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AGENDA

PENSIONS INVESTMENT COMMITTEE

Date: TUESDAY, 6 SEPTEMBER 2011 at 7.00 pm

Committee Room 4
Civic Suite
Lewisham Town Hall
London SE6 4RU

Enquiries to: Clare Weaser
Telephone: 0208 314 7369 (direct line)
Email: clare.weaser@lewisham.gov.uk

COUNCILLORS

Councillor Whittle (Chair)
Councillor Maslin (Vice-Chair)
Councillor Allison
Councillor Best
Councillor Fletcher
Councillor Muldoon
Councillor Wise
Councillor Pattisson

Observers

Mrs Humble – Pensioners Representative

Officers
Janet Senior Ex Dir for Resources
Selwyn Thompson – Group Manager
Shola Ojo – Principal Accountant
Carol Eldridge – Group Manager (Pensions and Payroll)

Members are summoned to attend this meeting

Barry Quirk
Chief Executive
Lewisham Town Hall
Catford
London SE6 4RU
Date: 25 August 2011

INVESTOR IN PEOPLE

The public are welcome to attend our committee meetings, however occasionally committees may have to consider some business in private. Copies of reports can be made available in additional formats on request.

ORDER OF BUSINESS – PART 1 AGENDA

PENSIONS INVESTMENT COMMITTEE			
Report Title	**MINUTES**		
Key Decision			**Item No. 1**
Ward			
Contributors	**CHIEF EXECUTIVE**		
Class	**Part 1**	**Date: 6 September 2011**	

Recommendation

That the Minutes of that part of the meeting of the Committee, which was open to the press and public, held on 15 June 2011 be confirmed and signed.

LONDON BOROUGH OF LEWISHAM

MINUTES of the meeting of the PENSIONS INVESTMENT COMMITTEE, which was open to the press and public, held on WEDNESDAY, 15 JUNE 2011 at LEWISHAM TOWN HALL, CATFORD, SE6 4RU at 6.30 p.m.

Present

Councillors Allison, Best, Fletcher, Maslin, Muldoon, Pattison, Whittle and Wise.

Independent Investment Advisers: Scott Donaldson, Hymans Robertson

Officers: Conrad Hall - Head of Business Management and Service Support
Selwyn Thompson – Group Manager Budget Strategy
Shola Ojo – Principal Accountant Budget Strategy
Omar Farooqui – Accountant Budget Strategy
Jim Ricketts - Interim Capital and Treasury Manager

,
Apologies for absence were received from Mr Tucker.

Minute No. | Action

1. APPOINTMENT OF CHAIR AND VICE CHAIR

RESOLVED that Councillor Whittle be appointed Chair and Councillor Maslin be appointed Vice Chair of the Pensions Investment Committee for the municipal year 2011/12.

2. MINUTES

RESOLVED that the Minutes of the meeting of the Pensions Investment Committee, held on 10 March 2011, be confirmed and signed.

3. DECLARATIONS OF INTERESTS

All members of the Committee declared an interest as a member of the Lewisham Pension Scheme.

4. TERMS OF REFERENCE

RESOLVED that the terms of reference of the Pensions Investment Committee be noted.

5. UBS BOND PRESENTATION

5.1 Mr Digby Armstrong, Client Director and Simon Foster, Portfolio Manager attended the meeting and made a presentation on behalf of UBS.

5.2 The Chair said that the UBS (bonds) portfolio was up 1.9% since inception. He asked whether UBS were optimistic in suggesting that interest rates would not change and about financials bearing in mind that the Chancellor George Osbourne had announced that he intended to regulate the banks further. In addition, unemployment was at its highest level since 1996. Mr Foster said that he welcomed extra regulation with regard to bond investment because it enhanced security. Profitability may be affected but this principally impacted on equity returns rather than bonds . Mr Foster said that a global standard of regulations that were fair to banks and investors was needed.

5.3 Mr Foster said that the portfolio was overweight to financials at about 4%. This position reflected their confidence in the sector.

5.4 With regard to interest rates, Mr Foster said that the economy was dependent on the financial sector which performs well in 'boom' periods but not when markets are depressed. The Governments borrowing position had to be addressed. However this retrenchment impacted on the wider economy and in particular consumer confidence. To sustain economic activity the Government was keeping rates low . He considered that other methods to support the economy should be investigated.

5.5 Councillor Fletcher asked about business and consumer confidence. Mr Foster said that business confidence was not as bad as consumer confidence which had been poor. However, with housing markets improving and interest rates staying the same, Mr Foster considered that this would increase consumer confidence. Companies have big balance sheets and there were signs that things were getting better. Business had cut back costs during the recession but they need to invest the cash which had been generated through increased profitability. He said that the UK economy looked vulnerable and did not predict much improvement in the near future.

5.7 The Chair thanked Mr Foster and Mr Armstrong for their presentation.

RESOLVED that the presentation be noted

6. INVESTEC COMMODITIES PRESENTATION

6.1 Richard Chadderton and Scott Winship attended the meeting and presented on behalf of Investec.

Minute No. Action

6.2 The Chair asked how risk was being managed. Mr Winship said that Investec were trying to ‘grow’ money for the portfolio using commodities. They wanted to deliver a return of +15% with less volatility than in the equities market. He referred to the integrated risk management on page 19 of the presentation and said that their aim was to keep risk between 10-15%.

6.3 Councillor Muldoon asked about the risk with regard to rare earth and hedging the portfolio. Mr Winship said that they do not look at rare earth because there are considerable obstacles in gaining access to what is a limited market. With regard to political risk, Mr Winship said that Investec were aware of political risk and the fund was well diversified with no high risk exposures To mitigate non financial risks Investec have an active engagement policy which is considered important. They were a member of the UNPRI and were in the process of recruiting a member of staff who will be responsible for ensuring that stocks are compliant with Ethical Investments.

6.4 The Chair thanked Mr Winship and Mr Chadderton for their presentation.

RESOLVED that the report be noted.

7. INVESTMENT PERFORMANCE FOR QUARTER ENDED 31 MARCH 2011

7.1 The Group Manager Budget Strategy presented the report.

7.2 Councillor Best said that performance had been disappointing relative to the benchmark and what this was attributable to. The Group Manager Budget Strategy said that performance had been patchy and Lewisham had supported managers during periods of underperformance having taken a long term perspective. Whilst markets had generally not been conducive to a number of the managers investment styles performance had not improved significantly when markets changed.

7.3 Councillor Wise said that Investec’s performance relative to the benchmark had been poor. Mr Donaldson said that this was an issue Because the Investec benchmark was directly related to commodities whilst Investec principally invested in companies with an exposure to commodities. The commodity markets were extremely volatile and were currently buoyant. The Investec approach attempts to reduce the volatility associated with direct commodity investment whilst obtaining exposure to the relatively higher returns.

RESOLVED that the report be noted.

8. THE INDEPENDENT PUBLIC SERVICE PENSIONS COMMISSIONS FINAL REPORT – THE HUTTON REPORT

8.1 The Group Manager Budget Strategy presented the report.

8.2 Councillor Muldoon asked how many officers would be affected by HMRC's changes which had brought in an annual cap of £50k to pension schemes. The Head of Business Management and Service Support said that there had only been a small amount of publicity by the government on this issue. He said that it would only affect officers on senior grades who received a significant pay increase. Their length of service and the level of pay/salary increase would determine the impact. He estimated that an officer would need to have secure a wage increase of between £10-20k before it would have an impact on an individual.

8.3 The Group Manager Budget Strategy said that the government would be consulting local authorities on their recommendations in the Autumn and a report would be submitted to this committee thereafter. The Chair said that he was particularly interested in the statutory pensionable age and the impact on manual workers of any changes. ED Res

RESOLVED that the report be noted.

9 INVESTMENT MANAGERS BONUS POLICY

The Group Manager Budget Strategy said that the report had been submitted to the Committee at the request of members at the last meeting. Details of managers bonus policies was set out in the confidential papers. The report concluded that bonuses were prevalent in the financial services industry and used to incentivise staff.

RESOLVED that the report be noted.

10 DRAFT PENSION FUND ACCOUNTS – YEAR ENDING 31 MARCH 2011

10.1 The Group Manager Budget Strategy presented the report. He said that paragraph 3.11 should be deleted because all the information required had been received.

10.2 Councillor Best asked whether AVC's were still being promoted The Interim Capital and Treasury Manager said that it is a statutory requirement to offer a AVC facility and that details were contained in note 11. The costs and assets associated with the AVC scheme were however not included in the main pension fund accounts.

RESOLVED that the draft Pension Fund Accounts for the year ended 31 March 2011 as set out in Appendix 1 to the report be noted.

11 EXCLUSION OF THE PRESS AND PUBLIC

RESOLVED that under Section 100(A)(4) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraphs 3, 4 and 5 of Part 1 of Schedule 12(A) of the Act, as amended by the Local Authorities (Executive Arrangements) (Access to information) (Amendments) (England) Regulations 2006 and the public interest in maintaining the exemption outweighs the public interest in disclosing the information:

12 Review of Pension Fund Investment Management
13 Investment Managers Bonus Policy

The following is a summary of the items considered in the closed part of the meeting.

12 Review of Pension Fund Investment Management

RESOLVED that the report be noted

13 Investment Managers Bonus Policy

RESOLVED that the report be noted

The meeting ended at 9.10 p.m.

Chair

PENSIONS INVESTMENT COMMITTEE			
Report Title	**DECLARATIONS OF INTERESTS**		
Key Decision			**Item No. 2**
Ward			
Contributors	**CHIEF EXECUTIVE**		
Class	**Part 1**	**Date: 6 SEPTEMBER 2011**	

Declaration of interests
Members are asked to declare any personal interest they have in any item on the agenda.

Personal interests
There are two types of personal interest :-
(a) an interest which you must enter in the Register of Members' Interests*
(b) an interest where the wellbeing or financial position of you, (or a "relevant person") is likely to be affected by a matter more than it would affect the majority of in habitants of the ward or electoral division affected by the decision.

*Full details of registerable interests appear on the Council's website.

("Relevant" person includes you, a member of your family, a close associate, and their employer, a firm in which they are a partner, a company where they are a director, any body in which they have securities with a nominal value of £25,000 and
(i) any body of which they are a member, or in a position of general control or management to which they were appointed or nominated by the Council, and
(ii) any body exercising functions of a public nature, or directed to charitable purposes or one of whose principal purpose includes the influence of public opinion or policy, including any trade union or political party) where they hold a position of general management or control,

If you have a personal interest you must declare the nature and extent of it before the matter is discussed or as soon as it becomes apparent, except in limited circumstances. Even if the interest is in the Register of Interests, you must declare it in meetings where matters relating to it are under discussion, unless an exemption applies.

Exemptions to the need to declare personal interest to the meeting
You do not need to declare a personal interest where it arises solely from membership of, or position of control or management on:

(a) any other body to which your were appointed or nominated by the Council
(b) any other body exercising functions of a public nature.

In these exceptional cases, unless your interest is also prejudicial, you only need to declare your interest if and when you speak on the matter .

Sensitive information
If the entry of a personal interest in the Register of Interests would lead to the disclosure of information whose availability for inspection creates or is likely to create a serious risk of violence to you or a person living with you, the interest need not be entered in the Register of Interests, provided the Monitoring Officer accepts that the information is sensitive. Where this is the case, if such an interest arises at a meeting, it must be declared but you need not disclose the sensitive information.

Prejudicial interests
Your personal interest will also be prejudicial if all of the following conditions are met:

(a) it does not fall into an exempt category (see below)
(b) the matter affects either your financial interests or relates to regulatory matters - the determining of any consent, approval, licence, permission or registration
(c) a member of the public who knows the relevant facts would reasonably think your personal interest so significant that it is likely to prejudice your judgement of the public interest.

Categories exempt from being prejudicial interest

(a)Housing – holding a tenancy or lease with the Council unless the matter relates to your particular tenancy or lease; (subject to arrears exception)
(b) School meals, school transport and travelling expenses; if you are a parent or guardian of a child in full time education, or a school governor unless the matter relates particularly to the school your child attends or of which you are a governor;
(c) Statutory sick pay; if you are in receipt
(d) Allowances, payment or indemnity for members
(e)Ceremonial honours for members
(f) Setting Council Tax or precept (subject to arrears exception)

Effect of having a prejudicial interest
If your personal interest is also prejudicial, you must not speak on the matter. Subject to the exception below, you must leave the room when it is being discussed and not seek to influence the decision improperly in any way.

Exception
The exception to this general rule applies to allow a member to act as a community advocate notwithstanding the existence of a prejudicial interest. It only applies where members of the public also have a right to attend to make representation, give evidence or answer questions about the matter. Where this is the case, the member with a prejudicial interest may also attend the meeting for that purpose. However the member must still declare the prejudicial interest, and must leave the room once they have finished making representations, or when the meeting decides they have

finished, if that is earlier. The member cannot vote on the matter, nor remain in the public gallery to observe the vote.

Prejudicial interests and overview and scrutiny

In addition, members also have a prejudicial interest in any matter before an Overview and Scrutiny body where the business relates to a decision by the Executive or by a committee or sub committee of the Council if at the time the decision was made the member was on the Executive/Council committee or sub-committee and was present when the decision was taken. In short, members are not allowed to scrutinise decisions to which they were party.

PENSIONS INVESTMENT COMMITTEE			
Report Title	**Investment Performance for Quarter Ended 30 June 2011**		
Key Decision	**No**		Item No. 5
Ward			
Contributors	**Executive Director for Resources**		
Class	**Part 1**		Date: **6 September 2011**

1. Summary

1.1 This report sets out the performance of the pension fund investment portfolio and that of the individual managers for the quarter ending 30 June 2011.

1.2 The report comprises the following sections:

2. Recommendations
3. Background
4. Portfolio Summary
5. Conclusions
6. Financial Implications
7. Legal Implications

2. Recommendations

It is recommended that the Pensions Investment Committee note the contents of the report.

3. Background

3.1 The revised management arrangements for the Pension Fund investment portfolio have been operational for approximately three years and this report sets out the performance for the quarter ended 30th^{t} June 2011 and since inception as provided by the Fund's investment advisors Hymans Robertson.

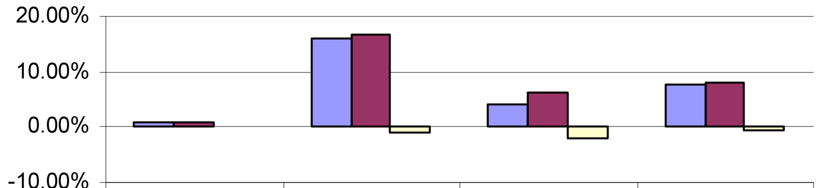
3.2 The full report and performance commentary will be provided at the meeting by the investment advisors.

4. Portfolio Summary

4.1 The fund had a market value of £781.8 million at the 30th June 2011 which represented a gain of £20.1 million (2.76%) over the March valuation of £761.7 million.

4.2 The fund achieved a return of 0.9% in the quarter which was 0.2% above the benchmark of 0.7%. The fund performance over the longer term is a set out below.

Table 1: Fund Performance



	Quarter Ending	One Year	Three Years	Since Inception
Fund	0.90%	16.00%	4.10%	7.60%
Benchmark	0.70%	16.90%	6.20%	8.10%
Relative	0.20%	-0.90%	-2.10%	-0.50%

4.3 The Council participates in a performance measurement survey conducted by the WM Company. This ranks the Council's investment against that of the other 97 Councils participating in the survey and expresses this as a position out of 100. In the latest figures available up to the year ending the 31st March 2011, the Council ranked 84th in comparison to its position as at 31st March 2010 (48th), with the change being attributable to asset allocation and stock selection.

4.4 The fund currently employs nine specialist managers with mandates corresponding to the principal asset classes. The managers and the associated performance targets are as set out below:

Table 2: Portfolio Summary

Manager	Mandate	Performance Target	Date Appointed	Value 30 Jun 2011 £m	Value 31 Mar 2011 £m
Alliance Bernstein	Global Equity	1.50%	1 Nov 2004	176	177.4
Fauchier	Hedge Fund	5% over 5 Years	28 Jun 2008	22	22.0
Harbourvest	Venture Capital	5% over 10 Years	29 Jun 2006	31.3	28.0
RCM	Global Equity	1.50%	18 Sep 2008	170.6	169.1
Schroders	Property	0.75%	12 Oct 2004	70.9	69.3
UBS (Equity)	UK Equity (Index)		27 Feb 2008	133.6	125.9
UBS (Bonds)	Fixed Interest		28 Feb 2008	129.4	124.7
INVESTEC	Commodities		25 Feb 2010	40	40.1
M & G	UK Financing Fund		1 May 2010	8	5.2
				781.8	£761.7

4.5 The performance of the individual managers relative to the appropriate benchmarks is as set out in table 3.

Table 3: Managers Performance Relative to Target

	Quarter Ended 30 Jun 2011	One Year	Since Inception
Alliance Bernstein	-1.0%	-1.3%	-2.2%
Fauchier	-2.4%	-2.6%	-5.1%
Harbourvest	1.6%	-11.8%	-0.8%
RCM	0.8%	-1.5%	-4.1%
Schroders	0.7%	0.5%	-0.7%
UBS (Equity)		-0.2%	0.2%
UBS (Bonds)	-0.3%	0.5%	-0.7%
INVESTEC	6.3%	-6.4%	-1.8%
M & G	0.6%	2.0%	1.6%

The table indicates the relatively short duration of the current structure, the volatility of returns and the continuing under-performance of all mandates with the exception of the private equity, UK equity, and financing fund managers.

4.6 The performance of individual managers will be analysed by the Pension Fund's Investment Advisor at the meeting.

5. Conclusions

5.1 The improved performance in this quarter compared to the previous quarter can be principally attributable to the performance of Investec. Most managers outperformed their targets this quarter with only three managers underperforming.

6. Financial Implications

6.1 The comments of the Executive Director for Resources have been incorporated into the report.

7. Legal Implications

7.1 As the administering authority for the Fund, the Council must review the performance of the Fund's investments at regular intervals and review the investments made by Fund Managers quarterly.

7.2 The Pension Regulations require that the Council has regard to the proper advice of its expert independent advisers in relation to decisions affecting the Pension Fund. They must also have regard to the separate advice of the Chief Finance Officer who has statutory responsibility to ensure the proper administration of the Council's financial affairs including the administration of the Pension Fund.

8. **Crime and Disorder Implications**

There are no crime and disorder implications directly arising from this report.

9. **Equalities Implications**

There are no equalities implications directly arising from this report.

10. **Environmental Implications**

There are no environmental implications directly arising from this report.

BACKGROUND PAPERS

None reported

APPENDICES

The full report and performance commentary will be provided at the meeting by the investment advisors.

FURTHER INFORMATION

If there are any queries on this report or you require further information, please contact Selwyn Thompson, Group Manager Budget Strategy on 020 8314 6932.

Agenda Item 6

HYMANS ROBERTSON

London Borough of Lewisham Pension Fund

Review of Investment Managers' Performance for Second Quarter of 2011

Prepared By:

Scott Donaldson - Partner
Albert Chen - Investment Analyst

For and on behalf of Hymans Robertson LLP
August 2011

Real people. Real skills. Real results.

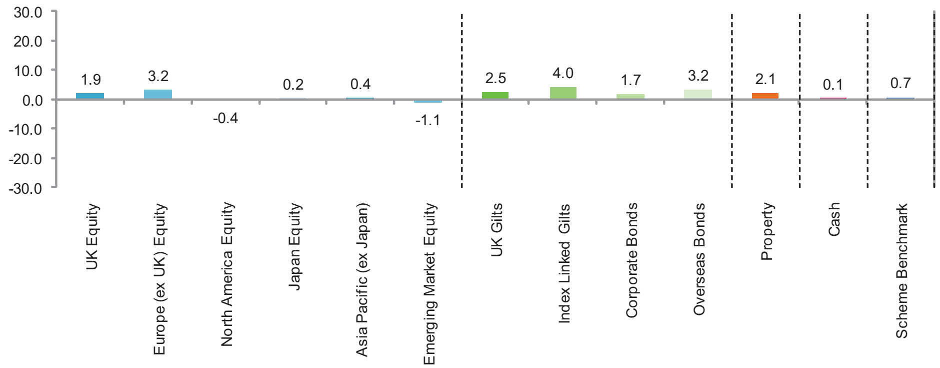
Contents

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investment in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

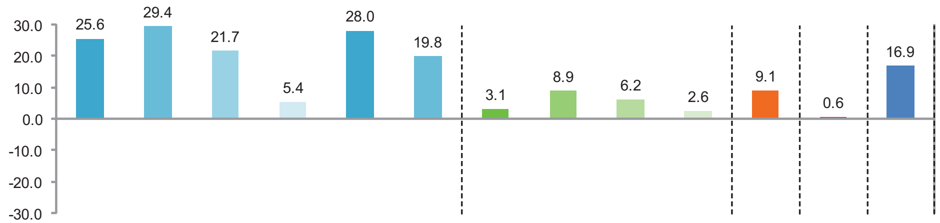
Hymans Robertson LLP has relied upon third parties and may use internally generated estimates for the provision of data quoted, or used, in the preparation of this report. Whilst every effort has been made to ensure the accuracy of such estimates or data, we cannot accept responsibility for any loss arising from their use.

Historic Returns for World Markets to 30 June 2011

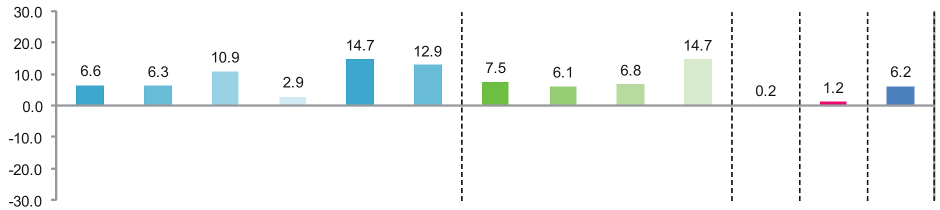
3 Months (%)



12 Months (%)



3 Years (% p.a.)



Historic Returns - Comment

A dominant theme during much of the quarter was the debt crisis in Greece and how the matter might be resolved. Equities fell steeply as the crisis reached its peak in mid June. This was followed by a sharp rally, late in the quarter, as the European Union and IMF agreed a ‘bailout’.

The direct negative influence on equities was the deterioration in the global economic outlook. Data published during the quarter indicated a significant slowdown in economic growth in the US. In the UK, economic growth during the first three months of 2011 (reported in Q2) merely offset the contraction recorded in the preceding quarter. Economic strength in Germany and France masked weakness in other Euro-zone countries. Global inflationary pressures intensified, adding to the strains on the global economy.

In bond markets, yields on ten year issues fell (prices rose) in countries perceived to offer security in uncertain times. In contrast, bond yields rose (prices fell) in heavily indebted euro-zone countries. Key events during the quarter were:

Global Economy

- US central bank lowered its forecast for economic growth in 2011 and 2012
- Short-term interest rates were held in UK, US and Japan; modest increase in euro-zone
- Rating agencies assigned a negative outlook on US government debt; the political stand-off in agreeing the US debt limit has been unhelpful
- US confirmed the end of its quantitative easing programme (effective end June)
- Japanese economy contracted for two consecutive quarters

Equities

- US equities reached a post ‘crisis’ high in April on strong corporate results
- The strongest sectors relative to ‘All World’ Index were Health Care (+7.7%) and Consumer Goods(+5.9%); the weakest were Oil & Gas (-5.7%) and Financials/Technology (both -2.7%)

Bonds

- Index linked gilts outperformed fixed interest issues on concerns over inflation
- The yield differentials between highly indebted Euro countries and Germany widened further

Due to economic uncertainty, market expectations for an increase in short-term interest rates have been pushed out, potentially into 2012, despite inflationary pressures. Indications that the US may engage in a further round of quantitative easing is a measure of its determination to support the economy if necessary.

Portfolio Summary

Valuation Summary

	Values (£m)				
Asset Class	Q1 2011	Q2 2011	Actual Proportion %	Target Proportion %	Difference %
Global Equity	472.3	474.6	61.3	60.0	1.3
Bonds	124.7	127.6	16.5	16.0	0.5
Property	69.3	71.0	9.2	10.0	-0.8
Hedge Fund of Funds	22.0	21.8	2.8	3.0	-0.2
Private Equity	28.0	31.2	4.0	3.0	1.0
UK Financing Fund	5.3	8.0	1.0	3.0	-2.0
Commodities	40.1	39.8	5.1	5.0	0.1
Total Client	**761.7**	**774.1**	**100.0**	**100.0**	

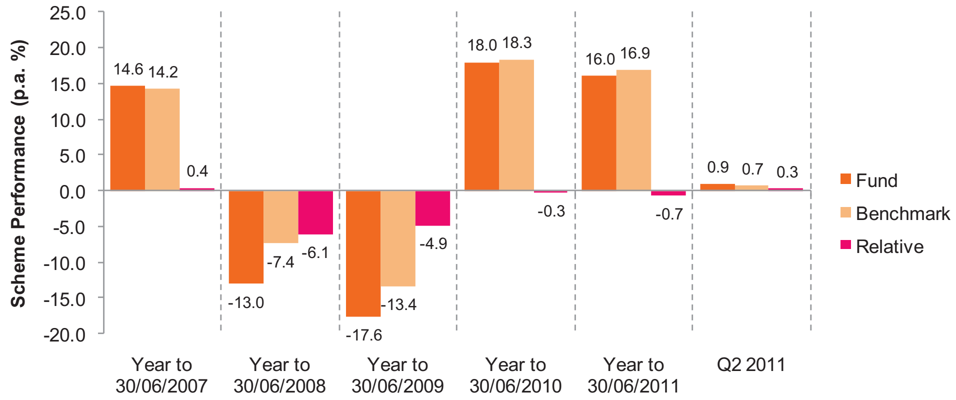
Comments

The Fund's portfolio value increased by £12.4m over the quarter, with most managers posting small positive returns.

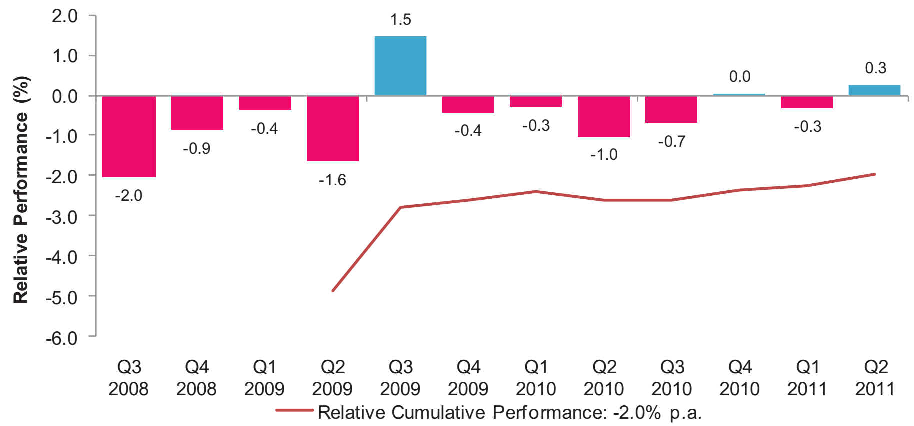
The Fund outperformed its benchmark, returning 0.9% relative to the benchmark return of 0.7%. The outperformance was largely due to the Investec commodities mandate which posted a mildly negative return as broader commodities indices fell more sharply.

During the quarter, an additional £1.3m was invested into the M&G UK Financing Fund and £65k was invested into the HarbourVest mandate to fund existing commitments.

Performance Summary

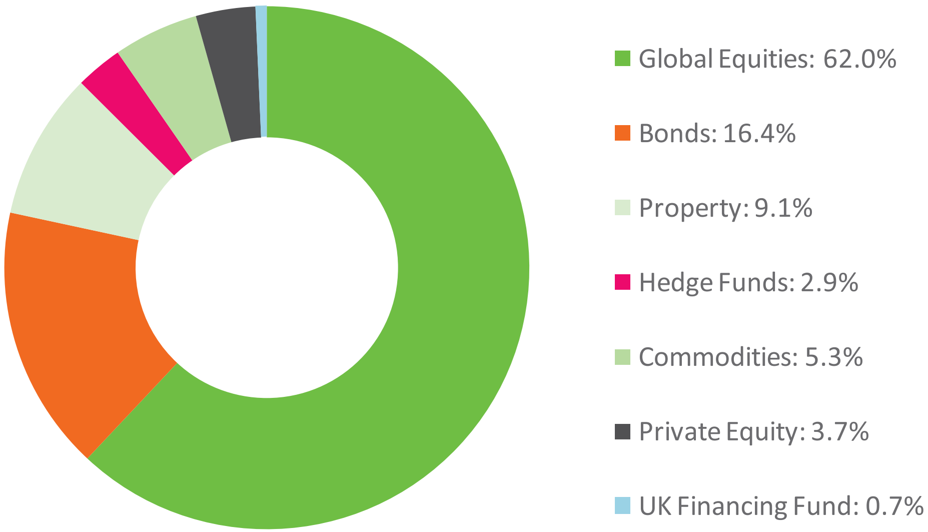


Relative Quarterly and Relative Cumulative Performance

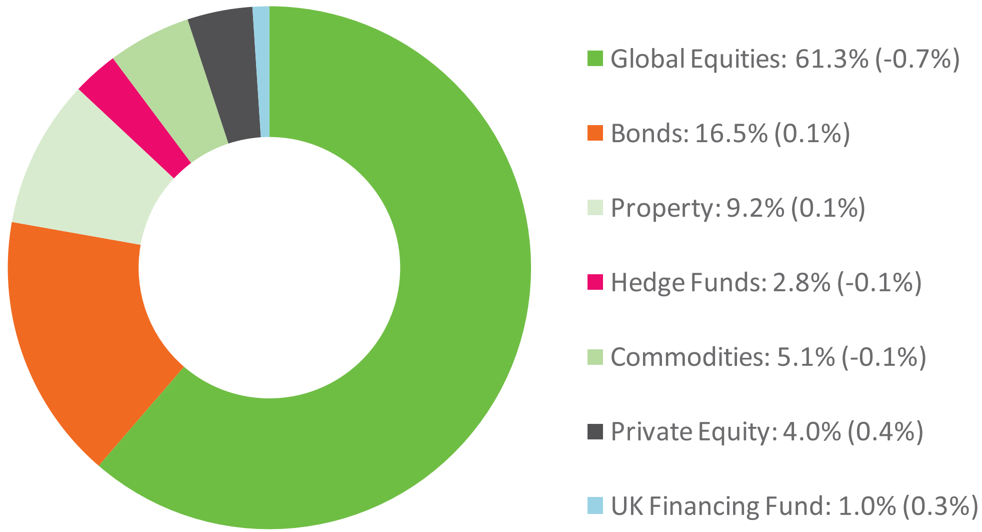


Fund Asset Allocation

Asset allocation as at 31 March 2011



Asset allocation as at 30 June 2011



Comments

During the quarter, an additional £1.3m was invested into the M&G UK Financing Fund and £65k was invested into the HarbourVest mandate to fund existing commitments.

Excluding the above transactions, changes to asset allocations resulting from underlying asset class movements were minor.

Manager Summary

Manager Valuations

Manager	Value (£m) Q1 2011	Q2 2011	Actual Proportion %	Target Proportion %	Difference %
Alliance Bernstein - Global Equity	177.4	175.8	22.7	22.0	0.7
RCM - Global Equity	169.1	170.5	22.0	22.0	0.0
UBS - UK Equity (Index)	125.9	128.3	16.6	16.0	0.6
UBS - Fixed Interest	124.7	127.6	16.5	16.0	0.5
Schroders - Property	69.3	71.0	9.2	10.0	-0.8
Fauchier - Hedge Fund of Funds	22.0	21.8	2.8	3.0	-0.2
Investec - Commodities	40.1	39.8	5.1	5.0	0.1
Harbourvest - Venture Capital	28.0	31.2	4.0	3.0	1.0
M&G - UK Companies Financing Fund	5.3	8.0	1.0	3.0	-2.0
Total	**761.7**	**774.1**	**100.0**	**100.0**	0.0

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Manager Summary

Manager	Date Appointed	Benchmark Description	Performance Target (% p.a.)	Rating *				
Alliance Bernstein - Global Equity	01 Nov 2004	MSCI All Country World Index	1.5% p.a. above benchmark			●		
RCM - Global Equity	18 Sep 2008	MSCI All Country World Index	1.5% p.a. above benchmark					●
UBS - UK Equity (Index)	27 Feb 2008	FTSE All Share	-					●
UBS - Fixed Interest	31 Oct 2004	Composite Bond Index	1.1% p.a. above benchmark			●		
Schroders - Property	12 Oct 2004	IPD Pooled Property Fund Index	-					●
Fauchier - Hedge Fund of Funds	28 Jun 2008	LIBOR + 5% p.a.	-				●	
Investec - Commodities	25 Feb 2010	Dow Jones-UBS Commodities Total Return Index	-					●
Harbourvest - Venture Capital	29 Jun 2006	MSCI All Country World Developed Index	5% p.a. above benchmark					●
M&G - UK Companies Financing Fund	01 May 2010	LIBOR	4-6% p.a. above benchmark					●

* For information on our manager ratings, see individual manager pages

Key:- Replace - On-Watch - Retain

Performance Summary - Managers

Performance Summary

		Alliance Bernstein - Global Equity	RCM - Global Equity	UBS - UK Equity (Index)	UBS - Fixed Interest	Schroders - Property	Fauchier - Hedge Fund of Funds	Investec - Commodities	Harbourvest - Venture Capital	M&G - UK Companies Financing Fund	Total Fund
3 Months (%)	Absolute	-0.9	0.9	1.9	2.4	2.5	-1.0	-0.6	2.1	0.8	0.9
	Benchmark	0.1	0.1	1.9	2.7	1.8	1.4	-6.9	0.5	0.2	0.7
	Relative	-1.0	0.8	0.0	-0.3	0.7	-2.4	6.8	1.6	0.7	0.3
12 Months (%)	Absolute	20.0	19.8	25.4	7.8	8.1	3.0	10.9	10.5	2.6	16.0
	Benchmark	21.3	21.3	25.6	6.1	7.6	5.6	17.3	22.3	0.6	16.9
	Relative	-1.1	-1.2	-0.2	1.6	0.5	-2.5	-5.5	-9.6	2.0	-0.7
3 Years (% p.a.)	Absolute	1.0	N/A	6.7	10.7	-4.5	N/A	N/A	-0.5	N/A	4.1
	Benchmark	5.2	N/A	6.6	10.0	-1.4	N/A	N/A	8.5	N/A	6.2
	Relative	-3.9	N/A	0.1	0.6	-3.1	N/A	N/A	-8.3	N/A	-2.0
Since Inception (% p.a.)	Absolute	6.7	12.6	4.8	10.3	2.2	1.1	8.9	4.0	2.2	7.6
	Benchmark	8.9	16.7	4.6	8.5	2.9	6.2	10.7	4.8	0.6	8.1
	Relative	-2.0	-3.5	0.2	1.6	-0.6	-4.8	-1.6	-0.8	1.6	-0.4

Alliance Bernstein - Global Equity

HR View Comment & Rating

Claude Chene, the London based CEO of Europe and Head of Distribution for the UK & Ireland, has resigned to become Global Head of Distribution at Ignis Asset Management. Chene moved to the UK in 1998 to launch Alliance Bernstein's UK and European proposition. Following Chene's departure, Richard Haxe's role as Head of European Distribution will once again incorporate the UK and Ireland, whilst David Steyn, Global COO who is based in Munich, will take over as CEO of Europe. Chene's departure is disappointing, but has no direct impact on portfolio management.

Dan Roarty has joined as the new Technology Sector Head for Global and International Research Growth portfolios. He joined the firm on 2 May 2011 and officially took over management of the Technology sector on 1 July 2011. Prior to joining the firm, Roarty spent nine years at Nuveen Investments where he co-managed a large-cap growth strategy. His prior experience also includes technology equity research in roles with Morgan Stanley and Goldman Sachs.

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Performance Summary - Comment

Alliance Bernstein underperformed their benchmark during Q2 2011, with the mandate returning -0.9% against the benchmark return of +0.1%.

Exposure to selected Energy stocks (Forest Oil, Devon Energy) and Consumer Cyclicals (Esprit, Gap) were the greatest detractors to performance over the quarter as investors moved to more defensive positioning. Offsetting the underperformance to some degree were positive contributions from selected stocks in the Capital Equipment (Nissan) and Medical (Sanofi) sectors.

At quarter end, the portfolio had moved to a greater underweight in Consumer Cyclicals, while increasing the overweight position in Financials. The manager also increased the overweight exposure to Japan during the quarter, and shifted to an underweight regional allocation to North America.

Performance Summary to 30 June 2011

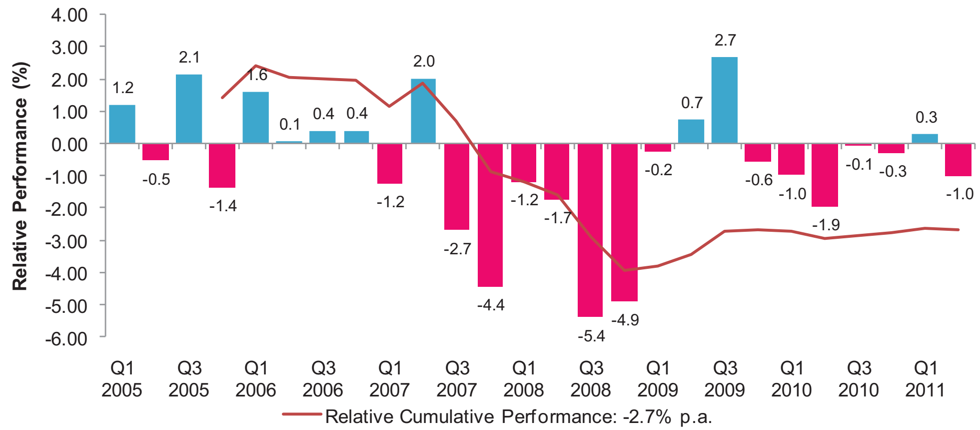
	3 Months (%)	12 Months (%)	3 Years (% p.a.)	Since Inception* (% p.a.)
Fund	-0.9	20.0	1.0	6.7
Benchmark	0.1	21.3	5.2	8.9
Relative	-1.0	-1.1	-3.9	-2.0

* Inception date 01 Nov 2004.

3 Year Relative Return

Actual % p.a.	Target % p.a.
-3.9	1.5

Relative Quarterly and Relative Cumulative Performance



RCM - Global Equity

HR View Comment & Rating

There were no significant staff changes to report during the period.

Performance Summary to 30 June 2011

	3 Months (%)	12 Months (%)	Since Inception* (% p.a.)
Fund	0.9	19.8	12.6
Benchmark	0.1	21.3	16.7
Relative	0.8	-1.2	-3.5

* Inception date 18 Sep 2008.

3 Year Relative Return

Actual % p.a.	Target % p.a.
N/A	1.5

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Performance Summary - Comment

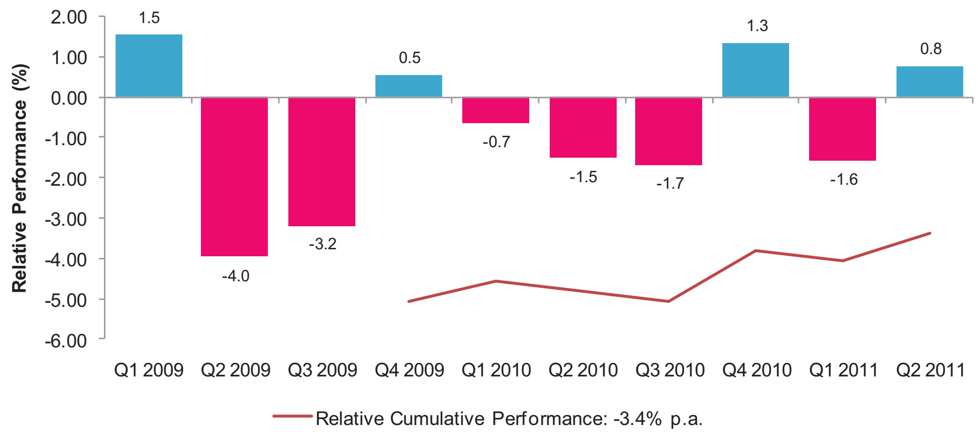
Over the quarter, RCM achieved a portfolio return of 0.9%, ahead of the benchmark return of 0.1%.

Positives came from stock selection in the Materials, Financials and Information Technology sectors. The best performing sector in the quarter was Healthcare and remains an area of high conviction for RCM going forward. The negatives came from an underweight position in Consumer Staples and stock selection in Consumer Discretionary, Telecommunications and Industrials sectors.

Over the quarter, RCM increased their exposure to consumer spending and reduced selected holdings in Energy and Healthcare. An underweight exposure to Utilities (1.2% of the fund vs. 3.8% of the benchmark) remains the largest negative active bet taken as the fund continues to be positioned to benefit from a growth up-turn in areas such as Germany and China.

At stock level, the manager's conviction in holding Adidas paid off over the quarter and the stock continues to be held as RCM believe the outlook for the company remains strong.

Relative Quarterly and Relative Cumulative Performance



UBS - UK Equity

HR View Comment & Rating

Rating				
Replace		On Watch		Retain ●

There were no significant business updates for the UBS passive business during the quarter.

Performance Summary to 30 June 2011

	3 Months (%)	12 Months (%)	Since Inception* (% p.a.)
Fund	1.9	25.4	4.8
Benchmark	1.9	25.6	4.6
Relative	-0.0	-0.2	0.2

* Inception date 27 Feb 2008.

3 Year Relative Return

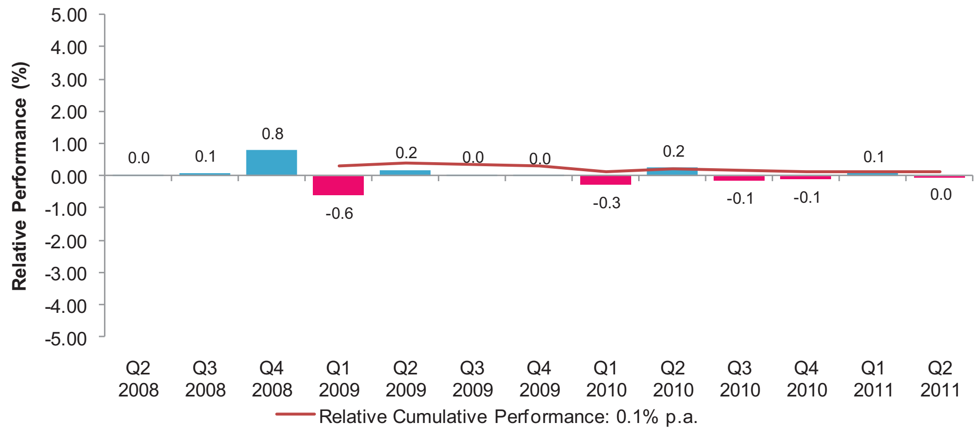
Actual % p.a.	Target % p.a.
0.1	0.0

Performance Summary - Comment

UBS succeeded in closely matching benchmark performance over the quarter, as would be expected of a passive manager.

The strongest sector performers during the quarter were Healthcare and Consumer Goods, while Oil & Gas and Basic Materials were the weakest performers.

Relative Quarterly and Relative Cumulative Performance



UBS- Fixed Interest

HR View Comment & Rating

In June, UBS announced the departure of Bob Jolly, Head of Sterling Bonds, who reported into Rob Gambi, Global Head of Bonds. Alix Stewart has taken over as lead portfolio manager for all the UK Fixed Income strategies - she did have responsibility for a number of Sterling portfolios prior to Jolly's departure.

Jolly has left UBS to join Schroders in September as head of Global Macro. The timing of his departure is unfortunate as Gambi has done well to rebuild a strong team over the last 2 years. It will be interesting to see who Gambi brings in as a replacement for Jolly – the calibre of individual will provide insight into how supportive the firm as a whole is to the success of the Sterling Fixed Income team.

We have not rated UBS positively for Fixed Income capabilities for some time. This is no reflection of the investment individuals but rather a reflection of the firm's loss of confidence in its Bond team during the events of 2008/2009.

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Performance Summary - Comment

The UBS fixed interest mandate underperformed its benchmark over the quarter, returning 2.4% versus the benchmark return of 2.7%, although it continues to remain ahead of benchmark over the longer term performance periods of 12 months and 3 years.

Following recent economic data and statements from policy makers, the manager views rate hikes as being unlikely this year. Duration positioning across the underlying funds is close to benchmark. The manager continues to remain positive on corporate bonds, supported by positive earnings surprises and large cash balances on corporate balance sheets.

During the quarter the manager removed the underweight to US Treasuries and reduced the relative overweight to UK gilts. The manager remains underweight German government bonds in the expectation that further rate rises will be priced into the German yield curve.

Performance Summary to 30 June 2011

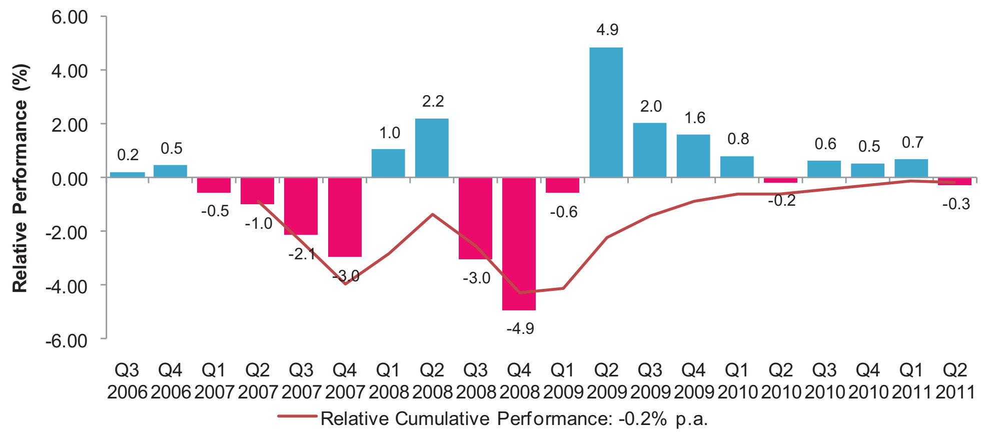
	3 Months (%)	12 Months (%)	Since Inception* (% p.a.)
Fund	2.4	7.8	10.3
Benchmark	2.7	6.1	8.5
Relative	-0.3	1.6	1.6

* Inception date 31 Oct 2004.

3 Year Relative Return

Actual % p.a.	Target % p.a.
0.6	1.1

Relative Quarterly and Relative Cumulative Performance



Schroders - Property

HR View Comment & Rating

In April, Schroders announced the appointment of Nick Scott as Head of Retail for the Schroder Exempt Property Unit Trust (SEPUT), one of the holdings within the Schroders multi-manager mandate (7.4% of NAV as at 30 June 2011).

Scott has joined from NewRiver Retail, with over 20 years of retail experience across both the occupational and investment markets. Scott spent over 10 years at Parkridge Developments Ltd where he was Director of Investment & Development, responsible for the creation of value enhancement strategies with specific emphasis on the retail sector.

There were no other changes to the Schroders property team during the quarter.

Performance Summary - Comment

The portfolio outperformed its benchmark over the quarter, returning 2.5% against the benchmark return of 2.4%. The portfolio's overweight exposure to buoyant central London office market was a major contributor. Improved performance from the portfolio's continental European holdings was also a positive.

During the quarter the manager received redemption proceeds from its UBS Triton holding and re-invested the funds in one of the portfolio core holdings, the Standard Life Property Fund, and the Real Income Fund. As noted in our previous quarterly report, the Real Income Fund is a new fund managed by Schroders which seeks to identify UK property that can maintain real income and protect value in a low growth environment.

Looking forward the manager continues to seek to reduce the portfolio exposure to 'opportunistic' style funds with higher debt levels in favour of the portfolio's existing 'core' holdings.

Performance Summary to 30 June 2011

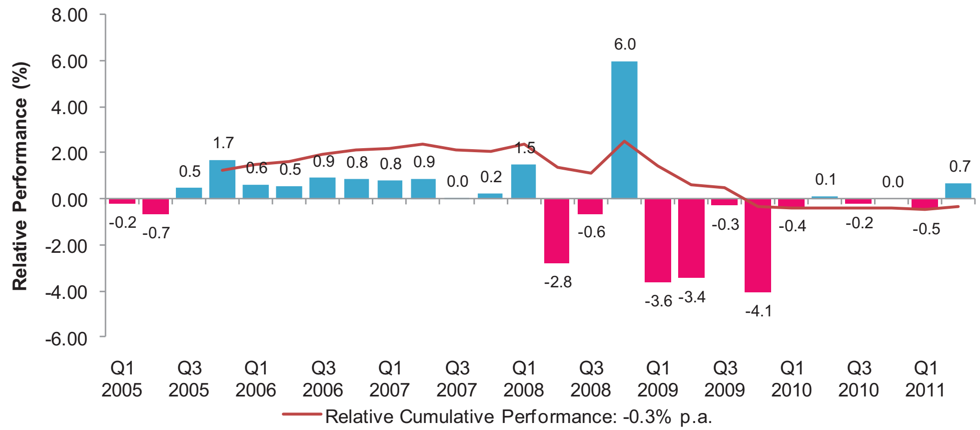
	3 Months (%)	12 Months (%)	3 Years (% p.a.)	Since Inception* (% p.a.)
Fund	2.5	8.1	-4.5	2.2
Benchmark	1.8	7.6	-1.4	2.9
Relative	0.7	0.5	-3.1	-0.6

* Inception date 12 Oct 2004.

3 Year Relative Return

Actual % p.a.	Target % p.a.
-3.1	0.0

Relative Quarterly and Relative Cumulative Performance



Fauchier - Hedge Fund of Funds

HR View Comment & Rating

In April, Fauchier Partners extended the redemption period on one of their US funds from one month to 3 months to enable investment in less liquid strategies like long/short credit and distressed debt that have slightly longer withdrawal periods than global macro or long/short equities. Fauchier Partners said the decision to extend the notice period was independent of market conditions and had been planned. This is not the first term change for Fauchier since the crisis. In 2009 it extended the withdrawal term on another fund and last June investors in its Jubilee Special Situations product agreed to an 'investor level gate', under which each could not withdraw over 12.5% of their capital on any one redemption day.

We do not expect this to have a material impact on the funds our clients are invested in but we will continue to monitor the firm.

Performance Summary - Comment

The Fauchier mandate finished the quarter down -1.0%, underperforming relative to its benchmark return of 1.4%.

Detractors to performance included the fund's positions in Lansdowne UK Equity and Lansdowne Global Financials Fund, most notably because of both funds holding overweight positions in Lloyds TSB which has seen significant value wiped off its share price this year.

By strategy, the portfolio's macro fund holdings were the weakest performer amidst an uncertain outlook for global economic growth and markets being increasingly driven by politics rather than economics. Event driven managers generally profited from the uptick in corporate activity, however the fund's holdings in this strategy did not materially benefit from this positive environment.

Performance Summary to 30 June 2011

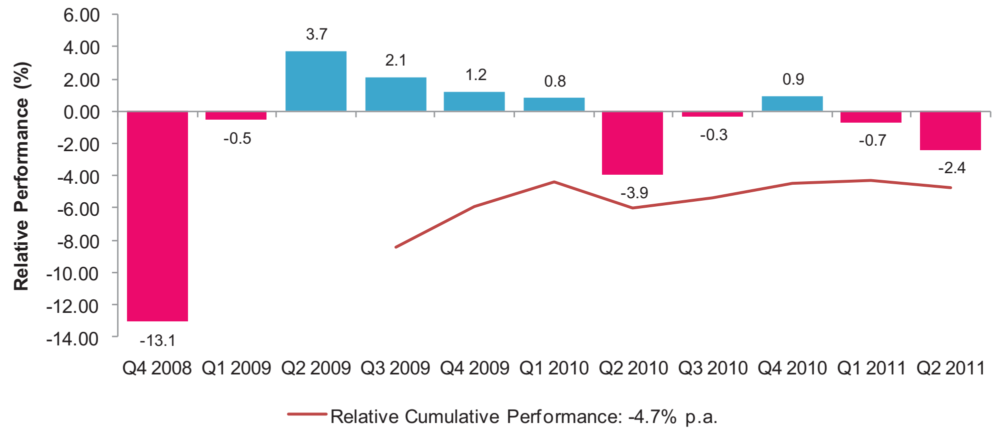
	3 Months (%)	12 Months (%)	Since Inception* (% p.a.)
Fund	-1.0	3.0	1.1
Benchmark	1.4	5.6	6.2
Relative	-2.4	-2.5	-4.8

* Inception date 28 Jun 2008.

3 Year Relative Return

Actual % p.a.	Target % p.a.
N/A	5.0

Relative Quarterly and Relative Cumulative Performance



Investec - Commodities

HR View Comment & Rating

There have been no significant changes to the Investec commodities team to report during the quarter.

Performance Summary to 30 June 2011

	3 Months (%)	Since Inception* (% p.a.)
Fund	-0.6	8.9
Benchmark	-6.9	10.7
Relative	6.8	-1.6

* Inception date 25 Feb 2010.

3 Year Relative Return

Actual % p.a.	Target % p.a.
N/A	0.0

Performance Summary - Comment

The Investec commodities mandate outperformed during a difficult quarter for commodity markets in general, returning -0.6% against the benchmark return of -6.9%.

Stock selection in the Base and Bulk commodities sector contributed to performance, with outperformance achieved in both Long and Short equity positions. Short positions in Zinc and Nickel also contributed as both commodities fell over 10% during the period.

The biggest detractors from a sector perspective were the portfolio's exposure to long equity positions in Energy. Long equity Gold positions, including African Barrick Gold and European Goldfields, also detracted from performance.

Harbourvest - Venture Capital

HR View Comment & Rating

HarbourVest remains one of our favoured fund of fund firms due to its global reach, broad and deep network of relationships, and array of impressive, experienced individuals.

Performance Summary to 30 June 2011

	3 Months (%)	12 Months (%)	3 Years (% p.a.)	Since Inception* (% p.a.)
Fund	2.1	10.5	-0.5	4.0
Benchmark	0.5	22.3	8.5	4.8
Relative	1.6	-9.6	-8.3	-0.8

* Inception date 29 Jun 2006.

3 Year Relative Return

Actual % p.a.	Target % p.a.
-8.3	5.0

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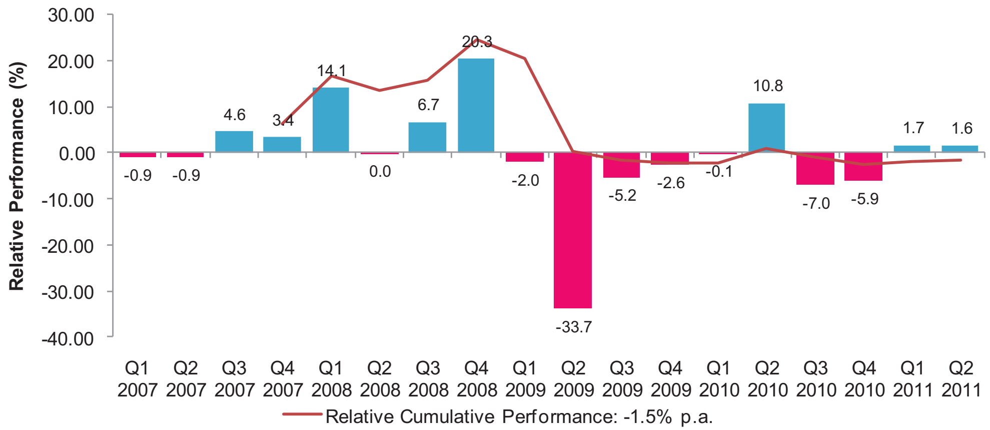
Performance Summary - Comment

The HarbourVest mandate returned 2.1% during the quarter, outperforming its benchmark return of 0.5%.

Given the volatility and pricing of this asset class, it can be misleading to place too much emphasis on short-term performance.

The returns shown are sourced from Northern Trust.

Relative Quarterly and Relative Cumulative Performance



M&G - UK Companies Financing Fund

HR View Comment & Rating

As noted in our previous quarterly report, the investment period for the fund has been extended to July 2012.

The manager continues to see a favourable lending environment for the fund.

Performance Summary to 30 June 2011

	3 Months (%)	Since Inception* (% p.a.)
Fund	0.8	2.2
Benchmark	0.2	0.6
Relative	0.7	1.6

* Inception date 01 May 2010.

3 Year Relative Return

Actual % p.a.	Target % p.a.
N/A	0.0

Performance Summary - Comment

The UK Companies Financing Fund returned 0.8%, ahead of its LIBOR benchmark return of 0.2% for the quarter.

During the quarter the fund made two additional drawdowns. At 30 June 2011, the fund had made seven loans amounting c.40% of committed capital. M&G are in continuing discussions with a number of companies regarding potential loans, with the size of potential deals being between £50m to £100m.

The returns shown are sourced from Northern Trust.

Performance Calculation

Geometric vs Arithmetic Performance

Hymans Robertson are among the investment professionals who calculate relative performance geometrically as follows:

((1 + Fund Performance) / (1 + Benchmark Performance)) - 1

Some industry practitioners use the simpler arithmetic method as follows:

Fund Performance - Benchmark Performance

The following example illustrates the shortcomings of the arithmetic method in comparing short term relative performance with the longer term picture:

	Arithmetic Method			Geometric Method			Difference
Period	Fund Performance	Benchmark Performance	Relative Performance	Fund Performance	Benchmark Performance	Relative Performance	
Quarter 1	7.00%	2.00%	5.00%	7.00%	2.00%	4.90%	**0.10%**
Quarter 2	28.00%	33.00%	-5.00%	28.00%	33.00%	-3.76%	**-1.24%**
Linked 6 months			-0.25%			0.96%	**-1.21%**
6 Month Performance	36.96%	35.66%	1.30%	36.96%	35.66%	0.96%	**0.34%**

Using the arithmetic method

If fund performance is measured quarterly, there is a relative underperformance of 0.25% over the six month period.
If fund performance is measured half yearly, there is a relative outperformance of 1.30% over the six month period.

Using the geometric method

If fund performance is measured quarterly, there is a relative outperformance of 0.96% over the six month period.
If fund performance is measured half yearly, an identical result is produced.

The geometric method therefore makes it possible to directly compare long term relative performance with shorter term relative performance.

HYMANS ROBERTSON

60 SECOND

NEWS SUMMARY

PUBLIC | SECTOR

STOCKMARKET TURMOIL AND FUNDING THE LGPS

August 2011

Recent market events have sent LGPS funding levels to depths not seen since autumn 2008. Back then we advised that the very long term time horizon of most employers means LGPS funds can ride out short term volatility in market conditions; unlike very mature private sector funds, they do not need to sell assets now in order to pay benefits. We also advised that there was no need for an immediate rise in employer contribution rates.

These sentiments still hold true today, despite the drop in the number of contributing members which most funds are experiencing, as this briefing note explains.

This note also contains a brief summary of the more immediate issues, from an actuarial perspective, which relate to situations where any deficit is crystallised, such as:

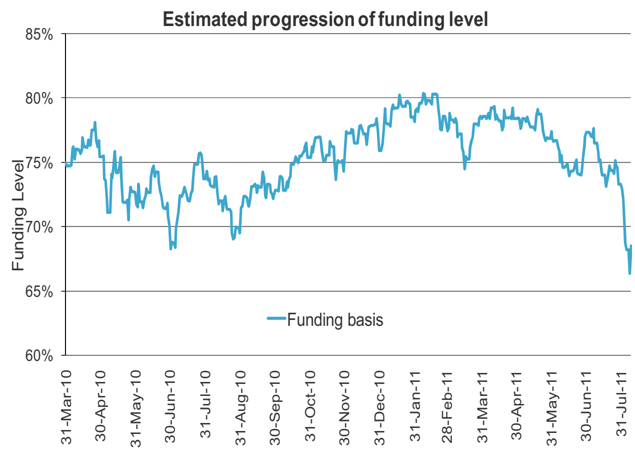
- cessation valuations;
- bulk transfers, and
- even transactions within the fund – yet another headache in relation to any academies about to join?!

FALLING FUNDING LEVELS, GROWING DEFICITS

Turmoil in the financial markets has dominated headlines in the last week or so. Weak economic growth, fears over sovereign debt and the threat of a double-dip recession in both the US and Europe have all had a part to play in the recent dramatic falls in asset values. The fall in UK gilt yields is a double whammy for pension funds as liabilities increase in value.

For a typical fund in England and Wales, the funding level at 31 March 2010 was around 75%. Based on prevailing prices (9 August), we estimate that the funding level has dropped to around 68%. This has come about not just from falling asset values; the value of liabilities has increased due to lower long term real yields and hence a lower net discount rate.

The chart below shows the sharp drop in funding level that the 'typical' fund has experienced in recent weeks.



WHAT DOES THIS MEAN FOR CONTRIBUTION RATES?

Higher deficits generally mean higher employer contributions, a greater reliance on future investment returns or a combination of the two.

For the long-term, secure employers funds may be content to accept that, unless conditions do improve, the chances of reaching their long-term funding target are diminished. In the main this will be the far more palatable option than asking already cash-strapped local authorities to pay in more to prop up the funding level.

Whilst it would be disingenuous to pretend that LGPS funds are immune to market events, we would support funds in not increasing employer contributions to the LGPS immediately, for the following reasons:

- The next valuation is not due until 2013 and market conditions (asset values and real bond yields) may yet improve.
- Funds are generating more than enough investment income to cover any shortfall of contributions compared to benefit payments so there is no need to sell assets to meet benefit payments (albeit the processes to draw down income may not be in place for many funds).
- With member contributions and future benefits under review a knee-jerk reaction to market movements would appear to be an over-reaction.

In any event, there is no power in the regulations to increase employer contributions due to adverse market conditions.

Recent events do however highlight the risks associated with the current growth-biased investment strategy of most funds and the need to think carefully about whether the current strategy remains appropriate for private companies and employers who no longer admit new entrants. Some funds are already re-considering their funding and investment strategy for mature employers and we would encourage others to do the same.

WHAT SHOULD YOU DO NOW?

INVESTMENTS

Investment issues have been covered in our recent Capital Markets Service note. Local authority funds have typically invested a high proportion of their funds in return-seeking assets such as equities, because they are expected to deliver higher returns over the longer term for an acceptable level of risk. This does result in volatility, which local authority funds can generally accommodate because of their long term nature. The acceleration in the maturity of fund membership due to redundancies, possible opt-outs and, for Councils, the establishment of academies, may mean funds' appetite for investment risk may diminish over time. Whilst we are not advocating any immediate action, we do support the re-appraisal of investment risk that some funds are already undertaking – recent events act as a clear reminder that many funds remain heavily reliant on equities as their main source of growth.

COMMUNICATIONS AND MANAGING EXPECTATIONS

If market conditions continue as they are, administering authorities may wish to warn employers about the potential impact on the outlook for contribution rates at the 2013 valuation. Any increases are likely to be greatest for shorter term employers whose participation in the fund may end in the reasonably near future and employers (often less financially secure) who are required to repay deficits over a shorter period than tax-raising bodies.

The statutory nature of members' benefits mean members should have nothing to fear from recent market events. You may find it worthwhile to communicate this to members, some of whom might think that stock-market falls could affect their pension. Member communication is particularly important in today's environment given the uncertainty and anxiety surrounding the review of public service pensions.

ADMISSION AGREEMENTS COMING TO AN END

We would encourage funds to review contribution rates for any employers whose admission agreements are scheduled to end over the next 3-4 years. As deficits have grown; higher contributions now will reduce the likelihood of an unaffordable shortfall when the agreement ends, which would be passed on to other employers in the fund.

Other options include extending admission agreements which are due to end soon to see if market conditions improve; or, where no delay in termination is possible but the employer will continue to exist, deferring settlement of the final deficit amount. If market conditions improve, the amount could then be adjusted to take this into account.

BONDS

Bonds are typically for the protection of awarding authorities letting contracts. More and more bonds now include some allowance for financial risks and are intended to incorporate an allowance for any deficit at the date of bond review (usually carried out no more frequently than annually).

Funds may wish to discuss with awarding authorities, whether or not to review (and increase) bond amounts, although this will be unwelcome at a time when employers are perhaps facing other financial challenges. We would suggest that administering authorities engage with the employers for whose protection the bond exists before taking any action.

PASS THROUGH ARRANGEMENTS

Where a pass through approach is taken, the investment risk associated with the pension benefits of outsourced workers remains with the awarding authority. In this case, the increase in the deficit attributable to the awarding authority will be higher than would otherwise be the case, and will be a higher percentage of the pay of members who have remained in the employment of the local authority.

OUTSOURCINGS

Outsourcings are usually on a fully funded basis, with assets transferring from the awarding authority to the new employer equal to the value of the transferring liabilities, irrespective of the funding level. In current conditions this could lead to unintended consequences for both parties; reducing the residual funding level for the awarding authority, and generating a surplus for the new employer if market conditions improve.

There are various ways of dealing with this, but the most appropriate approach will depend on the specific circumstances.

ACADEMIES

The admission of academies has already been a fraught process for many LGPS funds. In current conditions transferring a share of the Council's deficit in relation to deferred members and pensioners to an academy may mean a zero or even negative transfer of assets, a situation which is very unlikely to appeal to any academies.

Administering authorities may wish to consider whether there are any alternatives to calculating the funding level and assets to transfer based on market conditions on the transfer date. Alternatively, they could consider limiting the extent to which academies are asked to make good the deficit in relation to deferred members and pensioners which has arisen due to recent market events.

BULK TRANSFERS

We would recommend that administering authorities consider delaying payment of any bulk transfers out of the fund where there is no provision to reduce the amount paid due to adverse market conditions. To do otherwise could crystallise a significant deficit for the transferring employer.

Alison Murray
Partner
11 August 2011

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Agenda Item 8

PENSIONS INVESTMENT COMMITTEE			
REPORT TITLE	**STATEMENT OF INVESTMENT PRINCIPLES**		
KEY DECISION	**Yes**	**Item No.**	**8**
WARD	**All**		
CONTIBUTORS	**Executive Director for Resources**		
CLASS	**Part 1**	**Date:**	**6 September 2011**

Reason for Urgency

It is a requirement under existing regulations to publish a Statement of Investment Principles (SIP) and revise this in accordance with any material changes. Officers needed to clarify some legal points with the Council's actuaries which lead to a delay in the report being despatched on time.

1. Purpose

The purpose of this report is to present the revised Statement of Investment Principles.

2. Summary

Pension Funds are required to issue and maintain a Statement of Investment Principles. The last updated version was presented to the Committee in September 2010 and this report presents the Committee with the updated version for 2011.

3. Recommendation

It is recommended that Pensions Investment Committee agree the revised Statement of Investment Principles, which is attached as an Appendix to this report.

4. Background

The Fund operates under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998. The SIP is a requirement of amending regulations of the same name which came into force on 4 January 2000. The administrating authority, as part of these regulations, must publish a SIP and revise this in accordance with any material change in policy. Additionally, the Fund must revise its SIP every three years, however it is presented to this committee on an annual basis.

5. Changes

Since the last SIP revision in 2010 many of the key contact officers have changed and this has been reflected in the attached document. There have been no material changes to the Fund’s structure, although Members will be aware of the proposals to change the structure of the Fund. An update to proposed structural changes are contained elsewhere on this agenda.

6. Financial Implications

6.1. There are no direct financial implications arising from this report. Indirectly, pending proposals to revise the Fund’s structure to a more passive management basis will change the Fund’s returns and fees will reduce. Members will be continually updated of these implications as the process for restructuring the Fund progresses.

7. Legal Implications

7.1. The Fund must comply with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 as amended by the 2003 regulations for limits on investments.

7.2. Additionally the Fund must comply with requirement to issue and review the Statement of Investment Principles as set out in the 1999 regulations.

For further information on this report, please contact Selwyn Thompson, Group Manager Budget Strategy on 020 8314 6932.

London Borough of Lewisham Pension Fund

Statement of Investment Principles

Revised July 2011

Contents

Appendices

1. Background

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.

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.

The fund at the 31st March 2011 had assets of approximately £760 million.

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, the actuary, and the investment consultants.

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.

The principles outlined in this document were first approved by the Investment Committee in 2000, and are reviewed periodically.

2. Responsibility for Fund Governance

2.1 Pensions Investment Committee

This Statement will be presented to The Pensions Investment Committee at the 6th September 2011 meeting for endorsement.

The Committee 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.

The Pensions Investment Committee meets quarterly and consists of eight voting members with a quorum of three. Stakeholders such as pensioners and contributors also sit on the Committee as observers. The current composition of the Committee is shown at Appendix I.

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 external advisers. Its primary responsibilities are to:

- Prepare the Statement of Investment Principles
- Set the objectives of the Fund and determine the strategic asset allocation.
- 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.

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

The Committee 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.

2.2 Investment Managers

The investment management structure of the fund will be determined after obtaining appropriate advice. Implementation of the current specialist mandate structure was completed in 2009.

The responsibilities of the investment managers are to:

- Ensure the investment of the Fund's assets are 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/or the Committee 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.

2.3 Custodian Bank

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.

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
- Manage uninvested 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

2.4 Independent Investment Adviser

The independent investment adviser position is currently vacant .

The specific responsibilities are to advise the Executive Director for Resources and the Committee 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.

2.5 The Actuary

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 the Committee in balancing the short and long term objectives of the Fund
- Provide FRS 17 reports on pension costs.
- Calculation of initial employers contributions for admitted and scheduled bodies.
- To review bond and guarantee levels for admitted bodies.

2.6 The Investment Consultant

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 the Committee 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.

2.7 The Executive Director for Resources

The Executive Director for Resources is responsible for:

- Implementation of policy
- Ensuring compliance with this document and notifying the Pensions Investment Committee of non-compliance
- Ensuring that this document is regularly reviewed and updated and reflects regulatory requirements.
- Submitting quarterly performance monitoring reports to the Pensions Investment Committee
- 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 the PIC in order to manage the assets of the Fund in a prudent and efficient manner. If this responsibility is used, the Committee will be updated at the next available opportunity.

3 Investment Objectives of the Fund

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

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 13% of the assets.

5 Investment Manager Structure and Fund Details

The Pensions Investment Committee 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.
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 II.

6 Investment Strategy and Asset Mix

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.

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.

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. Historically, equities have accounted for between 70 to 75% of Lewisham's Fund, and in the current structure constitute approximately 62% of the Fund.

The investment managers set their individual investment strategies to meet the performance objectives set by the Fund. The benchmarks, performance targets and operating ranges are outlined in Appendix II. With the exception of the passive UK equity mandate, the Fund's assets are currently managed on an active basis and are expected to outperform their respective benchmarks by the performance targets shown over a rolling three year period.

In choosing the benchmark, the funding position and maturity profile of the Fund, together with the risk tolerance level of the Council, are key considerations. Property is less volatile than equities and therefore provides diversification. Furthermore, the projected long-term future returns of property appear attractive relative to bonds and cash. The Fund has invested in several large pooled property funds, which to some extent counterbalance the illiquid nature of property. Furthermore, part of the private equity mandate has been achieved by investing in an equity based offering, again helping to offset illiquidity.

At the PIC meeting of the 24th February 2011, the committee took the decision to restructure the Pension Fund and increase the passively managed element of the pension fund. Hymans Robertson was appointed at the 15th June meeting to oversee the process of appointing the new fund manager and also a transition manager to oversee the process. This process is expected to take at least six months.

7 Freedom of information

The Council will attempt to respond to requests for information relating to the Fund, under Freedom of Information Act 2000, within the statutory timescales.

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.

The Pensions Investment Committee considers 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

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.

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

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 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 SRI objectives set out above. The managers will report periodically to the Committee on the exercise of these powers and will consult the Fund if in any doubt on related issues.

10 Monitoring of investment performance

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.

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 the Committee quarterly and to officers half yearly where they will be given the opportunity to justify their past performance and communicate the rationale behind their investment strategies for the shorter and longer term. Smaller investment managers such as the private equity and hedge fund managers will be expected to report annually to Committee and annually to officers. They must also be prepared to answer questions tabled by Members of the Committee. Each investment manager is required to present on a more frequent basis, if required.

In addition Lewisham's Internal Audit Service and the external auditors undertake periodic reviews to confirm that the arrangements and procedures established by the Committee are effectively complied with.

11 Risk

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.

The Fund is subject to the following risks:

- 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.

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

- Liquidity/Cashflow Risk
  Investments are held until such time as they are required to fund payment of pensions. Currently the fund is relatively immature and consequently there is a net inflow of funds from contributors The Council manages its cashflows 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

- 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 the Investment Committee as part of the manager monitoring process. In addition the management structure is based on complimentary management styles in an attempt to ensure that the portfolio has an element of counter-balancing to ensure there is exposure to different phases in the economic cycle.

- 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 mitigates this risk by establishing a well diversified strategic asset allocation, reviewing the investment strategy regularly and following a regular fund manager review process.

- 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.

- Counterparty Risk

  This risk of 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 has strict criteria within its stock lending agreements to mitigate counterparty risk in these transactions.

- 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.

- Environmental, Social and Ethical Issues Risk

  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.

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 3.

12. STOCK LENDING

The Council entered into a stocklending arrangement with the Custodian Northern Trust in April 2010.

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 collaterisation conditions.

Appendix 1: Who's Who

1. Investment Committee	
Councillors **Cllr Whittle (Chair)** **Cllr Maslin (Vice Chair)** **Cllr Allison** **Cllr Best** **Cllr Fletcher** **Cllr Muldoon** **Cllr Wise** **Cllr Pattisson**	**Union Representatives** **Mr J Hale** UNISON **Vacant** UNITE **Pensioner Representatives** **Mrs C Humble** **Vacant** **Admitted Body Representative** Vacant
2. Executive Director for Resources **Janet Senior** Town Hall, London, SE6 4RU	
3. Investment Managers	
Alliance Bernstein Devonshire House, 1 Mayfair Place , London WIJ 8AJ	**UBS Global Asset Management** 21 Lombard Street, London EC3V 9AH
Schroders 31 Gresham Street, London EC2V 7QA	**HarbourVest** 8th floor, Suite 7,Berkeley Square House, Berkeley Square. London
RCM (UK) Limited 155 Bishopsgate London EC2M 3AD	**Fauchier Partners** 72 Welbeck Street London W1G 0AY
Investec Asset Management 2 Gresham Street London EC2V 7QP	**M&G** Laurence Pountney Hill London EC4R 0HH

4. Custodian Bank **The Northern Trust Company** 50 Bank Street, Canary Wharf, London E14 5NT	**5. Actuary** **Hymans Robertson LLP** 20 Waterloo Street Glasgow G2 6DB
6. Investment Consultant **Hymans Robertson LLP** 20 Waterloo Street Glasgow G2 6DB	**7. Solicitors** **Legal Services** Town Hall, London, SE6 4RU
8. Performance Measurement **The Northern Trust Company** 50 Bank Street, Canary Wharf, London E14 5NT	**The W.M. Company** (a subsidiary of State Street Bank) World Markets House, Crewe Toll, Edinburgh, EH4 2PY
9. Commission Recapture Agent **Lynch, Jones & Ryan, In** 3 Times Square, New York, NY 10036, U.S.A.	**10. Bankers** **The Co-operative Bank** Regional Public Sector Manager Public Sector The Co-operative Bank 4th Floor, 9 Prescot Street London. E1 8BE.
11. Auditors **Audit Commission** First floor Millbank Tower, Millbank, London. SW1P 4HQ.	**12. Officers (investment)** **Selwyn Thompson :** Group Manager, Budget Strategy **Shola Ojo:** Principal Accountant **Omar Farooqui:** Accountant
13. Officers (Administration) **Carol Eldridge:** Group Manager **Mike Dobson:** Team Leader	**14. AVC providers** **Clerical Medical** PO Box 174 Walton Street Aylesbury Bucks. HP21 7YP. **Equitable Life** PO Box 177 Walton Street Aylesbury Bucks. HP21 7YH.
15. Membership of Professional Associations National Association of Pension Funds Local Authority Pension Fund Forum	

Appendix 2: Target Structure of Fund

Manager	Mandate	Target Allocation
Bernstein	Global Equities	22.00%
RCM	Global Equities	22.00%
UBS: Equity	UK Equities	16.00%
UBS: Bonds	Fixed Interest	16.00%
Schroder	Property	10.00%
Fauchier	Hedge Funds	3.00%
Harbour Vest	Venture Capital	3.00%
M&G Credit	Credit	3.00%
Investec	Commodities	5.00%
		100.00%

APPENDIX 3: INVESTMENT PERFORMANCE TARGETS, BENCHMARKS AND OPERATING RANGES

Alliance Bernstein

Portfolio: Global equities including the UK

Target: To seek to out-perform the benchmark return by + 1.5% per annum over rolling three year periods net of fees

Benchmark and Operating Ranges:

Asset Class	%	Index
Global Equities	100	MSCI ACWI
Cash	0	

Alliance Bernstein will operate a half hedge. This is where only half the portfolio is exchanged back into sterling allowing the portfolio to benefit from the currencies which appreciate against sterling and thus increasing the return in the portfolio through limited active portfolio management of the currency exposure.

RCM

Portfolio: Global equities including the UK

Target: To seek to outperform the benchmark return by + 1.5% per annum over rolling three year periods net of fees

Benchmark and Operating Ranges:

Asset Class	%	Index
Global Equities	100	MSCI ACWI
Cash	0	

A currency hedge similar to that operated by the other global manager will be negotiated.

UBS

Portfolio: UK passive equities and Global fixed interest plus

Target: To seek to out-perform the benchmark return by +1.1% per annum over rolling three year periods net of fees on bonds. On passive equities and assets under transition the target is to match the benchmark – i.e. no out-performance.

Benchmarks:

Asset Class	%	Index
UK Equities		FTSE All share Index
Fixed Interest:		
UK Corporate Bonds	21.7	iBoxx Sterling Non-gilt Over

15 year Index

UK Fixed Interest Gilts 28.3 FTSE-AGS Over 15 years

Gilts Index

UK Index Linked Gilts 34.8 FTSE-AGS Over 5 years Gilts Index

Overseas Bonds 15.2 J P Morgan(ex UK)

Government Bond Index

Schroder Property Investment Management

Portfolio : A Fund of funds approach in global property

Target : To seek to outperform the benchmark return by +0.75% per annum over rolling three year periods net of fees.

Benchmark

Asset Class	**%**	**Index**
UK property	>60	HSBC / IPD Pooled Property Fund Index-All Balanced Funds Median
Non UK property	<40	Absolute return of 8%
Cash	**0**	

Fauchier Partners

Portfolio: A fund of funds Hedge Fund investment in the Jubilee Absolute Return Fund.

Target: To seek to out-perform one month LIBOR by 5% over a rolling three year period.

Benchmark LIBOR

HarbourVest Partners (U.K.) Limited

Portfolio: A fund of funds limited partnership investing in Private Equity.

Target: To seek to outperform the benchmark return by 5.00% per annum over a rolling ten year period net of fees.

Benchmark To seek to outperform the benchmark return by + 5% per annum

Private Equity MSCI All World Developed Index

The private equity allocation is invested in four limited partnership vehicles and an equity offering quoted on the Dutch stock exchange.

M&G

Portfolio: UK companies financing fund

Benchmark: LIBOR

Target: 4-6% p.a above benchmark

The fund provides medium to long term core debt financing to mid-cap (ie approximately the 50th to the 350th largest companies by market capitalisation) UK companies with strong business fundamentals that are facing difficulties with their usual sources of debt finance due to the impact of the “credit crunch”.

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 the Committee based on advice from officers, the independent investment adviser 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 the Pensions Investment Committee.
- The Council has a Pension Fund Business Plan which is reviewed annually.
- There is a clear conflicts of interest policy and Members must make declarations of interest before each Committee or as matters arise during the course of Committee business.
- Training is provided to Members before each meeting on topics they are to consider and technical briefing notes are prepared and distributed prior to meetings.

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

- The Committee 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.
- The Committee 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, hedge funds, 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.

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 – partial compliance

- The Committee reviews investment performance on a quarterly basis and cross examines investment managers on wither 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.
- The establishment of an Investment Sub-Committee will assist trustees to assess their own effectiveness.

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.
- The Investment Committee has delegated responsibility for the exercise of voting rights and engagement with companies to investment managers. Within that delegation investment managers are 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 the Committee, its advisers and investment managers and details of the mandates and fee basis of investment managers.
- The Committee 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 Committee and are available on the web.
- A comprehensive annual pensioners newsletter is produced and distributed to all pensioners of the Fund.

Agenda Item 9

PENSIONS INVESTMENT COMMITTEE			
Report Title	**ANNUAL GOVERNANCE REPORT**		
Key Decision			**Item No. 9**
Ward			
Contributors	**CHIEF EXECUTIVE**		
Class	**Part 1**	**Date:6 SEPTEMBER 2010**	

Recommendation

It is recommended that the Pensions Investment Committee considers the draft Annual Governance Report as attached as an Appendix.

Annual governance report

London Borough of Lewisham Pension Fund

Audit 2010/11

Contents

Key messages

This draft report summarises the findings to date from my 2010/11 audit which is not yet complete. It summarises the messages arising from my audit of your pension fund financial statements.

Audit opinion and financial statements

This report summarises the findings from my 2010/11 pension fund audit to date. It identifies the key issues arising that you should consider before I will be in a position to issue my audit opinion on the Council's financial statements.

The Council provided the pension fund financial statements earlier than the main council financial statements, on 7 June 2011. At this stage I have found that the draft pension fund financial statements contain four material errors, four material omissions in the notes, and several non trivial and trivial errors. The errors found from my audit work to date are summarised in appendix 2.

A complete set of working papers to support the financial statements was not available at the start of the audit. Subsequent requests for further supporting information were not always provided in a timely manner and in some cases, did not provide sufficient evidence to support the audit query being raised. Due to these issues and the fact that the main contact left during the audit, the audit is currently ongoing. I will provide a further update to the Audit Panel in September when this report will be finalised.

Subject to the remaining items detailed on page 5, and the completion of review procedures I plan to issue an audit report on the council's financial statements that includes an unqualified opinion on the pension fund financial statements. Subject to the review of the pension fund annual report I also plan to issue an unqualified opinion on the financial statements included in the pension fund annual report. Appendix 1 (to follow in the final report as a separate attachment) contains a copy of my draft audit report on the pension fund annual report.

Before I complete my audit

I confirm to you

My report includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

Independence

I can confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence. I can also confirm there were no relationships resulting in a threat to independence, objectivity and integrity.

The Audit Commission's Audit Practice has not undertaken any non-audit work on the Council's pension fund during 2010/11.

Due to the errors that I have found during the audit to date and the delays in providing timely and accurate supporting working papers I am in the process of agreeing an additional fee for the pension fund with the Director of Resources. I will update you with progress in the final draft of this report.

I ask you to confirm to me

I ask the Pensions Investment Committee to:

- consider the matters raised in this report before the Council approves the financial statements (page 5);
- take note of the adjustments to the financial statements which are set out in this report (appendix 2); and
- consider the letter of representation before it is approved on behalf of the Council and before I issue my opinion (to follow as a separate attachment in the final report - appendix 6).

Financial statements

Subject to the remaining items noted below I plan to issue an audit report on the Council's financial statements that includes an unqualified opinion on the pension fund financial statements

Opinion on the pension fund financial statements

Subject to satisfactory clearance of outstanding matters below, I plan to issue an audit report including an unqualified opinion on the financial statements of the pension fund. Appendix 1 (to follow) contains a copy of my draft report. My work on the financial statements is not yet complete. The following items are outstanding.

- Accounting policy for two investments.
- Audited accounts from the investment manager for the price of the Investec fund 31 March 2011.
- Reconciliations: from AXIS (pension administration system) to the general ledger/from payroll to the general ledger for March 2011.
- Supporting information for the receipts and payments testing in April.
- Reconciliation to support the year end cash balance.
- Reconciliation between the purchases and sales in the accounts and the information from the investment manager.

I have received some responses to queries raised however I have not yet completed my testing on:

- review of the annual report (not yet received);
- debtors and creditors (and related completeness testing);
- contributions and benefits testing;
- investment income; and
- review of the investments disclosure and agreement to external confirmations (new note to be provided by the council).

Subject to the receipt and review of further working papers and further internal reviews, my team may raise further audit queries.

Errors in the financial statements

The financial statements submitted for audit were incomplete. The Council had not disclosed an analysis of the Financial Instruments nor the opening net asset Statement for 2009 which are required by the transition to International Financial Reporting Standards (IFRS) in 2010/11.

My audit to date has identified the following errors which management has agreed to adjust (refer to appendix 2). There are four material amendments to date within the net asset statement.

- There were two material classification errors within the investment categories on the net asset statement in 2010/11.
- The derivatives were shown on a gross basis on the net asset statement, instead of disclosing only the profit/loss.
- There was one material amendment made to the prior year classification of private equity, to ensure consistency between years.

None of these errors had an impact on the overall position of the fund account or the total net assets. There were three material disclosure omissions in the notes:

- There was no collateral disclosed held by the Council (£11million), nor related stock lending (£10.2million).
- The Council had not disclosed the value of the commitments relating to private equity (£26.2million).

There were several trivial and non trivial disclosure amendments made. The Council has agreed to adjust for all of the errors found to date and I will update Appendix 2 with any further issues found. I will update Appendix 3 (unadjusted errors) if necessary, in final draft of this report.

Recommendation
R1 Ensure that a full quality review is undertaken before the accounts are submitted for audit.

Financial statements

The Pension Fund financial statements are important means by which the Council accounts for its stewardship of public funds. The Council has final responsibility for these statements. It is important that you consider my findings before the Council adopts the financial statements.

In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

Key audit risk and findings

Key audit risk	Finding
1. Separate bank accounts required for the Fund Under revisions to legislation, the Fund must from 1 April 2011 have a separate and dedicated bank account rather than have its funds within the Council's banking arrangements. This increases the risk particularly with the year-end closing cash balance that will become the opening balance within a separate bank account.	The Council has confirmed that a new bank account has been open from 1 April 2011. However the Council has not yet used this bank account for the pension fund transactions in the 2011/12 year and hence the pension fund monies are not yet clearly ring-fenced from other monies held by the Council. The Council has confirmed that this will now be undertaken as soon as possible.
2. International Financial Reporting Standards (IFRS) Some presentational and classification changes will be required due to the implementation of IFRS.	I have reviewed the disclosures required under IFRS. The Council had correctly included the present value of funded benefits which is a new requirement in 2010/11 under International Accounting Standard (IAS)26. However I found that the Council had not disclosed the net asset statement for 2009 which is a requirement under the transition to IFRS. The Council also updated the accounts during the audit to include an analysis of financial instruments required under the international financial reporting standards, (along with related disclosures).

<table>
<tr><th>Key audit risk</th><th>Finding</th></tr>
<tr><td>3. Unquoted investments
The valuation of unquoted investments is potentially a very complex area. The pension fund has a material amount of unquoted investments. There are risks around accurate valuation at year end.</td><td>I reviewed the unquoted investments disclosed in the accounts. I found:
■ Harbourvest private equity investments. The 31 March 2011 valuation had not been used to prepare the accounts. Due to timing, the report used by the custodian was prior to March 2011 and therefore I found a discrepancy between the accounts and the confirmation I received from the investment manager of £2 million (the Council is to confirm the exact value and has agreed to adjust the accounts).
■ M&G: The custodian had used the valuation from the 31 December 2010 and this meant that the investments were disclosed at cost rather than fair value. Difference is trivial for 2010/11 (£5k) but the Council should ensure the investments are disclosed at market value for next year.</td></tr>
<tr><td>4. Preparation of the financial statements
The Council is planning to produce the Pension fund financial statements and working papers one month earlier than last year by producing them on the 27 May 2011. The Council needs to obtain all relevant information to avoid subsequent amendments for example in 2009/10 the Custodian provided late information causing material adjustments to the financial statements. There is a risk that the audit is not complete before the main contact leaves the council.</td><td>The Council provided the statements for audit on 7 June 2011, 11 days later than the date agreed with the auditors. The working papers were not ready with the accounts and there were subsequent delays in starting the audit and with audit progress. This was mainly due to the fact that the main contact left during the audit.

The Council has worked hard to provide responses to audit queries raised since the main contact left and I will work with the Council to complete the audit as soon as possible before the deadline.</td></tr>
<tr><td>5. Fair value disclosure of the investments
There is an inherent risk that investments disclosed in the net asset statement are not at disclosed fair value.</td><td>During the audit I obtained external confirmation for the value of investments disclosed in the net asset statement. I have the following issues to report.
■ I found that the investments disclosed were materially correct however I found three discrepancies between the net asset statement and the external confirmation from the fund manager: Values to be confirmed (non trivial differences). The Council confirmed that in some cases the prices differ slightly to the Investment manager valuation due to various factors including pricing sources and methods.</td></tr>
</table>

Key audit risk	Finding
	■ I also found that the external investment manager confirmation I received from Schroder contained a valuation for one investment as at 31 December 2010 instead of 31 March 2011. As a result I have no external support for the valuation of this investment (£7.1million) in the accounts as at 31 March, other than the custodian's confirmation. The difference between the December and the March price was non trivial (£178k). ■ I found discrepancies between the purchases disclosed in the accounts and the purchases disclosed in the fund manager (UBS report). The custodian had accounted for a 'return on investment' as a purchase. The Council has amended the accounts to resolve this difference (value to be confirmed).

Financial statements

Significant weaknesses in internal control

I reported one weakness in my audit opinion plan that was presented to the Pensions Investment Committee and I have repeated this weakness below. These weaknesses are only those I identified during the course of the audit that are relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control.

Internal control issues and findings

Description of weakness	Potential effect
1. Year end reconciliation (pre statement audit finding) My audit work has indentified that the Council is not regularly carrying out reconciliations between the general ledger and ■ contributions (payroll system); or ■ transfers in and out (pension system AXIS).	There is a risk that the general ledger is not kept up to date if no reconciliations are completed between the systems.
2. Cash book reconciliation I found during the audit that there was no cash book to support the cash relating to the pension fund at year end. The Council provided a reconciliation during the audit but there remained a discrepancy of (£73k- value to be updated by the Council)	The Council should ensure that it maintains records to support the cash balance. As the Council moves over to the new bank account this will remain important to ensure proper transfer and segregation between council and the pension fund monies.
3. Membership details There was no membership reconciliation to show the movement from opening number of members to the closing number of members. The AXIS report that I obtained as a working paper to support the note to the accounts at year end did not agree to the note due to timing (the original report printed to support the note had not been saved).	Keeping a reconciliation of members who join or leave the scheme provides additional control over the membership numbers.

Recommendations

R2 Ensure regular reconciliations are completed between the general ledger and the AXIS system/payroll system on a regular basis.

R3 Maintain detailed records to support the cash in the pension fund account and ensure that the new bank account is used in line with the regulations.

R4 Keep a full reconciliation of members in the pension fund, from the opening to the closing position at year end. Ensure that a working paper is provided to support the number of members at year end.

Financial statements

Quality of your financial statements

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures.

These are the issues I want to raise with you.

Accounting practices, policies, estimates and financial closures

Issue	Recommendations
1. Agreement to the ledger The Statement of Accounts submitted for audit did not agree to the ledger. There was a discrepancy of £6.2 million due to timing. The Council has now agreed to amend the ledger to agree to the accounts.	**R5** Ensure that the statement of accounts agrees to the ledger before submitting to the accounts for audit.
2. Working paper requirements The Council had not used the working paper requirements document that was agreed with the auditors to prepare working papers before the audit began. This resulted in substantial delays and material errors being identified during the audit.	**R6** Use the working paper requirements document agreed with the auditors to prepare the working papers before the audit begins.

Financial statements

Significant difficulties encountered during the audit

A complete set of working papers to support the financial statements was not available at the start of the audit. Subsequent requests for further supporting information were not always provided in a timely manner and in some cases, did not provide sufficient evidence to support the audit query being raised. I understand that the key contact preparing the pension fund left during the audit and this was the main reason for the significant delays. I do not expect the same issues to arise next year.

Letter of representation

Before I issue my opinion, auditing standards require me to ask the Audit Panel and management for written representations about the financial statements and governance arrangements (refer to Appendix 6 for a copy of this letter - to follow in final draft of the report).

Appendix 2 – Amendments to the draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to aid you in fulfilling your governance responsibilities.

Table 1: **Amendments made to statement or note (value)**

Adjusted mis-statement	Nature of adjustment	Value of amendment £000
Net Asset Statement: The equity tracker fund had been incorrectly reclassified as 'segregated equities' in 2010/11.	The Council reversed the reclassification made in 2010/11. This amendment has been made in the final version of the accounts.	125,633
Net Asset Statement: The index linked funds had been incorrectly reclassified as 'fixed income' in 2010/11.	The Council reversed the reclassification made in 2010/11. This amendment has been made in the final version of the accounts.	42,414
Net Asset Statement: The private equity has been correctly reclassified as 'other funds' in 2010/11, yet the prior year had not been adjusted to make this consistent between years.	The Council amended the prior year classification to recognise a prior period adjustment, and to ensure consistency between years.	23,681
Net Asset Statement: Derivatives. The Council had incorrectly accounted for the derivatives on a gross basis in the Net Asset Statement.	Amended the presentation on the net asset statement by showing only the profit or the loss of each derivative on the Net Asset Statement.	17,203 (assets)/17,283 (liabilities)

Adjusted mis-statement	Nature of adjustment	Value of amendment £000
Net Asset statement Unquoted Harbourvest investments. The investments had not been valued as at 31 March 2011 due to timing of the accounts preparation.	This amendment was subsequently made to the accounts, to show the value as at 31 March 2011.	2,000 (exact value to be confirmed by council)
Note 1 fund account: Admitted/scheduled body contributions. The Council incorrectly input the figure for admitted bodies under the line for scheduled bodies in the accounts.	This amendment was subsequently made in the accounts.	571
Note 14: Collateral disclosure. There was no collateral disclosed.	This amendment was subsequently made in the accounts.	10,996
Note 14: Stock Lending. There was no value disclosed for the stock lending.	This amendment was subsequently made in the accounts.	10,200
Private equity note. There was no value disclosed for the commitments relating to Private Equity.	This amendment was subsequently made in the accounts.	£26,200
Note 13: Cash held with the fund managers was incorrectly disclosed as being held with the custodian	The Council has amended the note to disclose the cash being held with the fund managers.	Various
Investments note: The Council incorrectly disclosed a change in value to the investments as 'purchases'.	This amendment was subsequently made in the accounts.	Value to be confirmed by Council in £

Table 2: **Amendment made to statement or note (change to text or omission)**

Statement or note	Amendment made to the text or statement
Net Asset Statement	The Council omitted the 2009 Net Asset Statement which is a requirement under IFRS. The Council has agreed to amend this in the final version of the accounts.
Financial instruments	The Council had not disclosed an analysis of the type of financial instruments held within the pension fund, nor an analysis of the risks relating to the financial instruments. The Council has agreed to include this in the final version of the accounts.
Rounding errors	There were inconsistencies between the main statements and the notes, as some figures have been rounded and some had not been rounded (several discrepancies up to £146k)
Accounting policies	There were no accounting policies disclosed for the measurement of two investments held: M&G and Investec.

Appendix 3 – Unadjusted misstatements to the financial statements

I identified the following misstatements during my audit but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities and ask you to correct these misstatements. If you decide not to amend, please tell me why in the representation letter. If you believe the effect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

		Comprehensive income and expenditure statement		Balance sheet	
Unadjusted misstatement	Nature of required adjustment	Dr £000s	Cr £000s	Dr £000s	Cr £000s
None at this stage					

Appendix 4 – Glossary

Audit opinion

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

Opinion

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

Materiality and significance

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

‘Significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

Weaknesses in internal control

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or

- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

Appendix 5 – Action plan

Recommendations	
Recommendation 1	
Ensure that a full quality review is undertaken before the accounts are submitted for audit.	
Responsibility	
Priority	
Date	
Comments	
Recommendation 2	
Ensure regular reconciliations are completed between the general ledger and the AXIS system/payroll system on a regular basis.	
Responsibility	
Priority	
Date	
Comments	
Recommendation 3	
Maintain detailed records to support the cash in the pension fund account and ensure that the new bank account is used in line with the regulations.	
Responsibility	
Priority	
Date	
Comments	

Recommendation 4	
Keep a full reconciliation of members in the pension fund, from the opening to the closing position at year end. Ensure that a working paper is provided to support the number of members at year end.	
Responsibility	
Priority	
Date	
Comments	

Recommendation 5	
Ensure that the statement of accounts agrees to the ledger before submitting to the accounts for audit.	
Responsibility	
Priority	
Date	
Comments	

Recommendation 6	
Use the working paper requirements document agreed with the auditors to prepare the working papers before the audit begins.	
Responsibility	
Priority	
Date	
Comments	

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0844 798 7070

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

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August 2011

PENSIONS INVESTMENT COMMITTEE			
Report Title	Exclusion of the Press and Public		
Key Decision	No		Item No. 10
Ward			
Contributors	Chief Executive (Head of Business & Committee)		
Class	Part 1	Date: 6 September 2011	

Recommendation

It is recommended that under Section 100(A)(4) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraphs 3, 4 and 5 of Part 1 of Schedule 12(A) of the Act, as amended by the Local Authorities (Executive Arrangements) (Access to Information) (Amendments) (England) Regulations 2006 and the public interest in maintaining the exemption outweighs the public interest in disclosing the information:-

11 Minutes

12 Passive Manager

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Agenda Item 11

Document is Restricted

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Document is Restricted

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Agenda Item 12

Document is Restricted