined in Schedule 1 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

The main limits are:

- no more than 10% of each portfolio can be invested in any individual holding
- no more than 25% of the Fund can be invested in each manager's in-house unit trusts.

A comprehensive review of the Fund's investment management arrangements was completed in October 2006, and a new specialist management structure was put in place. This took effect on 1 January 2007.

The Pension Fund Panel agreed to increase the limit on contributions to private equity and indirect property partnerships from 5% to 10% of the total Fund with effect from 1 March 2008, so that investment in alternative investments of up to 10%, agreed as part of the new investment management structure, proceeded. The decision to increase the limit to 10% complies with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The 10% limit on contributions to partnerships will apply until such time as the Fund's overall asset allocation is reviewed following the next full actuarial valuation.

## The expected return on investments

The overall objectives when investing the Fund are:

- to achieve a 100% funding level, which means that all current and future Fund liabilities (pensions and other benefits) can be met in full for the foreseeable future
- to maintain a stable employers' contribution level, with a long-term target of around 200% of employees' contributions set for the actuary.

Following an asset/liability study in 2005 by the Fund's actuary, Hewitt Associates Limited, the Fund's target is to achieve a long-term return 2.5% a year above a low-risk portfolio, which is defined as a portfolio invested 85% in index-linked gilts and 15% in fixed-interest gilts.

## Spread of investments

The Pension Fund Panel agreed the following specialist investment management structure, which took effect on 1 January 2007. The structure is designed to achieve the overall long-term target return without exposing the Fund to excessive risk.

Investment sector	Management style	% of Fund
UK equities	Low-risk active	20
UK equities	High-performance active	9
Global equities	High-performance active	36
Global bonds	Active	5
UK index-linked bonds	Passive	20
UK property	Direct and indirect	8
European property	Indirect	2
<b>Total</b>		<b>100</b>

Nine managers have been appointed for 11 separate mandates. Contracts are for an initial five-year period, but can be extended for periods of up to five years subject to satisfactory performance.

The Pension Fund Panel is also investing up to 10% of the Fund in alternative investments, such as private equities and hedge funds. These investments are being funded from new cash flows, as the Fund's income will exceed its expenditure over the foreseeable future. Bramdean Asset Management were appointed from 1 August 2007 to act as an adviser on appropriate alternative investments for the Fund for an initial five-year period, with the option of an extension for a further five years. **This mandate has since been transferred to Aberdeen Asset Management on similar terms.**

Projected annual investment returns on asset classes assumed by Hewitt Associates Limited in the 2005 asset/liability study are:

<b>Asset class</b>	<b>Projected annual return %</b>
UK fixed-interest stocks	5.5
UK index-linked stocks	5.25
UK equities	8.5
Global equities	8.5
Property	7.0

### **Realisation of investments**

Managers are asked to avoid unnecessary sales and purchases of stocks which incur transaction costs. They must regard all sales and purchases of stocks as being in the Fund's financial interests; that is, they will either improve the return or limit excessive risk.

Transaction costs are monitored closely and reported to the Pension Fund Panel once a year.

Managers of equity and bond portfolios are asked not to invest in stocks that are not readily realisable (that is, capable of being turned into cash).

### **Social, environmental and ethical considerations**

The prime objective of the investment of the Fund is to achieve the best financial return consistent with an acceptable degree of risk.

However, the Fund recognises that where companies adopt positive social, environmental and ethical principles in planning their activities, this can enhance their long-term performance and increase their financial returns.

The Fund has delegated to the fund managers responsibility for taking social, environmental and ethical considerations into account when assessing the financial potential and suitability of investments. Each manager must work positively with companies to promote forward-looking social, environmental and ethical standards, rather than adopting a policy of negative screening of stocks.

The County Council asks managers not to invest in stocks that could reasonably be expected to embarrass the Fund.

### **Exercise of rights attaching to investments**

Managers have been instructed to exercise the Fund's responsibility to vote on company resolutions wherever possible.

They have also been instructed to intervene, by voting or direct contact with company management, in companies that are failing and thus jeopardising the Fund's interests.

The Fund believes that if companies comply with the principles of the combined code published by the Stock Exchange, following the Hampel report on corporate governance, this can be an important factor in helping them succeed; but the Fund also accepts the need for a flexible approach that is in the common long-term interests of shareholders, company employees and consumers. The Fund's managers should cast their votes with this in mind.

In particular, the Fund's managers should cast their votes to ensure that:

- executive directors are subject to re-election at least every three years
- executive directors' salaries are set by a remuneration committee consisting of a majority of independent non-executive directors, who should make independent reports to shareholders
- arrangements for external audit are under the control of an audit committee consisting of a majority of independent non-executive directors, with clear terms of reference – these should include a duty to ensure that managers closely control the level of non-audit work given to auditors, and should not significantly exceed their audit-related fee unless there are, in any manager's opinion, special circumstances to justify it
- in the managers' opinion, no embarrassment is caused to the Fund in relation to its beneficiaries, Hampshire residents, or the general principles of the combined code.

The managers must report to the Panel with a full explanation in any case where they do not follow these guidelines.

## **Custody**

Northern Trust were appointed as the Fund's independent global custodian with effect from 1 August 2006 for a seven-year period ending on 31 July 2013, subject to satisfactory performance.

## **Stock lending**

Since 2006, the Fund has been part of Northern Trust's stock lending programme, whereby stocks (principally equities) held by the Fund are loaned to third parties in return for a fee that helps the Fund meet its funding objectives.

In accordance with Schedule 1 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, lending restrictions have been placed on Northern Trust to ensure that the proportion of Fund assets that are available to be lent at any time shall not exceed 25% of the total market value of Fund assets.

To acknowledge the risks in stock lending, collateral is provided of not less than 105% of the market value of the borrowed stock, unless the borrowed stock and collateral are denominated in the same currency, then a collateral level of 102% will apply. The collateral arrangements were tested in September 2008, when stock on loan to Lehman Bros at the time of its collapse were recovered in full by Northern Trust within a few days.

Although the Fund temporarily suspended stock lending in September 2008 as a result of the financial crisis, the Pension Fund Panel agreed that this should be reinstated from December 2009 as market conditions have normalised.

Overall, the Panel considers that the income from stock lending is beneficial to the Fund and that the risks are understood and well managed. The County Treasurer will continue to monitor the risks and, as in the case of the Lehman Bros collapse, would be able to instruct Northern Trust to suspend the programme with immediate effect.

## **Review of the Statement of Investment Principles**

This Statement of Investment Principles is subject to review at any time by the County Treasurer, who will report to the Pension Fund Panel accordingly, seeking approval for any changes.

### **The six principles for the management of defined benefit schemes – compliance**

#### **Effective decision-making**

The County Council has delegated responsibility for the management and administration of the Fund to its Pension Fund Panel through its Audit Committee.

Workshops and seminars are made available to Panel members and County Council officers on investment and pensions matters.

Detailed investment decisions are delegated to fund managers. Advice on asset allocation is sought from the actuary and other consultants as necessary.

Full briefings on investment and pensions matters are provided to Panel members by the County Treasurer. The Panel also takes advice on investment matters from its independent adviser and sounding board, Mr Harvey Cole.

There is no power under LGPS regulations to pay Panel members for pension fund work. A business plan, which includes a training plan, has been prepared.

The Fund's contract for actuarial and other advice is open to competitive tender periodically. The current contract with Hewitt Associates Limited runs until March 2010, with an option to extend up until March 2015, subject to satisfactory performance.

Mr Harvey Cole acts as an independent adviser and sounding board to the Pension Fund Panel.

Investment managers themselves are asked for advice and new approaches are developed in partnership.

Little use is made of other advisers as sufficient expertise is available in the County Treasurer's Department. Hence there is no separate tender process for other advice.

### **Clear objectives**

The Fund's objectives are set out clearly in this Statement of Investment Principles.

All mandates have clear objectives and timescales for performance assessment.

Acceptable levels of risk vary according to the nature of each manager's mandate, and are effectively determined by the agreed targets and timescales for performance assessment.

There are no soft commission arrangements.

The Fund's overall target return and the managers' individual targets are set out clearly in this Statement of Investment Principles and in the Annex.

### **Risk and liabilities**

The Fund's actuary, Hewitt Associates Limited, carried out asset/liability studies in 1999 and 2005.

Advice from the actuary and other sources was used to determine the final strategic asset allocation to take effect from 1 January 2007, which should enable the Fund to meet its liabilities and maintain stable employers' contribution rates.

Advice was also sought to draw up benchmarks and constraints within which the fund managers appointed after the review must work with effect from 1 January 2007.

### **Performance assessment**

Formal reviews of the managers' performance take place twice a year. Additional meetings take place between the managers and the County Treasurer each year as required.

There is no formal system for reviewing the performance of the members of the Pension Fund Panel.

### **Responsible ownership**

The Fund's policies on voting rights and engagement are set out clearly in this Statement of Investment Principles.

### **Transparency and reporting**

This Statement of Investment Principles covers all areas as proposed by the Myners Committee and subsequently confirmed by the Government.

The results of the Pension Fund Panel's performance monitoring exercises are published in the annual report for the Fund.

Key information is supplied each year to Scheme members in the annual leaflet.

An updated Statement of Investment Principles is published and made available to Scheme employers within three months of the Pension Fund Panel approving any significant amendment.

**Annex Investment management arrangements from 1 January 2007**

	Benchmark	Annual target performance gross/net of fees
Low-risk active UK equities		
Aberdeen Asset Management	FTSE All Share	+1.5% gross
Schroder Investment Management	FTSE All Share	+1.25% gross
High-performance UK equities		
GLG Partners (formerly SGAM)	LIBOR	+5% gross
High-performance global equities		
Aberdeen Asset Management	MSCI World	+3% gross
AllianceBernstein	MSCI World	+3.5% gross
Newton Investment Management	MSCI World	+3% gross
Active global bonds		
Western Asset Management	Barclays Capital Global Aggregate Bonds Index	+1.5% gross
Passive index-linked bonds		
Legal & General	FT British Government Over Five Years Index-Linked Gilts Index	
State Street Global Advisors	As above	
UK property		
CB Richard Ellis Investors	Retail Price Index (RPI)	+4.5% net
European property		
Aberdeen Property Investors	Eurozone Harmonised Index of Consumer Prices (HICP)	+5% net