



London Borough of Lewisham Pension Fund

Statement of Investment Principles

July 2014

APPENDIX C STATEMENT OF INVESTMENT PRINCIPLES

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APPENDIX C STATEMENT OF INVESTMENT PRINCIPLES

1. Background

- 1.1 This Statement is prepared in accordance with The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999, which requires administering bodies to prepare, maintain and publish a written statement of the principles governing investment decisions.
- 1.2 The Local Government Pension Scheme was established by statute as a final salary defined benefit pension scheme to provide death and retirement benefits for eligible members and their dependents. The benefits are defined by statute and increased each year in line with movements in the retail prices index.
- 1.3 The fund as at 31 March 2014 had assets of approximately £904 million.
- 1.4 The Council has delegated responsibility for the investment management of the Fund to the Pensions Investment Committee, which determines the appropriate investment policy after obtaining proper advice from the Executive Director for Resources and Regeneration, the actuary, and the investment consultants.
- 1.5 Management of the Fund is delegated to professional Investment Managers whose activities are defined by detailed Investment Management Agreements, and regulated by the Financial Services Authority.
- 1.6 The principles outlined in this document were first approved by the Investment Committee in 2000, and are reviewed periodically.

2. Responsibility for Fund Governance

A. Pensions Investment Committee

- 2.1 This Statement will be presented to The Pensions Investment Committee (PIC) at the 9th September 2014 meeting for endorsement.
- 2.2. PIC oversees the operation of the Fund and its investment powers are set out in the Local Government Pension Scheme Regulations. This Statement of Investment Principles is consistent with those powers.
- 2.3 PIC meets quarterly and consists of eight voting members with a quorum of three members. Stakeholders such as pensioners and contributors are allowed to sit on PIC as observers. The current composition of PIC is shown at Appendix 1.
- 2.4 The Committee has delegated authority to make decisions regarding the Fund, acting on the advice of the investment consultant, the Executive Director for Resources and Regeneration and the Council's lawyers. Its primary responsibilities are to:
 - Prepare the Statement of Investment Principles
 - Set the objectives of the Fund and determine the strategic asset allocation.

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- Appoint and review the appointments of all advisors to the Fund.
- Receive valuations of the assets together with market reports and transaction details from the investment managers
- Ensure that the investment managers are operating within the agreed benchmarks and tolerances
- Monitor the investment managers' performance against the indices and investment performance targets with which they are measured
- Determine the Fund's socially responsible investment and corporate governance policies. Monitor the risks taken by the investment managers relative to their respective benchmarks
- Set and monitor the annual budget and plan for the operation of the Fund.

2.5 Revisions to this statement will require the agreement of the Committee following written advice from the Executive Director for Resources and Regeneration. The Chair can provisionally agree revisions subject to subsequent ratification by the whole Committee.

2.6 PIC will review this statement at least every three years to reflect changes necessitated by the triennial actuarial valuation, and will monitor compliance with the statement regularly. The Committee will, however, be advised of any material changes to the Fund during the inter-valuation period.

B Investment Managers

2.7 The investment management structure of the fund will be determined after obtaining appropriate advice. Implementation of the current mandate structure was completed in November 2012.

2.8 The responsibilities of the investment managers are to:

- Ensure the investment of the Fund's assets is in compliance with legislation, the parameters specified by this document and the detailed Investment Management Agreement.
- Provide quarterly reports including a review of investment performance.
- Attend meetings with the Executive Director for Resources and Regeneration and/or PIC as and when required and respond promptly to all related enquiries.
- Exercise voting rights on share holdings in accordance with the Council's policy.
- To work with the appointed Custodian and ensure that accounting records are reconciled on a monthly basis.

C. Custodian Bank

2.9 Northern Trust are the independent custodian bank responsible for safe custody of share certificates and records of title to the Fund's investments, settlement of investment transactions, accounting and collection of dividends and income.

2.10 The Custodian's specific responsibilities are to:

- Provide the Council with periodic valuations of the Fund's assets and details of all transactions electronically on a daily basis.
- Collect income and make tax reclaims

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- Manage un-invested cash
- Report on the performance of the investment managers and the Fund relative to appropriate benchmarks on at least a monthly basis.
- Undertake stock-lending for the Fund within agreed parameters.
- Process corporate actions in accordance with the fund manager instructions as well as proxy vote in meetings

D. Independent Investment Adviser

2.11 The independent investment adviser position is currently vacant . The specific responsibilities are to advise the Executive Director for Resources and Regeneration and PIC in respect of the:

- Evaluation of the investment managers and their performance
- Selection and review of investment managers and custodians
- Provision of advice relating to investment issues.

E The Actuary

2.12 The scheme actuary appointed by the Council is Hymans Robertson LLP. The actuary's responsibilities are to:

- Undertake the statutory valuation of the Fund
- Provide advice on the funding level to aid PIC in balancing the short and long term objectives of the Fund
- Provide IAS19 reports on pension costs.
- Calculation of initial employers contributions for admitted and scheduled bodies.
- To review bond and guarantee levels for admitted bodies.

F. The Investment Consultant

2.13 Investment advice is provided by a representative of Hymans Robertson LLP. The investment consultant's responsibilities are to advise the Executive Director for Resources and Regeneration and PIC in respect of:

- Investment strategy, advising on the risks and returns associated with different asset strategies
- The selection and review of investment managers and custodian.
- Advice relating to personnel and governance issues within the managers organisations.

G. The Executive Director for Resources and Regeneration

2.14 The Executive Director for Resources and Regeneration is responsible for:

- Implementation of policy
- Ensuring compliance with this document and notifying PIC of non-compliance
- Ensuring that this document is regularly reviewed and updated and reflects regulatory requirements.
- Submitting quarterly performance monitoring reports to PIC

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- Preparation of the annual report and accounts
- Attendance at review meetings with Investment Managers.
- Operational issues relating to the Fund and the day to day administration of Investment Managers.
- Taking emergency decisions in between meetings of PIC in order to manage the assets of the Fund in a prudent and efficient manner. If this responsibility is used, PIC will be updated at the next available opportunity.

3 Investment Objectives of the Fund

- 3.1 The primary investment objective of the Fund is to ensure that the assets are invested to secure the benefits of the Fund's members under the Scheme. Against this background, the Fund's approach to investing is to:
- Optimise the return consistent with a prudent level of risk
 - Ensure that there are sufficient resources to meet the liabilities
 - Ensure the suitability of assets in relation to the needs of the Fund.

4 Realisation of Investments

- 4.1 The majority of stocks held by the Fund are quoted on major stock markets and may be realised quickly to meet cash flow requirements . Property and venture capital investments, which are relatively illiquid comprise approximately 12.7% of the assets.

5. Investment Manager Structure and Fund Details

- 5.1 PIC will ensure that investment managers are appointed who are authorised under the Local Government Pension Scheme Management and Investment of Funds Regulations 1999 to manage the assets of the fund.
- 5.2 The appointments of the Actuary and Investment Consultant are reviewed periodically. Although the investment managers have full discretion as to stock selection they are required to keep within the asset allocation ranges stipulated by the Investment Committee. These ranges are outlined in Appendix 2.

6 Investment Strategy and Asset Mix

- 6.1 An Investment Management Agreement is in place for each investment manager, which sets out the relevant benchmark, performance target and asset allocation ranges, together with further restrictions.
- 6.2 The strategic benchmark sets out the longer-term strategy adopted by the Fund in terms of the balance between equities, property, bonds and other investments. It plays an important role in meeting the longer-term cost of funding, and how that cost may vary over time. Within each major market the investment managers will maintain a diversified portfolio of securities through direct investment or via pooled vehicles.
- 6.3 Investment policy is influenced by the fundamental view that over the longer term, equity investment is likely to provide superior returns to other investment classes. In the last structure it was agreed that equity should constitute 63% of the Fund. However, with the closure of the

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Hedge of Funds mandate, and the completion of the Fund's triennial valuation, the benchmark has slightly changed so that equity should constitute 65%.

- 6.4 The investment managers set their individual investment strategies to meet the performance objectives set by the Fund. The new benchmark position is outlined in Appendix 2.
- 6.5 In September 2014 Pension Investment Committee meeting, the Committee adopted a rebalancing policy. The Policy is outlined in Appendix 3.

7. Freedom of information

- 7.1 The Council will attempt to respond to requests for information relating to the Fund, under Freedom of Information Act 2000, within the statutory timescales.
- 7.2 There are exemptions from the requirement to provide information, for example, where it has been provided for the Fund in confidence, or where disclosure would prejudice the commercial interests of any person or body.
- 7.3 PIC considers most of the information about the Fund under the 'Open - Part 1' of its meeting agenda, which is open to the public, including information on:
- investment performance compared with benchmark and target returns
 - capital additions and withdrawals
 - voting of shares.

8. Policy on Socially Responsible Investment

- 8.1 The Fund is bound in respect of Socially Responsible Investment (SRI) policy by law - based on decisions made in the courts which apply to all pension schemes. The Fund may not subordinate the interests of members to SRI policy objectives:
- Due to the requirement to treat the financial interests of the Fund and members as paramount, it is envisaged that the investment managers will operate a policy of positive engagement as opposed to negative screening
 - The investment managers will use the voting rights of the Fund to encourage ethical and socially responsible corporate governance based on the principle that, in the longer term, this should enhance shareholder value
 - Investment managers are encouraged to refrain from investing in organisations engaged in unethical practices, provided that there are suitable alternative investments, which will not in the long term result in a loss of Fund performance.
- 8.2 The Council recognises the need to collaborate with other investors to promote best practice on responsible investment and effectively engage with companies. The Council is a member of the Local Authority Pension Fund Forum (LAPFF) and participates in this to promote its views.

9 Corporate governance

- 9.1 The proper corporate governance of companies in which the Fund invests, as set out in the Combined Code of Corporate Governance, is of importance to the London Borough of Lewisham. Investment Managers have delegated responsibility to instruct the Custodian on the

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exercise of the voting rights of the investments, on the understanding that these rights are to be exercised to enhance the value of the relevant securities, and are in accordance with the Socially Responsible Investment (SRI) objectives set out above. The managers will report periodically to PIC on the exercise of these powers and will consult the Fund if in any doubt on related issues.

10 Monitoring of investment performance

- 10.1 The Northern Trust Company measures the performance of the Fund and of each investment manager periodically against relevant benchmarks. Comparisons can also be made against other local authority Funds through the WM Local Authority Pension Fund Universe. Each investment manager has been set a target outperformance in excess of the applicable benchmark. Over the longer term, the return generated by the Fund is expected to exceed the rate of return assumed by the actuary for funding the scheme on an ongoing basis.
- 10.2 The Council schedules meeting with Investment Managers on the basis of their strategic importance to the fund, the perceived risk associated with the investment portfolio and the advice of the professional advisors. On this basis major portfolio managers are required to present to PIC and to officers annually, or more frequently as PIC, acting on the advice of the Executive Director for Resources and Regeneration, may require. Given that the major portfolio managers are operating on passive mandates, where returns are expected to track the overall market performance very closely, it is anticipated that presentations to PIC are only likely to be required on an exception basis, i.e. when performance is significantly different to that of the market overall.
- 10.3 Smaller investment managers such as the private equity and commodities managers will also be expected to report annually to PIC and annually to officers. They must also be prepared to answer questions tabled by Members of PIC. Each investment manager is required to present on a more frequent basis, if required.
- 10.4 In addition Lewisham's internal auditors and the external auditors undertake periodic reviews to confirm that the arrangements and procedures established by PIC are complied with.

11. Risk

- 11.1 Investment invariably involves an element of risk. The Council in recognition of this has adopted a number of strategies to mitigate the impact of unavoidable risks on the fund.
- 11.2 The Fund is subject to the following risks:

11.2.1 Funding Risk

Asset values may not increase at the same rate as liabilities with an adverse impact on the funding position. A Funding Strategy Statement (FSS) is prepared every three years as part of the triennial valuation and the Council monitors the Fund's investment strategy and performance relative to the growth in the liabilities at least annually.

11.2.2 Financial mismatch risk

The Council recognises that assets and liabilities have different sensitivities to changes in financial factors. To mitigate the risk an investment strategy is set which provides exposure

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to assets providing inflation protected growth as well as cash flow generating assets that match the Fund's liabilities.

11.2.3 Liquidity/Cash flow Risk

Investments are held until such time as they are required to fund payment of pensions. In 2014/15 it is anticipated that the net payments from the fund to pensioners will exceed the contributions due, and the liquidity risk is therefore being very closely monitored. The Council manages its cash flows and investment strategy to ensure that all future payments can be met and that sufficient assets are held in liquid investments to enable short term cash requirements to be met.

11.2.4 Manager Risk

Fund managers could fail to achieve the investment targets specified in their mandates. This is considered by the Council when fund managers are selected and their performance is reviewed regularly by PIC as part of the manager monitoring process. However, adopting a strategy largely based on passive investment for approximately 70% of the Fund's assets makes the overall exposure to this risk relatively low.

11.2.5 Concentration Risk

This relates to the risk that the performance of a single asset class, investment or manager has a disproportionate influence on the fund's performance. The Council attempts to mitigate this risk by establishing a well diversified strategic asset allocation, reviewing the investment strategy regularly and following a regular fund manager review process.

11.2.6 Demographic Risk

This relates to the uncertainty around longevity. The Council recognises there are effectively no viable options to mitigate these risks and assesses the impact of these factors through the Funding Strategy Statement and formal triennial actuarial valuations.

11.2.7 Counterparty Risk

This risk relates to the other party(s) in a financial transaction (the counterparty) failing to meet its obligations to the Fund. The Council has set guidelines with its fund managers and its custodian to limit its exposure to counterparty risk by specifying minimum credit ratings and credit limits. It has similarly applied this strict criteria within its stock lending agreements to mitigate counterparty risk in these transactions.

11.2.8 Currency Risk

The strategic asset allocation adopted by the Council provides for an element to be held overseas to provide diversification and exposure to different economies. Such investment is however subject to fluctuations in exchange rates with an associated positive or adverse impact on performance. Managers of global equities have been provided with an element of discretion to hedge currencies to protect returns. The Council however recognises that it can adopt a long term perspective on investments and consequently is able to absorb short term fluctuations in exchange rates. The Council however continues to monitor developments in the currency hedging environment to determine if adoption of currency hedging is beneficial.

11.2.9 Environmental, Social and Ethical Issues Risk

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The Council recognises that environmental, social and ethical issues have the potential to impact on the long term financial viability of an organisation. The Council monitors both developments within the investment environment and the voting of its appointed managers through its participation in the LAPFF.

- 11.3 Regulations require pension fund administering authorities to state the extent to which they comply with the Chartered Institute of Public Finance (CIPFA) Pensions Panel Principles for Investment Decision Making. This covers the six principles of good investment practice issued by Government in response to the Myners review of institutional investment. The extent to which Lewisham complies is set out in Appendix 4.

12. STOCK LENDING

- 12.1 The Council entered into a stock-lending arrangement with the Custodian, Northern Trust, in April 2010.
- 12.2 The Council recognises that stock lending results in the transfer of ownership (including voting rights) to a counterparty whilst economic exposure is retained by the Fund. In order to mitigate the counterparty risk implicit in this arrangement the Council has applied stringent collateralisation conditions.

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Appendix 1: Who's Who

Please refer to pages 6 of this annual report.

Appendix 2: Benchmark Position

Asset class	Manager	Benchmark	New Benchmark proportion (%)
Equities:			
Private equity	Harbourvest	MSCI All Country World Developed Index	3.0
Listed Equity	Blackrock (passive)	Composite	31.2
Listed Equity	UBS (passive)	Composite	31.2
Bonds:			
	Blackrock (passive)	Composite	9.3
	UBS (passive)	Composite	9.3
Equities and Bonds Subtotal			84.0
Other:			
Property	Schroders	IPD Pooled Property Fund Index	10.0
UK Financing Fund	M&G	LIBOR	1.0
Commodities	Investec	Dow Jones-UBS Commodities Total Return Index	5.0
Temporary Cash Holding			0
Other Subtotal			16.0
Total			100.0

REBALANCING POLICY

A rebalancing policy is important as it provides a framework for maintaining the Fund's assets within range of its strategic benchmark. A rebalancing policy should be set in such a way as to avoid excessive rebalancing during volatile markets, and should take into account the following factors:

- Tolerance levels – the acceptable % allocation ranges for individual mandates/asset classes,
- Frequency – the frequency of monitoring/rebalancing, and
- Rebalancing target – the point to rebalance to.

In turn, the factors above should take into account characteristics of the individual asset classes, including liquidity (and transaction costs) and volatility.

Existing rebalancing arrangements are currently in place for the BlackRock and UBS passive multi-asset mandates. Rebalancing operates within each mandate, as follows:

Table 1: BlackRock and UBS rebalancing

Mandates	Policy
BlackRock	<p>Rebalancing tolerance levels of +/- 2% for the following allocations:</p> <ul style="list-style-type: none"> - UK Equity (20.5%) - Global Equity (56.5%) - Over 15 Year Gilts (7.6%) - Over 5 Year Gilts (7.7%) - UK Corporate Bonds (7.7%) <p>Monitored on a daily basis, with rebalancing occurring at the next available dealing date if outwith the tolerance range.</p>
UBS	<p>Strategic benchmarking is as follows:</p> <ul style="list-style-type: none"> - UK Equity (20.5%) - Global Equity (56.5%) - UK fixed interest (7.6%) - UK Index linked (7.7%) - UK Corporate Bonds (7.7%) <p>Monitoring and rebalancing occurs on a quarterly basis, with holdings rebalancing to the benchmark allocation.</p>

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Rebalancing arrangements for the Fund's mandates are set out below:

Table 2: Tolerance levels

Mandates	Deviation from Strategic benchmark	Action
BlackRock (passive multi-asset)	+/- 3%	Monitored on a quarterly basis, with rebalancing to +/- 1.5% at the next available opportunity.
UBS (passive multi-asset)	+/- 3%	Monitored on a quarterly basis, with rebalancing to +/- 1.5% at the next available opportunity.
Schroders Property	+/- 2%	Monitored on a quarterly basis, with rebalancing to +/- 1% at the next available opportunity.
Investec Commodities	+/- 1.5%	Monitored on a quarterly basis, with rebalancing +/- 0.75% at the next available opportunity.
HarbourVest Private Equity	-	Rebalancing is not available for this mandate, given its structure (pre-arranged commitments and buy-and hold).
M&G UK Financing Fund	-	Rebalancing is not available for this mandate, given its buy-and-hold structure.

In order to avoid excessive rebalancing, the assets will not be brought back to the absolute strategic benchmark, but to a position that is approximately half way between the tolerance level and the target allocation. This also takes into consideration that there is a time lag between reporting a variance, and the rebalancing of the funds.

Where a mandate is underweight and outwith its tolerance level, the Fund's surplus cash flow will be used to bring assets back to within the tolerable range. If the surplus cash is not sufficient, the rebalancing will be undertaken by selling funds from the mandates that are most overweight, and using the proceeds to purchase assets that are the most underweight.

Where a mandate is overweight and outwith its tolerance level, assets will be disinvested from the mandate, and the proceeds reinvested in the most underweight mandate. Where multiple mandates qualify as being 'most underweight', the proceeds will be re-invested in relative proportions to bring the respective mandates to a similar level of underweight.

It has been built into this policy the option for the Executive Director of Resources and Regeneration to exercise discretion to override table 5. This option offers flexibility that takes into account market conditions and other factors that will influence the process of rebalancing.

Appendix 4: Compliance with the CIPFA Principles for Investment

Decision Making

Regulations require administering authorities to assess the extent to which they comply with the CIPFA Principles for Investment Decision Making, and provide reasons for non-compliance. These reflect the principles of good investment practice issued by government in response to the Myners review.

The six principles which underpin best practice and the assessment of Lewisham's compliance is as set out below.

Principle 1: Effective Decision-Making

Trustees 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.

Trustees should have sufficient expertise to be able to evaluate and challenge the advice they receive and manage conflicts of interest.

Compliance statement - full compliance

- Decisions are taken by PIC based on advice from officers, and the investment consultant. Specialist investment managers are employed who are responsible for day to day investment decisions.
- In conjunction with the Fund's Independent Investment Advisor, the Council will establish a training and development programme for Members of PIC.
- There is a clear 'Conflicts of interest policy' and Members must make declarations of interest before each meeting of PIC or as matters arise during the course of the Committee business.

Principle 2: Clear Objectives

Trustees should set out an overall investment objective(s) for the scheme that takes account of the scheme's liabilities, the strength of the sponsor covenant and the attitude to risk of both the trustees and the sponsor, and clearly communicate these to advisers and investment managers.

Compliance statement – full compliance

- PIC has set its investment objectives in the context of an actuarial review that considered the assets and liabilities and maturity profile of the fund, and it approves a Funding Strategy Statement for the Fund.
- PIC has set a scheme specific benchmark, diversified to ensure that market volatility in the funds value is reduced through holding a proportion of the funds assets in alternative assets such as property, private equity, corporate credit, commodities and bonds.
- Each investment manager has a specific benchmark and target set for it and a time horizon, typically three years, for being measured against their target.

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Principle 3: Risk and Liabilities

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

These include the strength of the sponsor covenant, the risk of sponsor default and longevity risk.

Compliance statement – full compliance

- The Funding Strategy Statement and triennial valuation are written specifically with the structure of liabilities in mind and also address risks to the Fund.
- The Administering Authority's strategy recognises the relatively immature liabilities of the Fund, the security of members' benefits and the secure nature of most employers' covenants. The strength of the sponsor covenant and the risk of sponsor default combined mean that the scheme's actuary can set a recovery period of 20 years
- When setting the common contribution rate the Actuary is charged with increasing the future service rate by an amount equal to the Fund's solvency target to ensure a fully funded scheme (known as a "past service adjustment")

Principle 4: Performance Assessment

Trustees should arrange for the formal measurement of the performance of the investments, investment managers and advisers.

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

Compliance statement – full compliance

- PIC reviews investment performance on a quarterly basis and cross examines investment managers on whether a half-yearly or annual basis. Mandates are generally structured so that formal reviews of investment managers occur on a rolling three year basis.
- The Fund employs the services of a Custodian who produces quarterly reports on performance to the Fund.

Principle 5: Responsible Ownership

Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.

A statement of the scheme's policy on responsible ownership should be included in the Statement of Investment Principles.

Trustees should report periodically to members on the discharge of such responsibilities.

Compliance statement – Full compliance

- The Statement of Investment Principles sets out the Fund's approach to Socially Responsible Investment and Corporate Governance.
- PIC has delegated responsibility for the exercise of voting rights and engagement with companies to investment managers. Within that delegation investment managers are

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expected to support ethical and socially responsible corporate governance on the basis that in the longer term this will enhance the value of the companies concerned.

- Managers are held to account on their voting records.
- the Fund is a member of the Local Authority Pension Fund Forum

Principle 6: Transparency and Reporting

Trustees 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.

Trustees should provide regular communication to members in the form they consider most appropriate.

The report should contain a commentary on how any commitments made in the Statement of Investment Principles have been progressed during the reporting period.

Compliance statement – full compliance

- The Statement of Investment Principles sets out the responsibilities of PIC, its advisers and investment managers and details of the mandates and fee basis of investment managers.
- PIC papers are available for public inspection and are available on the Council's website. Formal statements such as the Communications Policy, Funding Strategy Statement, Statement of Investment Principles and Triennial Valuation are reported on at PIC meetings and are available on the web.
- A comprehensive annual pensioners newsletter is produced and distributed to all pensioners of the Fund.