

AGENDA MANAGEMENT SHEET

Name of Committee Pension Fund Investment Board

Date of Committee 18 May 2007

Report Title New Statement of Investment Principles

Summary Report setting out the new Statement of Investment Principles following the award of property and hedge fund mandates

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Would the recommended decision be contrary to the Budget and Policy Framework? No.

Background papers None

CONSULTATION ALREADY UNDERTAKEN:-

Details to be specified

- Other Committees
- Local Member(s)
- Other Elected Members Cllr Davis – Chairman of Pension Board
- Cabinet Member
- Chief Executive
- Legal Tony Maione
- Finance David Clarke, Strategic Director, Resources – reporting officer
- Other Chief Officers
- District Councils

Health Authority

Police

Other Bodies/Individuals

FINAL DECISION YES

SUGGESTED NEXT STEPS:

Details to be specified

Further consideration by
this Committee

To Council

To Cabinet

To an O & S Committee

To an Area Committee

Further Consultation

Pension Fund Investment Board – 18 May 2007

**Local Government Pension Scheme
New Statement of Investment Principles**

Report of the Strategic Director of Resources

Recommendation

That the new Statement of Investment Principles be adopted.

1 Introduction

- 1.1 On 12 and 13 February 2007, the Investment Board awarded three new mandates to property and hedge fund managers.
- 1.2 As a result of the new structure, it was judged that the existing Statement of Investment Principles (SIP) was out of date. Accordingly, a redraft was commissioned.

2 Revised Edition of the Statement of Investment Principles

- 2.1 The revised SIP is shown in **Appendix A**.
- 2.2 Members are invited to discuss the redraft and put forward any suggestions for additions or amendments.

3 Recommendation

- 3.1 That the new SIP be adopted.

DAVID CLARKE
Strategic Director of Resources

Shire Hall
Warwick
May 2007

Warwickshire Pension Fund

Statement Of Investment Principles

1 Introduction

Warwickshire County Council (the “Authority”) has drawn up this Statement of Investment Principles (the “Statement”) to comply with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998. The Authority has consulted with such persons as it considers appropriate including obtaining written advice from Mercer Investment Consulting and independent consultants in preparing this Statement.

Overall investment policy falls into two parts: strategic management and day-to-day management. The strategic management of the assets is fundamentally the responsibility of the Authority (acting on advice as it deems appropriate) and is driven by its investment objectives as set out in Section 3 below. The remaining elements of policy are part of the day-to-day management of the assets, which is delegated to the investment managers and described in Section 4.

Annex 1 shows how the Warwickshire Pension Fund currently complies with the Principles for Investment Decision Making in accordance with the CIPFA guidance published in April 2002 and in accordance with SI 1852 (2002).

Annex 2 sets out the role of the investment consultant.

2 Overall Responsibility

Warwickshire County Council is the designated statutory body responsible for the administration of the Warwickshire County Council Pension Fund on behalf of its constituent scheduled and admitted body employers. The responsibility for the Fund is delegated through the Regulatory Committee to the Pension Fund Investment Board.

The Pension Fund Investment Board consists of five County Councillors who are advised by an independent advisor, the Council’s investment consultant (Mercer Investment Consulting) and officers of the County Council. The Board is responsible for:

- Setting investment policy;
- Appointing suitable investment managers to implement the investment policy;
- Reviewing and monitoring investment performance.

The day-to-day monitoring of investment managers is delegated to the Strategic Director of Resources. The Strategic Director of Resources also has a statutory duty to ensure that proper financial arrangements are in place to manage the Fund. The Pension Board Investment Board meets four times a year at the conclusion of each quarter. The eight active investment managers will attend meetings on a regular basis.

The Pension Fund Investment Board is supported in its role by the Consultative Panel consisting of elected member and officer representatives from the district / borough councils, unions and a pensioner representative. The Consultative Panel meets with the Pension Fund Investment Board at the start of the spring and autumn meetings.

3 Investment Objectives and Risk

3.1 Investment Objectives

The Authority has set the objective to be at or above a 100% funding level in order that it is able to meet its current and future liabilities. It also has an objective to maintain a stable employer contribution rate that is as low as possible. In order to meet these objectives, a number of secondary objectives have been agreed as follows:

- (i) Seek returns that are consistently strong and outperform or match those available in the major investment markets and are comparable with other institutional investors.
- (ii) Emphasise markets that over time are likely to give better returns relative to the liabilities.
- (iii) Acknowledge the risks of investing and have regard to best practice in managing these risks.
- (iv) Have sufficiently liquid resources available to meet the Fund's current liabilities.
- (v) For the overall Fund to outperform the benchmark set out in 3.3, by 1.3% per annum over rolling three-year periods.

3.2 Risk

There are various risks to which any pension fund is exposed. The Authority has considered the following risks and believes that they do not exceed an acceptable level:

- (i) The risk of any deterioration in the funding level of the Fund.
- (ii) The risk that the investment managers, in their day-to-day management of the assets, will not achieve the rate of investment return expected by the Authority. The Authority recognises that the use of active investment managers involves such a risk. To limit its exposure to the risk of active managers underperforming, the Authority invests approximately 21% of the Fund's investments on an index-tracking basis, producing a level of certainty in achieving the specific market rate of return at a relatively low cost. The remaining 79% is placed with a number of external active managers, where it is believed that the risk of underperformance is outweighed by the potential gains from successful active management.

- (iii) Any investment decision carries with it risks of different types (for example, risk of underperformance, risk from mismatching, risk from under funding). The Authority recognises these different types of risk and seeks to minimise them as far as possible by regular monitoring of the performance of the fund managers, seeking advice from the actuary on the suitability of the assets with regard to the Fund's liabilities and ensuring that the Fund's portfolio is suitably diversified.

3.3 Investment Strategy

The Authority sets a long-term investment strategy (the mix of asset types) to have regard to the Fund's liability structure and the investment objectives above. This is reviewed at least every 3 years, after each actuarial valuation. The Authority believes that the following investment strategy is currently appropriate for controlling the risks identified in 3.2, given the liability profile of the Fund and its financial position.

Asset Class	Index-Tracker	UK Equity Specialists	Global Equity Specialists	Alternative Assets	Fixed Income	Total
UK Equities	2.00	27.00	3.50			32.50
Overseas Equities	10.00		22.50			32.50
European	7.50		5.50			13.00
North American	1.25		8.50			9.75
Far East/Emerging Markets	1.25		8.50			9.75
Property				5.00		5.00
Hedge Funds				5.00		5.00
UK Corporate Bonds	2.00				8.00	10.00
UK Fixed Interest	2.00				8.00	10.00
UK Index-Linked	5.00					5.00
Total	21.00	27.00	26.00	10.00	16.00	100.00

4 Management of the Assets

4.1 Rationale for Investment Management Structure

Having taken advice from its investment consultant, the Authority decided to implement a specialist manager structure. The approach allows the selection of "best in class" managers in each region or asset class, which should lead to superior performance. A specialist structure is less exposed to the performance of any one manager and hence reduces the probability that a poor manager selection detracts from overall performance. A further advantage of this approach is that the investment managers have been selected so that they are unlikely to apply the same investment themes or process and so this provides an additional level of diversification.

4.2 Main Assets

The Authority invests the main assets of the Fund in portfolios operated by external investment managers. The Authority is satisfied that the spread of assets by type and the investment managers' policies on investing in individual securities within each type provides adequate diversification of investments. The managers appointed are listed below.

Manager	Role	Proportion of Fund
Barclays Global Investors ("BGI")	Multi-asset Passive Portfolio	21%
State Street Global Advisors ("SSGA")	Active UK Equity Portfolio	13.5%
Threadneedle Investments ("Threadneedle")	Active UK Equity Portfolio	13.5%
MFS Investment Management ("MFS")	Active Global Equity Portfolio	13%
UBS Global Asset Management ("UBS")	Active Global Equity Portfolio	13%
UBS Global Asset Management ("UBS")	Active Bond Portfolio	16%
Schroder Investment Management ("Schroder")	Active Property (Multi-Manager) Portfolio	2.5%
Threadneedle Investments ("Threadneedle")	Active Property Portfolio	2.5%
Blackstone Alternative Asset Management ("Blackstone")	Active Fund of Hedge Funds Portfolio	5%

The investment managers' mandates include the following guidelines:

BGI (Multi-Asset Passive)

The details of the multi-asset passive mandate are as follows:

	Benchmark (%)	Index
UK Equities	9.5	FTSE All-Share Index
European (ex UK) Equities	35.5	FTSE AW Developed Europe (ex UK) Index
North American Equities	6.0 *	FTSE AW USA Index FTSE AW Canada Index
Japanese Equities	3.0	FTSE AW Japan Index
Pacific Basin (ex Japan) Equities	1.5	FTSE AW Developed Pacific (ex Japan) Index
Emerging Markets Equities	1.5	IFC Investable Index (ex Malaysia)
UK Corporate Bonds	9.5	iBoxx Sterling Non Gilts All Stocks years Index
UK Fixed Interest Gilts	9.5	FTSE A All Stocks Fixed Interest Gilt Index
UK Index Linked Gilts	24.0	FTSE A All Stocks Index Linked Gilt Index
Total	100.0	

* Split between the US and Canada in proportion with the FTSE AW Developed North America Index.

Within each class of assets, BGI will be expected to track the relevant benchmark index within agreed tolerance limits.

In addition, BGI will be expected to maintain the overall Fund benchmark, excluding the proportion of the assets invested in property and fund of hedge funds, (details given in section 3.3) by rebalancing its assets under management, i.e., the passive investment manager will act as a “Swing Manager” on behalf of the Fund. Therefore, the above mandate will only apply initially; the ongoing mandate will vary with swing management. Due to the nature of the Fund’s investment in property and fund of hedge funds, the allocations to Schroder, Threadneedle and Blackstone are monitored separately.

SSGA and Threadneedle

The details of the UK equity mandates are:

	Benchmark (%)	Allowable Range (%)	Index
UK Equities	100.0	+/- 5.0	FTSE All-Share Index
Cash	0.0	+/- 5.0	

The out-performance target for each UK equity mandate is FTSE All Share Index +1.5% per annum (gross of fees) over rolling three-year periods.

UBS (Global Equity)

The details of the global equity mandate are:

	Benchmark (%)	Allowable Range (%)	Index
European (inc UK) Equities	30.56	+/- 10.0	FTSE Europe Developed (inc UK) Index
North American Equities	30.56	+/- 10.0	FTSE AW Developed North America Index
Pacific Basin (inc Japan) Equities	30.55	+/- 10.0	FTSE Asia Pacific Developed Pacific (inc Japan) Index
Emerging Markets Equities	8.33	+/- 3.0	FTSE AW All Emerging Index
Cash	0.00	+/- 5.0	
Total	100.00		

Totals affected by rounding

The out-performance target for each global equity mandate is 1.5% per annum (gross of fees) over rolling three-year periods above the return of the indices weighted by the benchmark allocation.

MFS (Global Equity)

The details of the global equity mandate are:

	Benchmark (%)	Allowable Range (%)	Index
European (inc UK) Equities	36.11	+/- 10.0	FTSE AW Developed Europe Index
North American Equities	36.11	+/- 10.0	FTSE AW Developed North America Index
Japanese Equities	15.00	+/- 5.0	FTSE AW Developed Japan Index
Pacific Basin (ex Japan) Equities	4.45	+/- 3.0	FTSE AW Developed Pacific (ex Japan) Index
Emerging Markets Equities	8.33	+/- 3.0	FTSE AW All Emerging Index
Cash	0.00	+/- 5.0	
Total	100.00		

Totals affected by rounding

The out-performance target for each global equity mandate is 1.5% per annum (gross of fees) over rolling three-year periods above the return of the indices weighted by the benchmark allocation.

UBS (Bonds)

The details of the bond mandate are:

	Benchmark (%)	Allowable Range (%)	Index
UK Corporate Bonds	50.0	+/- 20.0	iBoxx Sterling Non-Gilts All Stocks Index
UK Fixed Interest Gilts	50.0	+/- 20.0	FTSE A All Stocks Fixed Interest Gilt Index
Cash	0.0	+/- 15.0	
Total	100.0		

The out-performance target for the bond mandate is 1.0% per annum (gross of fees) over rolling three-year periods above the return of the indices weighted by the benchmark allocation.

Schroder (Property – Multi-Manager)

The details of the multi-manager property mandate are:

	Benchmark (%)	Index
Property Multi-Manager	100.0	HSBC/AREF Pooled Funds Indices – Balanced Funds Weighted Average
Total	100.0	

The out-performance target for the property mandate is 1.0% per annum (net of fees) over rolling three-year periods above the index return. Schroder has the discretion to invest in European property up to 20% value of the portfolio.

Schroder has the discretion to use derivatives in the management of the fund.

Threadneedle (Property)

The details of the property mandate are:

	Benchmark (%)	Index
Property	100.0	HSBC/AREF All Balanced Funds Index
Total	100.0	

The out-performance target for the property mandate is 1.0% per annum (net of fees) over rolling three-year periods above the index return.

Threadneedle has the discretion to invest in European property as part of this mandate.

Blackstone (Fund of Hedge Funds)

The details of the fund of hedge funds mandate are:

	Benchmark (%)	Index
Fund of hedge funds	100.0	UK LIBID 7 Day Notice
Total	100.0	

The out-performance target for the fund of hedge funds mandate is 6% per annum (net of fees, in Sterling terms) over rolling three-year periods above the index return.

4.3 Investment Restrictions

The investment managers are prohibited from holding investments not defined as “investments” in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended). All investment managers are permitted to utilise derivatives in the efficient management of portfolios.

The investment managers’ investment decisions are further constrained by a maximum 5% limit on any single investment.

4.4 Realisation of Investments

In general, the Fund’s investment managers have discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments. There is no current policy on realising investments to meet benefit payments as the fund has positive cashflow from employee/employer contributions.

4.5 Monitoring and Review

The performance of the Fund’s investment managers is independently measured by Mellon Analytical Solutions (formerly Russell Mellon), a subsidiary of the

Authority's global custodian, on a quarterly and annual basis. They provide quarterly and annual performance reports to the Authority.

In addition, the Authority meets the investment managers at least once a year to review their actions together with the reasons for the background behind the investment performance. The investment managers also provide monthly and quarterly reports and give additional presentations to the Authority as appropriate.

Mercer Investment Consulting is retained as investment consultant to assist the Authority in fulfilling its responsibility for monitoring the investment managers. In addition, the Authority reviews the Fund's asset allocation between the managers on a quarterly basis.

The Authority also monitors the transactions costs of the investment activity of the fund managers.

The performance of the Fund's advisers is not formally monitored as no decisions are delegated to them.

5 Social, Environmental and Ethically Responsible Investment

The PFIB has on a number of occasions considered the issue of socially responsible investment. On each occasion, the PFIB has concluded not to pursue an active socially responsible investment strategy. The main areas of consideration in arriving at this decision are as follows:

- The requirement to act in the best interests of the Fund's members is, to a large extent, interpreted as being their best financial interest;
- A socially responsible approach to investments does not have to mean disinvesting in a company. Shareholder voting can be used to influence a company towards socially responsible behaviour;
- It is almost impossible to draw up a set of ethical criteria that would satisfy all members of the Fund;
- The belief that in the medium to long term companies that fail to adopt a socially responsible approach to their operations will not be viable.

6 Corporate Governance

(i) The Authority recognises its responsibility as an institutional investor to support and encourage good corporate governance practices in the companies in which it invests. The Authority considers that good corporate governance can contribute to business prosperity by encouraging accountability between boards, shareholders and other stakeholders. Good corporate governance also plays a major role in encouraging corporate responsibility to shareholders, employees and wider society.

(ii) Responsibility for voting has been delegated to the investment managers under the following remit:

"When exercising or procuring the exercise of any voting rights attaching to the investments of the Fund, the manager shall at all time

vote in line with their internal guidelines. The Authority has reviewed and is happy with the managers' internal guidelines.

The manager shall submit a quarterly report containing details and reasons for any decision by the Manager to exercise any voting rights against the management or consciously abstain from exercising any voting rights attached to any investments of the Fund.”

- (iii) The Investment Board will receive a report on the use of a Corporate Governance Service for analysis of governance issues and executing its proxy voting rights *. The Fund is also a member of the National Association of Pension Funds.

** future decision to be taken.*

- (iv) The Authority also supports the incorporation of the principles of the US Department of Labor Interpretive Bulletin and includes this requirement in the investment manager agreements.

7 Fee Structures

7.1 Rationale for Fee Structure

The investment managers and investment consultant submitted fee structures for the Authority's consideration. The Authority has reviewed the nature of these fee structures and is satisfied that they are appropriate.

7.2 Investment Consultant Fees

Mercer Investment Consulting fees are either based on fixed quotes for particular projects or, more normally, on a time cost basis.

8 Compliance with this Statement

The Authority will monitor compliance with this Statement annually. In particular, it will obtain written confirmation from the investment managers that they exercised their powers of investment with a view to giving effect to the principles contained in the Statement so far as is reasonably practicable. The Authority undertakes to advise the investment managers promptly and in writing of any material change to this Statement.

9 Review of this Statement

The Authority will review this Statement in response to any material changes to any aspects of the Fund, its liabilities, finances and its attitude to risk, which it judges to have a bearing on the stated Investment Policy. This review will occur no less frequently than every three years to coincide with the actuarial valuation.

PRINCIPLES FOR INVESTMENT DECISION MAKING

This statement shows how the Warwickshire Pension Fund currently complies with the Principles for Investment Decision Making in accordance with the CIPFA guidance published in April 2002 and in accordance with SI 1852 (2002).

Principle	Current Compliance
1. Effective decision making	
1a. Decisions should be taken only by persons or organisations with the skills, information and resources necessary to make them effectively. Where trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take.	✓ Investment decisions delegated to managers. Ongoing training undertaken by Board members.
1b. Trustees should ensure they have sufficient in-house staff to support them in their investment responsibilities.	✓
Trustees should also be paid, unless there are specific reasons to the contrary	✓ As part of member allowances.
1c. It is good practice that trustee boards should have an investment sub-committee to provide the appropriate focus	✓ The Pension Board's main focus is investment.
1d. Trustees should assess whether they have the right set of skills, both individually and collectively, and the right structure and processes to carry out their roles effectively.	✓
They should draw up a forward-looking business plan.	✓

Principle	Current Compliance
2. Clear objectives	
<p>2a Trustees should set out an overall investment objective for the fund that:</p> <p>represents their best judgement of what is necessary to meet the funds liabilities given their understanding of the contributions likely to be received from employers and employees; and takes account of their attitude to risk, specifically their willingness to accept under performance due to market conditions</p>	<p>✓ Targets are related to fund liabilities.</p> <p>✓</p>
<p>2b. Objectives for the overall fund should not be expressed in terms which have no relationship to the fund's liabilities, such as performance relative to other pension funds, or to a market index</p>	
3. Focus on asset allocation	
<p>3a. Strategic asset allocation decisions should receive a level of attention (and, where relevant, advisory or management fees) that fully reflect the contribution they can make towards achieving the fund's investment object.</p>	<p>✓ Asset allocation is the responsibility of the Board.</p>
<p>3b. Decision makers should consider a full range of investment opportunities, not excluding from consideration any major asset class, including private equities</p>	<p>✓ Alternative investments including property have been fully considered and are now included in the Fund benchmark.</p>
<p>3c. Asset allocation should reflect the fund's own characteristics, not the average allocation of other funds</p>	<p>✓</p>
4. Expert advice	
<p>4a. Contracts for actuarial services and investment advice should be opened to separate competition.</p>	<p>✓ Currently provided by the same firm but treated as separate contracts.</p>
<p>4b. The fund should be prepared to pay sufficient fees for each service to attract a broad range of kinds of potential providers.</p>	<p>✓</p>

Principle	Current Compliance
5. Explicit mandates	
5a. Trustees should agree with both internal and external investment managers an explicit written mandate covering agreement between trustees and managers on:	
An objective, benchmark and risk parameters that together with all other mandates are coherent with the fund's aggregate objective and risk tolerances	✓
The managers approach in attempting to achieve the objective	✓
Clear timescales of measurement and evaluation, such that the mandate will not be terminated before the expiry of the evaluation timescale for underperformance alone.	✓
5b. The mandate and trust deed and rules should not exclude the use of any set of financial instruments, without clear justification in the light of specific circumstances of the fund.	✓
5c. Trustees, or those to whom they have delegated the task, should have a full understanding of the transaction related costs they incur, including commissions. They should understand all the options open to them in respect of these costs, and should have an active strategy – whether through direct financial incentives or otherwise – for ensuring these costs are properly controlled without jeopardising the fund's other objectives.	✘ (Work is currently being undertaken)
5d. Trustees should not without good reason permit soft commissions to be paid in respect of their fund's transactions.	✓

Principle	Current Compliance
6. Activism	
6a. The mandate & trust deed should incorporate the principles of the US Dept of Labor Interpretive Bulletin on activism	✓ Board approved the inclusion of activism at their meeting of 16/09/02.
6b. Trustees should also ensure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and measure the effectiveness of this strategy.	✓ Corporate Governance strategy is currently being compiled.
7. Appropriate benchmarks	
Trustees should:	
7a. explicitly consider, in consultation with their fund managers, whether the benchmarks they have selected are appropriate; in particular, whether the construction of the index creates incentives for sub-optimal investment strategies	✓
7b. if setting limits on divergence from an index, ensure they reflect the approximations involved in index construction and selection	✓
7c. consider explicitly for each asset class invested, whether active or passive investment would be more appropriate given the efficiency, liquidity and level of transaction costs in the market concerned	✓
7d. whether they believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving managers the freedom to pursue genuinely active strategies.	✓

Principle	Current Compliance
8. Performance measurement	
8a. Trustees should arrange for the measurement of the fund	✓ Detailed performance measurement undertaken by Mellon Analytical Solutions.
and make formal assessments of their own procedures and decisions as trustees.	✗ For self assessments.
8b. They should also arrange for a formal assessment of the performance and decision-making delegated to advisers and managers.	✓ For fund managers, no decisions delegated to advisers.
9. Transparency	
9a. A strengthened SIP should set out:	
who is taking which decisions and why this structure has been selected;	✓
the fund's investment objective;	✓
the fund's planned asset allocation strategy, including projected investment returns on each asset class, and how the strategy has been arrived at;	✓
the mandates given to all advisers and managers.	✓
9b. The nature of the fee structures in place for all managers and advisers and why this set of structures has been selected.	✓
10. Regular reporting	
10a. Trustees should publish their SIP	✓ SIP published
and the results of their monitoring of advisers and managers.	✗ Does not apply to monitoring of managers as this is felt to be confidential information.
10b. They should send them annually to members of the fund, including an explanation of why the fund has chosen to depart from any of these Principles.	✓ copies to be sent to all employers annually via Annual Report.

Role of Investment Consultant

Mercer Investment Consulting are employed as Investment Consultants to the Fund. The Investment Consultant provides advice to the Authority but does not have responsibility for decision making in any areas. The role encompasses, but is not limited to, the following areas:

- i. assistance in helping the Authority formulate investment objectives;
- ii. advice on Investment Strategy;
- iii. advice on devising an appropriate investment manager structure;
- iv. assistance in selecting and monitoring of investment managers.