

# **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 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 called “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 Schedule 1.
- 1.3 A copy of this statement is provided to the Fund’s investment managers, who are required to follow the principles that it sets out.

### **2.0 Governance Structure**

- 2.1 The Shetland Islands Council is the administering authority of the Shetland Islands Council Pension Fund.
- 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 will consist of three Councillors, one Admitted Bodies employer representative and four Trade Union representatives. The Trade Union representatives being decided by the Employers Joint Consultative Committee.
- 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 newly formed Pension Fund Committee of the Shetland Islands Council has delegated responsibility for the supervision of the Pension Fund.

### **3.0 Objective of the Fund**

3.1 The Fund's 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
- 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 2026-27 where the Pension Fund is 100% funded.

### **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 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.

4.3 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.

4.4 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.

4.5 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 Retail Price Index (RPI). Similar index linked securities are issued by a number of overseas governments but they have additional exposure to fluctuations in the exchange rate.

- 4.6 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.
- 4.7 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.
- 4.8 Cash is usually deposited with institutions for short periods and will attract interest at market rates.

## 5.0 Balance Between Different Types of Investment

- 5.1 The Pension Fund places emphasis over the long term in equities, which are most likely to maximise long-term returns. However, the Fund is diversified to include other assets such as Bonds, Property and Cash.
- 5.2 The fund is measured against a customised benchmark, which is as follows:

<b>Asset Class</b>	<b>Allocation %</b>	<b>Benchmark</b>
Global Equities (passive)	20	FTSE All World Developed ex UK
Global Equities (active)	20	MSCI WI +3%
Diversified Growth Fund	20	LIBOR +3-4%
UK Equities (passive)	18	FTSE All Share
Property	12	IPD Pooled Property
Alternative Credit	10	LIBOR + 3-5%

## 6.0 Risk

- 6.1 It is recognised that seeking to achieve the Pension Fund's objectives carries a certain amount of investment risk. It is accepted that this leads to significant volatility of returns and an ultimate risk that objectives will not be met.

- 6.2 The fund seeks to control risk through investing in a diverse range of asset classes, over a long-term investment horizon. Following a recent strategy review in 2014 the fund is split into six investment sectors with the largest allocation being 58% to equities. This equity allocation is split between passive and active management each having different fund managers.
- 6.3 The Pension Fund's other investments include a diversified growth fund which invests into various different investment areas, an alternative credit fund covering various fixed income sectors and a property fund which is invested via a fund of funds approach.
- 6.4 The current Pension Fund managers, their mandates, benchmark percentage of reserves are as follows:

Manager	Mandate	% of Reserves
BlackRock	Equity UK & Global (passive)	38
Kleinwort Benson	Global Equities (active)	20
Newton	Diversified Growth Fund	20
Schroders	Property (fund of funds)	12
M&G	Alternative Credit	10

- 6.5 An independent performance analyst company WM Company reviews the managers' performance and provides quarterly reports on each manager.
- 6.6 An independent investment consultant company is used to provide specialist advice on all aspects of the Pension Fund's investments.
- 6.7 Northern Trust is the sole custodian for the Pension Fund's assets.

## **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 the investment strategy in 2014.
- 7.2 Each fund manager's benchmark is specific to that manager's mandate and is stated at section 5.2.

- 7.3 The benchmark and performance target set for each Manager are intended to ensure that the Fund investment returns achieved are in excess of that assumed in the Actuarial Valuation.

## **8.0 Realisation of Investments**

- 8.1 The Fund will hold sufficient cash in its bank account to meet the likely benefit payments. Additionally, the majority of the Fund's assets are held in assets 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 will be 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 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 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 in the 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 Schedule 1.

## **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 Council has set up a Pension Fund Committee to take on the role and responsibilities of the Scheme Manager, and a Pensions 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 Pensions Board will consist of three Councillors, one Admitted Bodies employer representative and four Trade Union representatives.

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

The Pension Fund Committee and Board will receive all pension fund related reports and hear any Pension Fund manager presentations. All pension related decisions will be taken by the Pension 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 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 three years after the updated funding level and actuarial valuation results are known. The review will be conducted with investment consultants and focus on the split between the main asset classes (equities, bonds, property and cash).

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 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 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

An independent external analyst company measures the investment performance of the individual Pension Fund managers, and also the total performance of the Pension Fund.



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

A Governance Compliance Statement in the Pension Fund Accounts measures the 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, Fund performance against benchmark and the contribution to the overall funding level is attributable to the investment manager appointments and the investment strategy. The Pension Board will scrutinise the Pension 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 Fund's managers have adopted the Institutional Shareholders' Committee Statement of Principles.

The 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 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 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 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.