Shropshire County Pension Fund

Statement of Investment Principles

1. Introduction

The purpose of the Statement of Investment Principles (‘the Statement’) is to document the principles, policies and beliefs by which the Pensions Committee of the Shropshire County Pension Fund (“the Fund”) manages the Fund’s assets. This document takes account of:

- The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009
- The requirements of the Pensions Act 2004
- The requirements of the Occupational Pension Schemes (Investment) Regulations 2005;
- The principles of the Myners Code
- CIPFA guidance

The Local Government Pension Scheme (“LGPS”), of which the Fund is a part, is established under the Superannuation Act 1972 and is regulated by a series of Regulations made under the 1972 Act.

Shropshire Council is the Administrating Authority for the Fund

The Pensions Committee consulted with employing bodies and received written advice from the Fund’s investment consultant, Aon Hewitt, on this statement.

There are close links between this statement and two other statements. The Funding Strategy Statement (“FSS”) sets out the main aims of the fund and explains how employers’ contribution rates are set to achieve those aims. The Governance Compliance Statement sets out the structure of delegations of responsibilities for the Fund.

A copy of this Statement will be sent to each investment manager hired by the Fund, the auditor, the actuary and the investment consultant. A copy will also be sent to members of the Pension Board.

The Statement will be reviewed annually and when there is a significant change in the Fund’s circumstances.

2. Governance

Shropshire Council has delegated to the ***Pensions Committee*** the administration of the Pension Fund, and the functions relating to local government pensions, etc., as set out in Schedule 1 to the Functions Regulations. The main areas of investment responsibility include:

- determination of strategic asset allocation;
- determination of portfolio structure;
- selection and appointment of external investment managers; and
- ongoing monitoring and evaluation of the investment arrangements.

The Pensions Committee is made up of nine members comprising both elected councillors and non-voting employee and pensioner representatives.

Members of the Pensions Committee recognise that they have a duty to safeguard, above all else, the financial interests of the Fund's beneficiaries. Beneficiaries, in this context, are considered to be the Fund Members (pensioners, employees and employers), together with local Council Tax Payers.

2.1 Advice and Consultation

Members of the Committee receive independent investment advice from the following sources

- Roger Bartley - strategic and overall investment approach advice.
- Aon Hewitt - analysis and advice of a technical nature in relation to all investment related aspects of the pension fund including (but not limited to) portfolio construction, manager monitoring and appointment, and interpretation of performance measurement information.

The Fund's Scheme Administrator has responsibilities under S151 of the Local Government Act 1972 and provides financial (non-investment) advice to the Committee, including advice on financial management, issues of compliance with internal regulations and controls, budgeting and accounting and liaison with independent advisers.

2.2 Liabilities

The LGPS is a defined benefit pension scheme which provides benefits related to the salary of members. The Scheme is a contributory defined benefit arrangement, with active members and employing authorities contributing to the Scheme.

The value of the Fund's ongoing liabilities is sensitive to various demographic (principally longevity) and financial factors. The financial factors relevant to the fund's investment policy are:

- the rate of return on assets;
- salary escalation for active members;
- price inflation for pensioners; and
- long-term interest rates.

2.2 Maturity and Cashflow

The Fund remains open to new members and new accruals. Contributions are received from both active members and Employing authorities. Active members contribute on a tiered system. Employing authorities contributions are determined based on advice from the Fund's actuary based on the triennial valuation.

3. Objectives

The Fund's primary long term investment objective is to achieve and maintain a funding level at, or close to, 100% of the Fund's estimated liabilities; and within this, to endeavour to maintain low and stable employers' contribution rates. Given the constraints on local authority spending, volatility in the employer's contribution rate is undesirable.

4. Risks

The Committee regards 'risk' as the likelihood that it fails to achieve the objectives set out above and has taken several measures, which are set out in this Statement, to minimise this risk so far as is possible.

In particular, in arriving at the investment strategy and the production of this Statement, the Committee have considered the following key risks:

- asset-liability mismatch risk (asset allocation risk)
- the need to pay benefits when due (cash-flow risk)

- actions by the investment managers (investment risk)
- the failure of some investments (concentration risk)
- currency and counterparty risk
- custody risk

In terms of magnitude, the Committee considers asset-liability mismatch risk to be one of the most important to control. Therefore, following each actuarial valuation, the Committee conducts an asset/liability review, which focuses on the impact of asset allocation on expected future funding levels. The Committee considers the results using advanced modelling techniques, and, with the assistance of expert advisers, are able to measure and quantify them in terms of their definitions of risk. This allows the Committee to assess the probabilities of critical funding points associated with different investment strategies.

Consideration is given to the volatility of a number of parameters (e.g. items associated with accounting measures, contributions etc.), to further assess the potential risks associated with a particular investment strategy.

The process of risk management continues through to implementation. The decision as to whether to pursue active management is evaluated separately for each asset class, with regard to the potential reward within that class for taking on active risk. Active risk is then diversified through the use of different investment managers and pooled funds. Each investment manager appointed by the Committee is bound by the terms and conditions of an Investment Management Agreement where restrictions and targets are clearly documented, including a measure of risk. The pooled fund investments and direct investments are governed by the terms and conditions of the fund and or policy documents. Frequent monitoring of portfolio performance and exposure characteristics also aids in the ongoing risk management for the Fund.

5. Strategic Asset Allocation

The Committee regards the choice of asset allocation policy as the decision that has most influence on the likelihood of achieving their investment objective. The Committee retains direct responsibility for this decision which is made on the advice of their investment adviser with input from their Fund actuary and in consultation with the Employing Authorities.

The investment strategy will normally be reviewed every three years. In addition if there is a significant change in the capital markets, in the circumstances of the Fund or in governing legislation then an earlier review may be conducted.

In keeping within the regulatory framework set out in the LGPS regulations, the Committee formulates the investment strategy with a view to

- the advisability of investing money in a wide variety of investments
- the suitability of particular investment and types of investment

The Committee will consider a full range of investment opportunities including:

- quoted and unquoted equity
- government and non-government bonds
- Liability Driven Investment (LDI)
- property and infrastructure
- hedge funds and other alternative investments

The Committee further considers the legality of all investments for compliance with the LGPS.

The Committee determines the strategic asset allocation policy after considering projections of the Fund's assets and liabilities which are calculated by the Fund's investment adviser, in liaison with the

Fund's actuary. This asset-liability study examines different combinations of assets to determine which combination will best meet the Fund's objectives.

5.1 Expected return on investments

The study takes into account the particular liabilities of the Fund.

In addition to a full specification of the Fund's benefits, the study will make important assumptions about the behaviour of various asset classes (such as their expected return over long periods of time and the variability of those returns) and the liabilities in the future. In framing these assumptions, it is assumed that:

- Equities may be expected to outperform other asset classes over the long term, but the returns are more unpredictable over the short term. Gilts in turn can be expected to outperform cash deposits but with greater variability.
- Asset classes do not perform in the same way; some may go up in value while others are going down.
- The performance of certain asset classes (particularly index-linked gilts) is more closely linked to the behaviour of inflation than others and so they represent a good match for liabilities linked to inflation.

Expected annualised returns are formulated for each asset class based on long term capital market assumptions, using ten year expected returns and volatilities. The returns and volatilities used for each asset class are shown in the table below, and represent the current 10 year annualised nominal return assumptions from Aon Hewitt at 31 December 2013 (as used in the Asset-Liability Modelling study carried out in May 2014) and at 30 September 2015.

	31 December 2013		30 September 2015	
Asset class	**Expected Return %**	**Volatility %**	**Expected Return %**	**Volatility %**
UK Equities	7.7	20.0	7.3	19.0
Global Unconstrained Equities	10.1	21.8	8.9	21.4
Global Passive Equities	7.7	19.8	7.3	20.5
UK Property	7.1	14.5	6.0	12.5
UK Gilts (15 year duration)	3.6	11.0	2.6	11.0
UK Investment Grade Corporate Bonds (10 year duration)	4.3	9.0	3.5	9.0
UK Index-Linked Gilts (15 year duration)	2.6	9.0	1.9	9.0
Unconstrained Bonds	-	-	5.7	10.0
Global Fund of Hedge Funds	5.4	8.0	4.6	9.0
Multi-Strategy Hedge Funds	5.9	8.3	6.3	12.0
Global Private Equity	9.2	26.0	9.1	27.5
Infrastructure (USD)	8.1	20.4	7.0	19.0
Inflation (CPI)	2.3	-	2.0	-

5.2 Investment strategy

The Fund’s strategic asset allocation was agreed by Pensions Committee in September 2015 and following implementation, will be as follows:.

Asset Class	Allocation	Control Ranges
Total Equity	**52.0**	**47.0 – 57.0**
Unconstrained Global Equity	24.0	20.0 – 28.0
UK Equity	8.0	5.5 – 10.5
Passive Equity (100% Hedged to GBP)	20.0	16.0 – 24.0
Total Alternatives	**23.0**	**18.0 – 28.0**
European (Incl UK) Property	5.0	n/a
Private Equity	5.0	n/a
Infrastructure	3.0	n/a
Fund of Hedge Funds	5.0	n/a
Multi-Strategy Hedge Funds	5.0	n/a
Total Bonds	**25.0**	**20.0 – 30.0**
Liability Driven Investment (LDI)	3.5	2.0-5.0
Unconstrained Bonds	21.5	17.5-25.5

5.3 Rebalancing policy

Officers will review the position of the fund quarterly to ensure the assets are within the control ranges listed above, and will rebalance as appropriate.

5.4 Currency hedging policy

The Committee considers currency risk as an unrewarded risk – one that is expected to increase the volatility of the Fund, but not increase return. Passive equity investments are fully currency hedged by the investment managers.

6. Implementation

The Committee have appointed investment managers to manage the Fund’s investments as set out in the Appendix.

The Committee believe the use of active management within the Fund will increase the likelihood that the Fund will meet its objectives.

The Committee also avails of passive management where they believe the extra risk and costs of active management would not benefit the Fund and to manage overall risk.

The activities of each manager are governed by their Investment Management Agreement. This includes details on the portfolio performance objectives and risk limits as well as information on permissible investments.

6.1 Selection & realisation of investment

Each investment manager has full discretion in terms of stock selection within the constraints of the investment management agreement signed with each manager. The majority of investments held within the Fund are quoted on major markets and may be realised quickly, if required. Certain asset classes, Hedge funds, Private Equity, Property and Infrastructure are relatively illiquid and may take longer to realise, if required.

The current list of investment managers and pooled funds used with a view to implementing the above strategy is set out in the Appendix A to this document. The Appendix is included for information only, and does not form part of the Statement of Investment Principles.

6.3 Security Lending

The fund reactivated its security lending policy with Northern Trust in February 2011, having temporarily paused the lending activity in the period after the collapse of Lehmans. The collateral arrangements for the lending programme have been tightened on advice from Aon Hewitt, and the programme restarted.

The manager(s) of pooled funds may undertake a certain amount of stock lending on behalf of unit-holders. Where a pooled fund engages in this activity the extent is fully disclosed by the manager.

6.2 Custody

The Committee regards the safekeeping of the Fund's assets as of paramount importance and has appointed Northern Trust company as global custodian and record-keeper of the Fund's assets.

7. Review and Control

The Committee are satisfied that they have adequate resources to monitor the investment arrangements.

7.1 Performance Measurement

The Committee monitors the strategy and its implementation as follows.

- The Committee receives, on a quarterly basis, a written report on the returns of the fund and asset classes together with supporting analysis.
- The performance of the total fund is also measured against the strategic benchmark, which is comprised of the asset class benchmarks weighted by the strategic allocations, and against agreed outperformance targets.
- The performance of the fund in each asset class is measured against the relevant benchmark. A comparison against a universe of portfolios with similar mandates will also be made from time to time.

7.2 Service Provider Monitoring

The Committee reviews from time to time the services provided by the investment adviser and other service providers as necessary to ensure that the services provided remain appropriate for the Fund.

8. Environmental, Social and Governance and Exercise of Rights

The Committee expects the investment managers to take steps to ensure that environmental, social and governance factors are adequately addressed in the selection, retention and realisation of investments as far as such factors may affect investment performance.

BMO (formerly F&C) provides a responsible engagement overlay on the Fund's UK equity portfolios. BMO enters into constructive discussions with companies on the Fund's behalf to put to them the case for improved financial returns through better management of the negative impacts they might have on the environment and society in general.

The Fund is also a member of the Local Authorities Pension Fund Forum (LAPFF), which seeks to combine like-minded bodies to promote the above issues. At present 64 Local Authorities are members of this forum with a combined asset value of 75% of local government pension fund assets.

8.1 Myners Investment Principles

Details to the extent to which the Pensions Committee complies with the six Myners principles and the extent to which management and investment arrangements at Shropshire comply (in accordance with the existing CIPFA guidance), and where not, what action is proposed in order to comply are set out in Appendix B.

9. Investment Manager and Adviser Fees

Investment management fees comprise an ad valorem or fixed base fee element and in some cases a performance based element. The ad valorem fee is calculated as a percentage of assets under management. Where applicable, the performance based element is calculated as a percentage of outperformance. The assessment period ranges from one to three years depending on the investment manager and the mandate. The exact details of the fee arrangements are specific to the investment manager and are as agreed in the respective Investment Manager Agreements.

Appendix A: Current Investment Managers

Fund assets are invested in portfolios managed by external investment managers shown in the table below. They are benchmarked against the indicated indices. The table shows whether portfolios are managed on a segregated or pooled basis, and their outperformance target. Based on expert advice, investment managers may be replaced at any time and this list may not always be current.

This appendix shows the position at September 2015 and has been appended to the Statement of Investment Principles for information only, and does not form part of the Statement.

Investment Manager	Asset class	Benchmark	Target
	Active portfolios		
PIMCO Europe Ltd	Unconstrained bonds	1 month Sterling LIBOR	+4% p.a.
BlackRock	Unconstrained bonds	3 month USD LIBOR	+ 4-6% p.a.
GAM	Unconstrained bonds	3 month Sterling LIBOR	+ 3-5% p.a.
BMO	Liability Driven Investment (LDI)	Hedge Benchmark (based on FTSE over 5 yrs Index Linked Gilt Index)	Outperform the benchmark
Majedie Asset Management	UK Equities	FTSE All Share	+2% p.a. over rolling 3 year periods
MFS Investment Management	Global Equities	MSCI World	+2% p.a. over rolling 3 year periods
Investec Asset Management	Global Equities	MSCI All Country World NDR	+ 3-5% p.a. over rolling 3 year periods
Harris Associates	Global Equities	MSCI World	+ 2-3% p.a. over 3 to 5 years
Harbour Vest Partners Limited	Private Equity Fund of Funds	Broad public equities index	+ 3-5% p.a.
Global Infrastructure Management	Infrastructure	n/a	RPI +5% p.a.
Aberdeen Property Investors	European (incl UK) Property	Composite of INREV VA Europe Index, vintage 2005 – 2008 and IPD UK All Balanced Funds Index	RPI +4% p.a.
Brevan Howard	Multi-Strategy Hedge Fund	3 month Sterling LIBOR	+6.0% p.a.
BlackRock	Fund of Hedge Funds	3 month Sterling LIBOR	+5.0% p.a.

Indexed (Passive) Portfolios			
Legal & General Investment Management	Global Equity	FTSE Developed World – GBP Currency Hedged	Match benchmark

Appendix B: Myners Principles Compliance Statement

Principle	Comply or explain	Comment/Examples	Development needs
1. Effective decision making ▪ Administrating authorities should ensure that: ▪ 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	Comply	Pensions Committee takes decisions relating to setting investment objectives and strategic asset allocation, appointment of investment managers. Pensions Committee members, substitute members and officers participate in an annual training day, attend educational seminary and receive occasional papers and presentations at committee meetings. The training requirements of new Pensions Committee members are addressed and appropriate training programmes made available, with a formal Training Programme being submitted to the Committee for consideration on an annual basis. The Pension Board provide assurance and good governance around the Pension Committee and the process.	
2. 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 administrating authority and scheme employers, and these should be clearly communicated to advisors and investment managers	Comply	A Fund specific investment objective is set to maintain a funding level at, or close to 100% and within this, to endeavour to maintain low and stable employers contribution rates. As set out in the Funding Strategy Statement, the actuary takes account of a range of factors on the Fund's liabilities in setting contribution rates as part of the valuation process. Performance and risk parameters are specified in relation to relevant indices and appropriate time periods and are set out in investment mandates.	

3. Risk and liabilities ▪ In setting and reviewing their investment strategy administrating authorities should take account of the form and structure of liabilities. ▪ These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk	Comply	Asset/Liability review is carried out every three years and the actuary takes account of a range of factors on the Fund's liabilities as set out in the Fund's Funding Strategy Statement which addresses the issues of financial assumptions, longevity and strength of covenant. If required, the actuarial funding position can be reported to the Pensions Committee on a quarterly basis, using information provided by Aon Hewitt.
4. Performance assessment ▪ Arrangements should be in place for formal measurement of performance of the investments, investment managers and advisors ▪ Administrating authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members	Comply	The Officers have an independent performance measurer in place. They also receive regular updates from Aon Hewitt regarding managers and the Officers meet regularly with their managers and advisors to review their performance. The Fund has recently assessed its effectiveness as a decision-making body and aims to spend more time on strategic level and asset allocation decisions compared to meeting managers going forwards.
5. Responsible ownership ▪ Administrating authorities should ▪ Adopt or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents ▪ Include a statement of their policy on responsible ownership in the statement of investment principles ▪ Report periodically to scheme members on the discharge of such responsibilities	Comply	The SIP includes a statement on responsible ownership. An independent advisor is appointed to engage with companies on socially responsible issues and voting at company meetings is effected through the Fund's investment managers.
6. Transparency and reporting ▪ Administrating authorities	Comply	A range of documents are published relating to the

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	Fund's investment management and governance including the Governance Compliance Statement, Funding Strategy Statement, Statement of Investment Principles, Communication Policy Statement and Annual report and accounts. These documents are available in full on the Fund's website and any amendments are published. Stakeholders are also invited to attend the annual meeting of the scheme.