

# Shetland Islands Council Pension Fund

## Statement of Investment Principles

### 1.0 Introduction

- 1.1 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, amended by the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2016 requires administering authorities of the Local Government Pension Scheme (LGPS) to prepare, maintain and publish a Statement of Investment Principles (SIP) governing their decisions about investments.
- 1.2 A SIP must state the extent to which the administering authority comply, or give the reasons where they do not do so, with the six principles of investment practice set out in the document "CIPFA - Investment Decision Making and Disclosure in the Local Government Pension Scheme. A Guide to the Application of the Myners Principles". Compliance with the Myners Principles are attached as Appendix B.

### 2.0 Governance Structure

- 2.1 The Shetland Islands Council is the administering authority of the Shetland Islands Council Pension Fund. The Council delegates this responsibility to the Pension Fund Committee.
- 2.2 As per the Public Service Pensions Act 2013 the Council was required to establish a new pension scheme governance structure. This involved the establishment of a Pension Fund Committee to take on the role and responsibilities of the Scheme Manager, and a Pension Board to be responsible for assisting the Scheme Manager in relation to compliance with scheme regulations.
- 2.3 The Pension Fund Committee will have the same membership as the Council's Policy and Resources Committee. The membership of the Pension Fund Committee will consist of eleven Councillors.
- 2.4 The Pension Board consists of four trade union representatives and four employer representatives. The four employer representatives will consist of three representatives from the Shetland Islands Council (Councillors) and one Admitted Bodies employer representative. The four Trade Union representatives will be appointed by their respective Trade Unions.

- 2.5 Section 6(10) of the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 [the LGPS Regulations], stipulates that a Pension Board is to meet at the same place and time as the Pension Fund Committee of the Scheme Manager to consider the same agenda as the Committee, in which case the Chair of the Pension Fund Committee shall act as chair of that meeting.
- 2.6 The Pension Fund Committee of the Shetland Islands Council has delegated responsibility for the supervision of the Pension Fund.
- 2.7 Investment decisions are made based on advice from Council Officers and professional external advisers. The Pension Fund Committee and Pension Board will meet as a minimum quarterly.

### **3.0 The Pension Fund's Objectives**

- 3.1 The primary objective of the Shetland Islands Council Pension Fund is to provide for scheme members' pension and lump sum benefits on their retirement or for their dependents on death before or after retirement, on a defined benefit basis. There is limited discretion to vary these benefits.
- 3.2 The Pension Fund's investment objectives have been set to ensure the Pension Fund meets its primary objective, these investment objectives are as follows:
- To secure and maintain sufficient assets to meet liabilities which fall due by the Fund under the Local Government Pension Scheme.
  - To minimise the risk of assets failing to meet these liabilities, through an investment strategy that is specifically tailored to the Pension Fund's requirements.
  - To maximise investment returns within an acceptable level of risk, whilst at the same time providing stability in the level of employers' contribution rates.
  - To reach a point by 2027 where the Pension Fund is fully funded. This date is deemed as when the Pension Fund's contributions and benefits will be equal. This would allow the Pension Fund to pay all liabilities due at that time and in the future.

### **4.0 Types of Investments**

- 4.1 All investments and investment limits will comply with the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.
- 4.2 The investment objective is to maximise the overall return whilst maintaining a prudent and balanced investment exposure. To achieve this aim and the Pension Fund's objectives it will utilise the following different types of investments.

- 4.3 UK Equities provide an equitable share in the assets and profits of listed UK companies. Income is provided through share dividends, which, although variable in amount from year to year, have historically over the longer term risen above inflation. Equities produce capital gains/losses as share prices reflect investors' expectations of the prospects of a specific company, sector or market.
- 4.4 International Equities are similar to UK Equities but with exposure to the currency of the market where the share is listed. The investment returns can be enhanced, or reduced, by the appreciation or depreciation respectively of the market currency against sterling.
- 4.5 Bonds are debt instruments issued by Governments and other borrowers. Bonds provide a fixed rate of interest and are generally redeemed at par by the issuer at a pre-determined future date. The price primarily reflects the fixed level of interest, the term to redemption and the overall return (the yield) demanded by investors. Prices of bonds tend to fluctuate less than the prices of equities.
- 4.6 Index Linked bonds are issued by the UK Government. They provide interest and the redemption value is directly linked to price inflation as measured by the Consumer Price Index including housing costs (CPIH). Similar index linked securities are issued by a number of overseas governments but they have additional exposure to fluctuations in the exchange rate.
- 4.7 Property is investment in land and/or buildings such as Offices, Retail and Industrial. The income comes from the rents payable. Property prices primarily reflect the rents they are able to produce and investor demand. Investors can invest either directly in individual properties or alternatively through a stake in collective investment vehicles set up to invest in a portfolio of property assets.
- 4.8 Diversified growth products invest in a wide variety of different asset classes. Typical assets classes are; equities, private equity, corporate bonds, high yield bonds, emerging market debt, property, commodities, currency, infrastructure etc. A diversified growth fund generally aims at a similar level of returns to equities but with a much reduced level of volatility.
- 4.9 Private Credit will be a new asset class in the new investment strategy. This involves providing finance (loans) in private markets, mainly to small to medium sized businesses over a 5 to 8 year period. Income is generated from steady interest payments on the agreed loans, with the principal repaid at the end of the loan.
- 4.10 Infrastructure equity will be a new asset class in the new investment strategy. These are investments in large facilities that are essential for economic activity (e.g. utilities, transport, renewables) or provide societal benefits (hospitals, prisons, schools) that deliver long term contractual income and inflation protection.

- 4.11 There is also a requirement to maintain sufficient cash in the Pension Fund bank account to meet liabilities as they fall due for payment. When conditions allow cash can be deposited with institutions for short periods and will attract interest at market rates.

## **5.0 Balance between Different Types of Investment**

- 5.1 The investment strategy for the Pension Fund has been developed with the support of external investment consultants. The external investment consultants also conduct the tender exercises to ultimately find the Investment Managers who are judged most suitable to manage the Pension Fund's assets. The Pension Fund currently employs a range of managers that have been chosen in light of the overall investment strategy, and have benchmarks and targets set to provide a prudent and balanced investment exposure to an acceptable level of investment risk.
- 5.2 When a fund manager is awarded a Pension Fund mandate by the Pension Fund Committee, the set parameters of investment for the fund manager are agreed as per the tender process. The fund managers are then given full discretion over their choice of investments within the agreed parameters of their mandate.
- 5.3 The Pension Fund places emphasis over the long term in equities, which are most likely to maximise long-term returns. However, the Pension Fund's investments are diversified over a range of different asset classes to spread investment risk and balance the investment strategy.
- 5.4 The Pension Fund's current strategic allocation and the new approved strategic allocation, which shall come into effect once all documentation and contracts are agreed with the new fund managers, are shown in Appendix A.

## **6.0 Risk**

- 6.1 It is recognised that seeking to achieve the Pension Fund's objectives will require a certain amount of investment risk within the investment strategy. It is accepted that this leads to significant volatility of returns and an ultimate risk that objectives will not be met.
- 6.2 The main investment risk of an investment strategy is recognised as arising from the asset allocation. Investment consultants are used to advise and propose an asset allocation strategy to suit the requirements and risk profile of the Pension Fund. Investment consultants are then used to conduct any tenders to find the best fund managers to invest as per the asset allocation.
- 6.3 The Pension Fund seeks to control investment risk through diversification of asset classes, fund managers, investment markets, size of holdings, through performance monitoring against benchmarks, while taking a long-term investment view.

- 6.4 To reduce the risk that the Pension Fund underperforms, performance target returns are set for each active investment fund manager relative to their benchmark. These are set out in the formal Investment Management Agreements or Subscription Agreements with each of the appointed fund managers.
- 6.5 The fund managers are required to provide data monthly and report quarterly on their portfolio's performance. These reports form the basis of the Pension Fund's monitoring of the fund managers. This monitoring will be reported to the Pension Fund Committee and Pension Board on a quarterly basis. This monitoring includes assessing the fund manager's achievement of performance against their individual benchmarks and targets.
- 6.6 The fund managers are also required to attend at the Pension Fund Committee at least once a year to give an account of their activities and performance.
- 6.7 The current Pension Fund's asset allocation is as follows:

<b>Asset Class</b>	<b>Strategy Allocation</b>
Equities	58%
Diversified Growth Fund	20%
Property	12%
Alternative Credit	10%

- 6.8 Following the Pension Fund Committee's approval of a new Pension Investment Strategy on 9<sup>th</sup> February 2022 the new investment strategy, once all changes have been incorporated, will have the following asset allocation:

<b>Asset Class</b>	<b>Strategy Allocation</b>
Equities	70%
Property	10%
Private Credit	10%
Infrastructure Equity	10%

- 6.9 The new investment strategy is split into four investment asset classes with the largest sector being a 70% allocation to equities. It is believed that over the long term equities will deliver strong investment returns, and as a result the Pension Fund retains a meaningful allocation to

equities. The Pension Fund is comfortable holding a material allocation to drive growth and meet benefit payments.

- 6.10 This equity allocation increases equity investment risk within the investment strategy. To reduce this risk the equity allocation is split between three fund managers, one passive fund manager and two active fund managers, each with different investment styles and mandate targets.
- 6.11 The Pension Fund's other investments in the new investment strategy include a property fund which is invested via a fund of funds approach, this spreads the property investment over different property funds with many property holdings within each fund. The private credit fund invests in long term loans which produce a steady long term return. The infrastructure equity fund gives not only a steady long term return but also gives added protection against inflation.
- 6.12 Sufficient cash is held in a Pension Fund bank account which is monitored daily by the Council's Treasury Section, to ensure there is sufficient cash to cover any required benefit payments.
- 6.13 An independent investment consultant company, currently Isio, is used to provide specialist advice on all aspects of the Pension Fund's investments.
- 6.14 Northern Trust is the sole custodian for the Pension Fund's assets. The services of a custodian are employed to ensure the safeguarding of the Pension Fund's assets and ensure that all associated income is collected.
- 6.15 Hymans Robertson is the Pension Fund's actuaries. The actuaries produce an actuarial valuation on the Pension Fund every three years. This states the funding level of the Pension Fund and sets employer contributions.

## **7.0 Expected Return on Investments**

- 7.1 Investment Managers will be held accountable for their performance through a regime of performance measurement against benchmarks and targets. These benchmarks and targets were agreed in conjunction with investment advisors and fund managers, as part of setting the investment strategy.
- 7.2 Each fund manager's benchmark is specific to that manager's mandate and is stated in Appendix A.
- 7.3 The benchmark and performance target set for each fund manager are intended to ensure that the total Pension Fund investment returns achieved are in excess of that assumed in the Actuarial Valuation.

## **8.0 Realisation of Investments**

- 8.1 The majority of the Pension Fund's assets are held in investments that are readily realisable within a couple of weeks, to meet any unexpected cashflow requirements.

## **9.0 Responsible Investment**

- 9.1 Whilst the fund managers have delegated powers for the acquisition and realisation of investments, fund managers are expected as part of their investment process, to consider all factors, including the social, environmental and ethical policies of companies in which they may invest, to the extent that these may materially affect the long term prospects of such companies. The fund managers will also be expected to enter into dialogue with companies in which they invest, in relation to the pursuance of socially responsible business practices, and report on these activities.
- 9.2 Corporate Governance is a key responsibility for institutional shareholders and as a matter of principle the Pension Fund will seek to exercise all of its voting rights in respect of its shareholdings. It is recognised however that in practical terms this may not always be possible for overseas holdings. However for UK stocks all voting rights will be exercised in a positive fashion, i.e. no abstentions.
- 9.3 The fund managers, who will act in accordance with this policy, will exercise voting.
- 9.4 All of the Pension Fund's managers have signed up to the United Nations Principles on Responsible Investment. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and therefore must be given appropriate consideration by investors if they are to fulfill their fiduciary (or equivalent) duty. The Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices, and so better align their objectives with those of society at large.
- 9.5 On an annual basis each Fund Manager makes available their internal controls report. These reports are produced by their respective external auditors, and review all aspects of the Fund Manager's operating controls, with any concerns and weaknesses reported. The reports are reviewed by Treasury within Finance annually, with any concerns or issues identified that may impact on the Pension Fund reported accordingly.

## **10.0 Securities Lending**

- 10.1 Stock lending involves the lending of certain investments to a counterparty (subject to strict credit rating controls) for a period of time

in return for a payment of commission. Northern Trust the Pension Fund's custodian undertakes stock lending on behalf of the fund, within strict guidelines to reduce the risk of financial loss to the fund in the event of default.

- 10.2 All of the Pension Fund investments are currently invested in unitised products, which Northern Trust cannot lend, but the fund manager may undertake an element of lending on behalf of the unit holders within the actual unitised fund.

## **11.0 Compliance**

The Statement of Investment Principles must also state the extent to which the authority complies, and to the extent it does not so comply, with the guidance given by the Scottish Ministers in regard to the six principles of investment practice set out in the document called "CIPFA - Investment Decision Making and Disclosure in the Local Government Pension Scheme. A Guide to the Application of the Myners Principles". The Fund's compliance with the guidance is provided in Appendix B.

Appendix A

# **Investment Management Arrangements**

**Current Pension Fund Strategic Investment Allocation**



<b>Asset Class</b>	<b>Fund Manager</b>	<b>Strategic Allocation</b>	<b>Performance Objective (Net of Fees)</b>	<b>Benchmark Indices</b>
Passive Global Equity	BlackRock	20%	Benchmark	FTSE All World Developed ex UK
Active Global Equity	KBI Global Investors	20%	Benchmark +3.0%	MSCI Developed World Index
Diversified Growth Fund	Newton	20%	Fixed Benchmark Return	SONIA +3-4%
Passive UK Equity	BlackRock	18%	Benchmark	FTSE All Share
Property	Schroders	12%	Benchmark +1.0%	IPD Pooled Property
Alternative Credit	M&G	10%	Fixed Benchmark Return	SONIA +3-5%

Note: SONIA (Sterling Overnight Index Average) is used for benchmarking against a cash return.

### **Approved New Pension Fund Strategic Investment Allocation**

After an investment strategy review of the Pension Fund's investments by external investment consultants Isio, a new investment strategy was approved by the Pension Fund Committee on the 9<sup>th</sup> February 2022 (Min Ref: 02/22). This new investment strategy involves changes to current investment mandates and to fund managers in the current investment strategy, and these changes

will come into effect once all documentation and new contracts have been agreed. The new investment strategy will have the following strategic asset allocation:

<b>Asset Class</b>	<b>Fund Manager</b>	<b>Strategic Allocation</b>	<b>Performance Objective (Net of fees)</b>	<b>Benchmark Indices</b>
Passive Global Equity	BlackRock	30%	Benchmark	FTSE All World Developed
Active Global Equity	Baillie Gifford	25%	Benchmark +2.0%	MSCI All Countries World Index
Active Global Equity	KBI Global Investors	15%	Benchmark +3.0%	MSCI Developed World Index
Property	Schroders	10%	Benchmark +1.0%	IPD Pooled Property
Private Credit	Permira	10%	Fixed Benchmark Return	Fixed 6-7%
Infrastructure Equity	IFM	10%	Fixed Benchmark Return	Fixed 10%

Appendix B

## **Compliance with Myners Principles**

## **Principle 1 Effective decision making**

Administering 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.

The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as Scheme Manager for the Shetland Islands Council Pension Fund.

The Council has also set up a Pension Board to be responsible for assisting the Scheme Manager in relation to compliance with scheme regulations.

The membership of the Pension Fund Committee will consist of eleven Councillors. The Pension Board will consist of three Councillors, one Admitted Bodies employer representative and four Trade Union representatives.

The Pension Fund Committee and Pension Board's knowledge will be supported by advice from Council Officers, external analysts, investment consultants and fund managers.

The Pension Fund Committee and Pension Board will receive all pension fund related reports and hear Pension Fund manager presentations. All pension related decisions will be taken by the Pension Fund Committee.

The day to day running of the Pension Fund is delegated to the Executive Manager Finance.

## **Principle 2 Clear objectives**

- An overall investment objective(s) 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 advisors and investment managers

The Statement of Investment Principles and the Funding Strategy Statement define the Pension Fund's primary funding objectives.

The setting of the Funding Strategy recognises the need to maintain stability of employer contribution rates over time.

A review of the investment strategy will be undertaken every five years after the updated funding level and actuarial valuation results are known. The review will be conducted with investment consultants and focus on the asset allocation between the main asset classes.

Investment and actuarial advisers are appointed under separate contract, in line with the EU procurement regulations.

Each Investment Management Agreement has clear benchmarks, risk parameters and where necessary individual targets for each mandate.

### **Principle 3 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 the covenant for participating employers, the risk of their default and longevity risk

The Pension Fund takes advice from the scheme's actuary regarding the nature of its liabilities.

The actuarial valuation includes the risk of default and longevity risk in analysing the liabilities of the scheme. Investment consultant advice is sought periodically, to ensure the fund is aware of the levels of risk within the asset mix and to assess the suitability of the structure in relation to outperforming its liabilities.

The Executive Manager Finance has responsibility for ensuring appropriate controls are in place for the Pension Fund. Controls are subject to periodical checks from internal and external audit and any issues brought to the attention of the Pension Fund Committee and Pension Board.

### **Principle 4 Performance assessment**

- Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors
- 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

Performance reports covering all of the Pension Fund's managers are considered by the Pension Fund Committee and Pension Board on a quarterly basis.

An annual report is presented to the Pension Fund Committee assessing the performance of the Pension Fund's investment advisors.

A Governance Compliance Statement in the Pension Fund Accounts measures the Pension Fund's governance arrangements against the standards set out in the guidance, with an action plan in place for ongoing issues.

Over the long-term, the Pension Fund's overall performance against benchmark and the contribution to the overall funding level is attributable to the investment strategy and the fund manager appointments within that strategy. The Pension Board will scrutinise the Pension Fund Committee's management of the Pension Fund including the review of the fund managers' performance and the investment strategy.

## **Principle 5 Responsible ownership**

Administering 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

The Pension Fund's managers have adopted the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.

The Pension Fund's policy on responsible ownership is contained in the Fund's Statement of Investment Principles.

A summary on responsible ownership will be included in the annual Pension Fund Management Review report, which the Pension Fund Committee and Pension Board will review.

## **Principle 6 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

The Pension Fund Committee's papers and minutes will be available via the Council committee management system website.

As well as reporting Scheme changes through the Pension Fund Committee, members of the scheme (active, deferred and pensioners) are kept up to date with changes through an annual Pensions Newsletter.

A hard copy of the full version of the Pension Fund's Annual Report and Accounts is provided to the scheduled and active admitted bodies of the scheme, and a summary of the review to all scheme members.

The Pension Fund has its own dedicated website where all communications, policy documents and information can be accessed.