Brent	**Brent Pension Fund Sub-Committee** 25 June 2013 **Report from the Deputy Director of Finance**
For action	Wards Affected: ALL

Statement of Investment Principles review

Reasons for urgency

In accordance with the Access to Information Rules, the following report was considered urgent in the opinion of the Chair in order to appraise members of the latest developments before the next meeting. The report was not available when the agenda was published given the additional officer time required to reconfigure the Fund's accounts for 2012/13 into a best practice format. The urgency of the report is based on the need to increase the limit on the maximum proportion of a Fund which can be invested in contributions to partnerships to 30%, given that the proportion is already at the current maximum limit of 15%.

1. Summary

1.1 To comply with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, the Brent Pension Fund's Statement of Investment Principles (SIP) must be reviewed and, if necessary, revised from time to time.

1.2 This latest review has been prompted by the Secretary of State for Communities and Local Government issuing a Statutory Instrument 2013 No.410 – Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2013 – which increases the maximum proportion of a local government pension fund which can be invested in contributions to partnerships from 15% to 30%. These Regulations came into force on 1 April 2013.

1.3 The Fund's SIP document in the attached Appendix 1 has been revised to incorporate the greater investment flexibility provided.

2. Recommendation

2.1 That the updated Statement of Investment Principles be approved.

3. Detail

3.1 The SIP describes the high-level principles governing the investment decision-making and management of the Brent Pension Fund and the policy that has been developed to ensure their implementation. It has been prepared, in line with guidance received from the Secretary of State for Communities and Local Government, with reference to the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel publication, 'Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012'.

3.2 The only substantive revision to the SIP is to increase the maximum proportion of a local government pension fund which can be invested in contributions to partnerships from 15% to 30% is referenced in item 17 (e) of the SIP.

3.3 The SIP has also been re-ordered under the six headings of best practice investment principles for LGPS funds as follows:

- effective decision making
- clear objectives
- risk and liabilities
- performance assessment
- responsible ownership
- transparency and reporting.

4. Financial and Legal Implications

4.1 None.

5. Diversity Implications

5.1 None.

6. Staffing Implications

6.1 None.

7. Background

7.1 Statutory Instrument 2013 No.410 – Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2013.
Report to the Pension Fund Sub-Committee of 26 February 2013 entitled 'Statement of Investment Principles review'.

8. Contact Officers

8.1 Persons wishing to discuss the above should contact the Exchequer and Investment Section, Brent Financial Services, on 020 8937 1472 at Brent Town Hall.

MICK BOWDEN
Deputy Director of Finance

ANTHONY DODRIDGE
Head of Exchequer and Investment

Appendix 1

LONDON BOROUGH OF BRENT PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES

It is accepted that six principles form the code of best practice for LGPS funds:

Effective decision making
Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation.
Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Clear objectives
An overall investment objective should be set out for the Fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.

Risk and liabilities
In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.
These include the implications for local tax payers, the strength of covenant for participating employers, the risk of their default and longevity risk.

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

Responsible ownership
Administering authorities should:

- recognise and ensure that their partners in the investment chain adopt the Financial Reporting Council's (FRC) UK Stewardship Code;
- include a statement of their policy on responsible ownership in the Statement of Investment Principles; and
- report periodically to scheme members on the discharge of such responsibilities.

Transparency and reporting
Administering authorities should:

- act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives;
- provide regular communication to scheme members in the form they consider most appropriate.

Effective decision making

1 Responsibilities are allocated to ensure that the managers are given authority to manage their portfolios, but that there is monitoring and review both at individual portfolio and at total Fund levels. The Pension Fund Sub-Committee at Brent Council is responsible as administering authority for:

a) determining the overall investment strategy and strategic asset allocation

b) appointing the investment managers, the Independent Adviser and the Actuary

c) reviewing investment manager performance and processes regularly.

2 As well as councillors, the Pension Fund Sub-Committee includes representatives of a large employer (the College of North West London) and of employees (the GMBU) as non-voting, but participating, observers.

3 The Chair of the Pension Fund Sub-Committee is responsible for ensuring that councillors taking investment decisions are familiar with investment issues and that the Pension Fund Sub-Committee has sufficient members for that purpose.

4 Councillors have agreed steps to support the learning and development of members of the Pension Fund Sub-Committee. In particular, there will be regular training opportunities through attendance at conferences and seminars, online packages or training sessions before Sub-Committee meetings. To date, there have been learning and development presentations on such items as the actuarial valuation, emerging market equity, overseas equity, private equity and fixed income investment.

5 The Pension Fund Sub-Committee takes proper advice from persons who are reasonably believed to be qualified by their ability in and practical experience of investment matters to enable them to fulfil their overall responsibility for the management of the Fund and its investment strategy, and individual decisions about investments.

6 The Director of Finance at Brent Council is responsible for:

a) advising and reporting to the Pension Fund Sub-Committee

b) reviewing the activities of the investment managers on a regular basis

c) keeping the accounts for the Fund and managing cash flow to distribute new money to managers.

7 The investment managers are responsible for:

a) the investment of Pension Fund assets in accordance with legislation, the Statement of Investment Principles (SIP) and the individual investment management agreements

b) preparation of monthly and quarterly reports detailing activity, investment performance and future strategy, and attendance at the Pension Fund Sub-Committee.

8 The Actuary is responsible for:

a) undertaking a triennial revaluation of the assets and liabilities of the Fund

b) providing annual FRS17 / IAS19 valuations

c) providing advice on the maturity of the Fund.

9 The Independent Adviser is responsible for the provision of advice to the Pension Fund Sub-Committee and the Director of Finance on all investment issues, in particular asset allocation, new developments and the monitoring of manager performance against the agreed benchmarks.

Investment objectives

10 The key investment objective for the Fund is to maximise long-term investment returns subject to an appropriate level of risk implicit in the targets set for each investment manager. The current targets are:

a) UK equities – to match the FTSE All Share index

b) overseas equities (developed markets) – to match the FTSE All World ex UK index

c) overseas equities (emerging markets) – to match the MSCI Emerging Markets index

d) fixed income – Horizon Total Return Bond Fund – to achieve a return of 6% per annum over rolling three year periods

d) UK smaller companies – to match the FTSE Small Cap index

e) property – UK property to match the IPD All properties index and European property to return an absolute 8% per annum

f) private equity – to achieve an average absolute return of 8% per annum over the life of the funds

g) fund of hedge funds – to achieve an average return of LIBOR plus 5% per annum

h) infrastructure – to achieve an average absolute return of 8% per annum

i) diversified growth fund – to achieve a return of Base Rate plus 3.5% per annum over rolling three years periods.

11 The achievement of these benchmark returns should attain a real rate of return of 4% - 5% above inflation per annum over rolling three-year periods (see item 13 asset allocation for returns expected from each market). The 2010 Actuarial Valuation assumed a return of gilts plus 3% per annum, giving a total return of 7.5% per annum.

12 Four general points should be noted. First, LGPS regulations require that funds achieve ‘proper diversification’, which may be considered in terms of ensuring that investments are spread through a number of markets whose movements are not closely correlated. This affords some protection in the event of market corrections, and allows gains from a variety of sources. Second, equities have been the best performing asset class over the very long term, property has performed well over ten years but has tended to be slightly behind equities, whereas bonds and cash have usually performed less well. Third, exposure to fixed income provides increased certainty of returns for a mature fund. Fourth, exposure to other asset classes adds to diversification and allows additional returns in less well researched markets. The Myners’ report advocated that funds should consider all the main asset classes in setting its asset allocation, allowing the Fund access to different risk premia (such as time, currency and different asset valuations).

13 The asset allocation adopted for the Fund is as follows:

Asset Class	**Percentage of Fund %**	**Expected Return p.a. %**	**Benchmark**
UK equities	13	6 – 9	FTSE All Share
UK smaller companies	4	6 – 9	FTSE Small Cap
O/seas equities – dev.	22	6 – 9	FTSE AW ex UK
O/seas equities - EM	8	6 – 9	MSCI EM
Fixed income	15	6	6% absolute return
Diversified growth	8	5 – 8	Base Rate + 3.5%
Property	8	5 – 8	IPD and 8% absolute return
Private equity	10	8 – 10	8% absolute return
Hedge funds	5	5 – 8	LIBOR + 5%
Infrastructure	6	8 – 10	8% absolute return
Cash	1	0 – 3	Cash

14 For UK equities, the manager holds stocks in proportion to their weighting in the FTSE All share Index (known as index tracking, or passive, management). Index tracking has been chosen because the average manager has, in the longer term underperformed the UK index, and passive management is less expensive than active management. For overseas equities (developed markets), the manager tracks the appropriate index. Active management has been chosen for exposure to overseas equities (emerging markets) and UK small companies, because there are opportunities for the manager to outperform through stock and sector selection. For fixed income, the manager has discretion to change the asset allocation, using other bond-like instruments as permitted. Active management has been chosen to allow opportunities for improved performance through stock selection and asset allocation. For fixed income, property, UK equities, overseas equities, emerging market equities, hedge funds, infrastructure, diversified growth and private equity, the Fund has invested in pooled funds that will allow diversified investment whilst offering the opportunity for additional returns.

15 Asset allocation is reviewed regularly to consider new opportunities that may arise. The expected returns detailed in item 13 are taken from forecasts made by the actuary and investment managers. It is anticipated that equities will outperform gilts over the long term. The next major review of asset allocation is expected to be in 2014, but allocations will be considered at least annually.

The current fund managers are:

UK equities	Legal & General
Overseas equities	Legal & General (developed markets), Dimensional (emerging markets)
Fixed income	Henderson
Property	Aviva
UK smaller companies	Henderson
Private equity	Capital Dynamics
	Yorkshire Fund Managers
Fund of hedge funds	Fauchier Partners
Diversified growth fund	Baillie Gifford
Infrastructure	Alinda Partners
	Capital Dynamics
	Henderson PFI Fund II

16 Management fees are calculated on the basis of a percentage of funds under management, rather than a performance basis, with the exception of the private equity, infrastructure and fund of hedge fund managers. This basis has been chosen because basic fees should provide sufficient incentive to managers in traditional areas, but performance fees are felt to be necessary to align interests in other areas.

17 LGPS investment regulations state that the administering authority shall have regard both to the diversification and the suitability of investments. The Pension Fund Sub-Committee has decided that the Brent Fund may not:

a) invest more than 10% of the Fund in unlisted securities

b) invest more than 10% of the Fund in a single holding, or more than 25% of the Fund in unit trusts managed by any one body

c) excluding loans to the Government, lend more than 10% of the value of the Fund to any one borrower

d) contribute more than 5% of the Fund to any single partnership

e) contribute more than 30% of the Fund to partnerships.

18 The reasons for this approach are:

a) diversification – the Myners report has highlighted the need to access a wider range of asset classes both to spread risk and add to returns. The main alternative asset classes under consideration by pension funds are property, private equity and infrastructure. The main route for access to private equity and infrastructure is through partnerships.

b) return opportunities – the Brent Pension Fund has committed 10% of assets to private equity and 6% to infrastructure through partnerships.

19 Asset allocation decisions are regularly reviewed and the suitability of the limits will be subject to reconsideration at least every three years as part of the asset allocation review.

20 The Brent Pension Fund has also imposed a number of restrictions to reduce risk and to maintain control of fee levels. The managers may not:

a) invest in any in-house fund without prior consent

b) exceed the limits set out in the asset allocation ranges detailed in the benchmark

c) borrow

d) engage in underwriting or sub-underwriting on behalf of the fund

e) enter into soft commission arrangements, by which business is directed to brokers in exchange for other services such as research or systems.

21 Managers may use derivatives to facilitate asset allocation decisions and trading, and to obtain exposure to markets / assets, to reduce trading costs. All open and completed transactions will be included in monthly transactions and quarterly reports. Managers may also lend stock to generate additional income for the Fund.

22 The restrictions are designed to aid transparency, avoid speculative investments, reduce the volatility of returns, and facilitate the realisation of investments. However, research has indicated that indiscriminate restrictions reduce managers' opportunities to use skill to add value. On this basis, restrictions are kept to a minimum.

23 Managers are given wide discretion over both stock selection and asset allocation within the restrictions detailed above. This allows clear accountability for decisions. The managers have established procedures to monitor and control risk, and to research market trends.

Risk and liabilities

24 There are three main definitions of risk:

a) severe market decline and funds losing value (absolute risk), as occurred in 2008

b) underperformance when compared to a peer group (WM local authority universe) or relevant stock / bond markets (relative risk)

c) not meeting the liabilities set out in the LGPS. The Fund had a deficit of £294m when valued in 2010, and is following a 25-year recovery period.

25 To reduce absolute risk the Fund is diversified between managers, asset classes, markets and sectors so that investments are not concentrated in one theme or country / region. Investment managers are also to observe the Brent Pension Fund's investment restrictions, which are designed to reduce risk.

26 To add value, the Fund seeks exposure to a variety of risks and associated risk premia. The search for outperformance will, on occasions, involve the risk of underperformance through the adoption of counter-cyclical positions. The extent of any underperformance, through relative risk, has been reduced by diversification and the use of index-tracking with regard to publicly quoted equities.

27 The third definition of risk – failure to meet liabilities – is the key risk and is managed in three ways. First, to enable the administering authority to meet benefit payments, managers may remit payments on a monthly basis when required. This will allow managers to plan any realisation of assets as necessary or, more likely, reinvest income from dividends or interest received. Second, assets and liabilities are valued at least on a triennial basis by an independent actuary (the actuarial valuation) to determine the financial health of the Fund. If a deficit is forecast, employers' contributions may be increased to ensure that all liabilities are met. Third, the Brent Pension Fund is mature, there being many more pensioners than working members - to the extent that 61% of assets are 'owned' by pensioner liabilities. Therefore, there is a need to consider the risks involved in pursuing a long-term equity-based strategy when a market correction, and lower dividend payments, could reduce the value of the Fund. There is currently a 'mismatch' between the allocation of around 85% of the fund to real assets (equities, alternative investments and property, that increase with the growth of the economy) and the maturity of the Fund. However, this is balanced by the expectation that equities will generate additional returns to facilitate the payment of pensioners', active and deferred members' benefits. Contributions from employers and employees are calculated on the basis that they will be sufficient to meet benefit payments over the foreseeable future. Managers will be able to continue to reinvest income and change their stock selections without concern about the need to realise assets quickly. However, most assets (around 70%) are liquid and invested in recognised stock exchanges.

28 If the Director of Finance becomes concerned that there may be an imminent severe market correction, that person is authorised in consultation with the Chair of the Sub-Committee and the Independent Adviser, to amend the Fund asset allocation and reduce exposure to those assets classes that may be affected.

29 The Pension Fund maintains cash balances both to pay for benefits and to meet private equity and infrastructure cash calls. The treasury policy will be to deposit cash balances with the Council's banker, NatWest, at an appropriate rate.

Performance assessment

30 LGPS regulations state that the administering authority should review, at least every three months, the investments made by managers and should have regard to professional advice. The Myners' review has emphasised the importance of monitoring dealing costs – these will be reviewed with other aspects of investment.

31 WM Performance Services is an independent performance monitoring agency that measures the performance of the Fund and the individual managers against both the benchmark and peer group funds. Reports are produced quarterly and annually to allow proper consideration of performance over both the short and medium term. If a manager consistently underperforms in relation to their benchmark over a 'substantial' period (defined as two years), a review of the mandate will be considered.

32 The Director of Finance monitors managers' activity on a daily, monthly and quarterly basis, and is in regular contact with investment houses. The Pension Fund Sub-Committee receives quarterly reports from the investment managers and the Director of Finance detailing activity and investment performance.

33 The Pension Fund Sub-Committee will review the performance of the Fund's Independent Adviser on a triennial basis, looking at the quality of advice and inputs made.

34 The Pension Fund Sub-Committee (trustees) will agree an annual and three year business plan to ensure that all areas of activity, including member training and development, are adequately examined and reviewed. The Pension Fund Sub-Committee will review its own performance on an annual basis, looking at the performance of the Fund overall and progress against the business plan.

35 The appointment of the investment managers will be reviewed regularly by the Pension Fund Sub-Committee to consider the desirability of continuing or terminating the appointment. Decisions will be based on monitoring the investment performance and processes at quarterly and other meetings.

36 Amongst the criteria by which managers will be selected are:

a) Investment process, including investment philosophy, research, the asset allocation process, controls on stock selection, and risk controls

b) Past performance, including spread of results and volatility

c) Personnel, including levels of experience, staff turnover, and the individual managers offered

d) Administration, including systems, contacts, references from other customers, and the ability to meet requirements on reporting

e) Resources, including the number of professionals employed, the number of funds serviced, the number of funds gained or lost over the last 5 years, and the controls on over-rapid growth

f) Professional judgement.

37 A manager may be replaced if, amongst other things, they fail to meet the investment objectives or it is believed that they are not capable of achieving the performance objectives in the future. Consistent underperformance over a two-year period would automatically place the manager's mandate under review.

Responsible ownership

38 The Pension Fund Sub-Committee has instructed its managers to exercise the Fund's responsibility to vote on corporate governance issues wherever possible. They have also been instructed to intervene in companies that are failing and thus jeopardising the Fund's interests, by voting or by contacting company management direct. All managers adopt the Council of Insititutional Shareholders' Committee Statement of Principles on 'The Responsibilities of Institutional Shareholders and Agents'. Managers do not make moral judgements on individual stocks.

39 The Brent Pension Fund has an overriding fiduciary duty in law to invest Fund monies to achieve the best possible financial return for the Fund consistent with an acceptable level of risk. However, the Fund recognises that companies can enhance their long-term performance and increase their financial returns by adopting positive social, environmental and ethical principles in planning and running their activities. The Fund has delegated to the external investment managers responsibility for taking social, environmental and ethical considerations into account when assessing the financial potential and suitability of investments.

40 Each investment manager is asked to work positively with companies to promote forward-looking social, environmental and ethical standards. This should not, however, deflect from the primary objective of achieving the best possible financial return for the Fund, in accordance with the Fund's fiduciary duty.

41 In line with the above, fund managers are instructed not to invest segregated elements of their portfolio in companies that generate over half of their income from tobacco products, due to the risk that tobacco companies may face large liabilities from outstanding court actions.

Transparency and reporting

42 Considerable progress has been made in communicating with employers and employees. Developments include:

a) a website
b) annual benefit statements to active members and deferred pensioners
c) regular newsletters for active members and pensioners
d) employer updates on Fund developments and scheme changes
e) A Funding Strategy Statement, setting out how the Fund plans to meet future liabilities
f) Annual reports are available on the website for both employers and employees
g) Induction material for new employees and pre-retirement courses.

43 It is also considered to be important that stakeholders are aware of the service standards set for responses by both Brent Council and Capita (Employee Benefits), the Council's pensions administration provider. The following service standards should be expected:

Type of work	**Maximum turnaround time (working days)**
Letters answered or acknowledged	5
Estimates of benefits	5
Notifications to new pensioners	10
Transfer value quotations	5
Preserved benefits – calculate and notify	10
New starters – membership confirmation	10