

LONDON BOROUGH OF NEWHAM PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES 2007/08

1. Introduction

- 1.1 This is the Statement of Investment Principles (SIP) adopted by the London Borough of Newham (LBN) in relation to the Council's Pension Fund. It reflects the conclusions drawn from the 2004 valuation and the Strategy review in 2005.
- 1.2 The LBN Pension Fund is a Local Government Pension Scheme (LGPS). It is not a trust based scheme. Rather, the investment of the Fund's assets is governed by the "Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999", as amended. Amongst other things these regulations require LBN to consult with stakeholders and to obtain and consider proper written, advice from suitably qualified persons on investments and the formulation of an investment policy, taking into account the suitability and diversity of the different asset classes selected. In this capacity the Council employs the Investment Practice of Hewitt Associates. This SIP is consistent with the restrictions and requirements of the regulations.
- 1.3 The Investment & Accounts Committee of LBN oversees the management of the Fund's assets. Although not trustees, the Members of the Investment & Accounts Committee owe a fiduciary duty similar to that of trustees to the council-tax payers, who would ultimately have to meet any shortfall in the Assets of the Fund, as well as to the contributors and beneficiaries of the Fund.
- 1.4 The terms of reference for the Investment & Accounts Committee within the Council's Constitution (8.06 2) are:
- To make all decisions under Regulations made pursuant to Section 7, 12 or 24 of the Superannuation Act not otherwise falling to the Executive Director of Resources to determine as set out in the officers scheme of delegation
 - Approval of the authority statement of accounts in accordance with the relevant Accounts and Audit Regulations made from time to time
 - The Committee shall be a member of the Local Authority Pension Fund Forum

The Investment & Accounts Committee has responsibility for:

- Determining an overall investment strategy and strategic asset allocation, with regard to diversification and the suitability of asset classes
- Appointing the investment managers, an independent custodian, the actuary and any external consultants considered necessary
- Reviewing on a regular basis the investment managers' performance against benchmarks, and satisfying themselves as to the managers' expertise and the quality of their internal systems and controls
- Monitoring compliance with the SIP & Funding Strategy Statement (FSS) and reviewing its contents
- Reviewing policy on social, environmental and ethical considerations, and on the exercise of voting rights

The Executive Director of Resources and the appointed Consultants and Actuaries support the Committee. The day-to-day management of the Fund's assets is delegated to investment managers.

- 1.5 This SIP will be reviewed at least once a year, or more frequently as required, in particular

following valuations, future Asset/Liability studies and performance reviews which may indicate a need to change investment policy or significant changes to the FSS.

- 1.6 From August 2002, the SIP is required to state how it complies with the ten investment principles as outlined within the CIPFA Pensions Panel Principles. This information is contained within Appendix A.

2. Fund Objectives

- 2.1 The aims of the Fund are to:
- Ensure that sufficient resources are available to meet all liabilities as they fall due
 - Enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies
 - Manage employer’s liabilities effectively
 - Maximise the returns from investments within reasonable risk parameters

3. Types and Balance of Investments

- 3.1 The Fund may utilise the following asset classes which are deemed suitable for the scheme:

Equities (UK and Overseas)	Derivatives
Fixed Interest Bonds (UK and Overseas)	Managed Funds
Index Linked	Stock Lending
Cash	Underwriting
Private Equity	Property

- 3.2 The Fund has chosen a specific benchmark in order to determine the appropriate balance between different types of asset. The Fund invests through a range of pooled Funds as well as directly in shares and has a mix of passive and active management. Stock selection is delegated to Investment Managers who may vary their allocation within set bands and must re-balance to the benchmark quarterly. Following a review of the investment strategy in 2005 the benchmark is as follows:

	%	Expected Return*
Equities	60.0	10-11%
Bonds	13.0	5 %
Property	12.0	7.5%
Private Equity	5.0	10-11%
Infrastructure	5.0	9.0%
Currency	5.0	15.0%
Total	<u>100.0</u>	

The Fund has made 5% allocations to private equity and infrastructure. These allocations are not invested immediately but are invested over a 3-4 year period as the fund manager invests in suitable companies. In the interim these assets are invested in UK equities.

* Expected return on assets derived from Hewitt Investment assumptions June 2006

- 3.3 The benchmark adopted reflects the circumstances of the Newham Fund in terms of its liability profile and solvency level. Although the Fund is relatively mature (i.e. there are relatively high numbers of pensioners compared to contributing numbers) it is cash positive. This position is likely to be maintained over the medium term of at least 10 years. As a result the Fund is able to take a fairly long-term perspective investing in real assets such as equities and property to increase the value of the Fund rather than Bonds which produce a steady income stream.

- 3.4 The Fund’s investments are structured so as to stay within the restrictions imposed by regulation. These are reflected in the management agreements and instructions to

Investment Managers.

4. Investment Management Arrangements

4.1 Investment Managers, authorised under the regulations, are appointed to manage virtually all the assets of the Fund. Some cash (making up less than 1% of the Fund) is held in house.

4.2 Following the Strategy Review and the on-going review by the Fund's Advisors, there has been a change of mandates, moving to Specialist as well as investment in alternative investment classes, so as to meet the objectives of the Fund which is to be fully funded in 20 years.

Manager	Mandate	% Fund
<u>Alliance Bernstein</u>	<u>Global Equity Active</u>	<u>12.5</u>
Axa Rosenberg	Global Equity Active	12.5
Legal & General	Multi-Asset Passive	35.0
Rreef	Property	12.0
Aberdeen Asset Management	Fixed Income Active	13.0
Various	Private Equity	5.0
Babcock & Brown	Infrastructure	5.0
Record Currency Management	Active Currency	2.5
JP Morgan	Active Currency	2.5

4.3 Investments in Property and Private Equity are illiquid relative to other asset classes.

4.4 Management agreements are maintained with each of the Investment Managers which set out the benchmark asset allocation ranges, performance target and any restrictions placed on the manager.

4.5 The Investment Manager's actions and performance are monitored quarterly and reviewed annually.

4.6 The manager's fee structure is based on a percentage of the market value of the managed assets. The fee charged is set as part of the appointment process.

5. Risk and Return

5.1 Funding of the LBN Pension Fund is based upon financial and demographic assumptions determined by the actuary. The main risks to the Fund are highlighted within section 7 of

the FSS. The risks to the Fund are controlled in the following ways:

- The adoption and monitoring of asset allocation benchmarks, ranges and performance targets constrain the Investment Managers from deviating significantly from the intended approach while permitting the flexibility for Managers to enhance returns
- The appointment of more than one Manager with different mandates and approaches provides for the diversification of Manager risk
- The investment management agreements constrain the Manager's actions in areas of particular risk and set out the respective responsibilities of both the Manager and LBN

5.2 The Fund is managed 82% on an active and 18% on a passive basis. The assets managed on an active basis are expected to out perform their respective benchmarks over the long term. In achieving the level of return managers are also required to limit underperformance. The passive manager has a target of achieving a return as close as possible to the respective benchmark index return for each market. Overall the Fund is expected to produce a return at least in line with the return assumed by the actuary in the last valuation.

5.3 The WM Company monitor the performance of each of the Managers and the Fund overall. Reports are considered quarterly and there is an annual review. The annual review also examines the impact of the Fund's benchmark. Performance of the Fund is monitored internally on a monthly basis. There is a statutory obligation for triennial valuation of the Fund with the option for interim valuations as required.

6. Realisation of Investments

6.1 The majority of the Funds assets are quoted in the major markets and are readily realisable. Property is relatively illiquid and makes up 12% of the Fund benchmark assets. Private Equity is also illiquid. As the Fund enjoys a positive cash flow there will not be a need to realise investments quickly in the medium term.

6.2 The investment managers are required to realise investments as soon as it becomes appropriate to do so under their mandates. In general the Fund's investment managers have discretion with regard to the realisation of investments.

7. **Socially Responsible Investment**

7.1 As a responsible investor the LBN Pension Fund wishes to promote corporate social responsibility, good practice and improved performance amongst all Companies in which it invests.

7.2 Whilst there has been a great deal of emphasis on the relationship of business, financial and economic factors to investment performance, the impact on returns of less tangible non-financial and reputational factors is more difficult to identify. Nevertheless it is clear that adverse publicity relating to low corporate, environmental or social standards can have an adverse impact on shareholder value, the Fund, its beneficiaries and local taxpayers. By having a good public image, the morale of the workforce will be higher, thus making it easier to attract and retain quality employees. Furthermore the Fund considers that the pursuit of high corporate social responsibility standards by Companies will lead to higher returns in the long term. A good public image may help to increase sales volumes. An improved financial standing will improve credit ratings, thus allowing a company to attract lower cost funding. By addressing outside factors, the company is able to demonstrate an above average standard of management competence which will improve the long term potential and sustainability of the organisation. At the very least the Fund expects the Companies in which it invests to comply with all applicable laws and regulations in home markets and to conform to local best practice when operating overseas.

- 7.3 In furtherance of this stance the Fund will support standards of best practice by Companies in both the disclosure and management of corporate social responsibility issues consistent with the Fund's fiduciary responsibilities. To this end the Fund will pursue a policy of active shareholder engagement with companies using its own efforts, those of its Fund managers and alliances with other investors. The Fund is a member of the Local Authority Pension Fund Forum and National Association of Pension Funds.
- 7.4 On occasions the Chair and Members of the Council's Investment & Accounts Committee has attended company AGMs to raise questions on matters concerning socially responsible issues, such as labour standards. There is potential for a company to improve its reputation and financial standing from positive engagement by addressing issues that if ignored, may be detrimental to the organisations long term standing.
- 7.5 The Fund will consider excluding certain types of investment from its actively managed portfolios, on grounds of social responsibility following advice on the implications for performance and diversification. For example, 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.

8. Shareholder Rights

- 8.1 The Fund is committed to making full use of its shareholder rights.

The Fund's policy on voting rights is based on the Cadbury, Greenbury and Hampel codes, as well as the stock exchange combined code, and the principles of protecting shareholder rights, minimising risk and enhancing value. The Fund expects its Fund Managers to vote in an appropriate and informed manner.

The exercise of shareholder's rights are delegated to the Fund Managers as part of their mandate. Fund Managers will vote in accordance with their Corporate Governance Policy Statements. These policy statements have been developed with the recommendations of Institutional Shareholder Service (ISS), National Association of Pension Funds (NAPF) and the Association of British Insurers (ABI).

9. Additional Voluntary Contributions

- 9.1 The Council provides a facility for members to pay additional voluntary contributions (AVCs) to enhance their benefits. Members have a choice of buying added years of service or accumulating their AVCs to purchase benefits on a money purchase basis. Investment of money purchase AVCs is undertaken through Clerical Medical Investment Group Ltd and the Equitable Life Assurance Society. The Equitable Life option is closed to new members.

10. Approval

The Draft Statement was presented and approved by the Investment & Accounts Committee on 28th June 2007. This revised Statement was noted by the Investment & Accounts Committee on 21st November 2007.

11. Compliance With Principles of Investment Practice

11.1 The London Borough of Newham Pension Fund complies with the CIPFA Pensions Panel Principles for Investment Decision-Making in the Local Government Pension Scheme in the United Kingdom.

These Principles are outlined in Appendix A.

12. Feedback

Feedback is welcomed on this Statement of Investment Principles.

If you have any comments to make for suggested amendments or wish to discuss any issues then please contact John Turnbull, Head of Finance, Newham Town Hall, Barking Road, London E6 2RP.

(email John.turnbull@newham.gov.uk)

APPENDIX A

COMPLIANCE WITH CIPFA PENSIONS PANEL PRINCIPLES FOR INVESTMENT DECISION MAKING IN THE LOCAL GOVERNMENT PENSION SCHEME IN THE UNITED KINGDOM

The London Borough of Newham Pension Scheme complies with the ten CIPFA Investment Principles. These principles were first outlined in the Myners Report.

The ten principles and degree of compliance are presented below:

1. **Effective Decision Making**

Decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. Where trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take.

Trustees should ensure that they have sufficient in-house staff to support them in their investment responsibilities. Trustees should also be paid, unless there are specific reasons to the contrary.

It is good practice for trustee boards to have an investment subcommittee to provide the appropriate focus.

Trustees should assess whether they have the right set of skills, both individually and collectively, and the right structures and processes to carry out their role effectively. They should draw up a forward looking business plan.

√ Full Compliance

The Council has an Investment & Accounts Committee for decision-making purposes {see in paragraph 1.4 of the Statement of Investment Principles (SIP)}.

Business plans are presented to the Committee annually and are monitored on a quarterly basis

Several of the Fund Trustees have extensive experience of dealing with Investment matters and training is made available to new Committee members. There is an ongoing programme of training available to trustees, including seminars, circulars, Committee discussions with advisers and networking. Committee Members are required to undertake a minimum of three days of investment training a year.

2. **Clear Objectives**

Trustees should set out an overall investment objective for the fund that:

- *Represents their best judgement of what is necessary to meet the fund's liabilities given their understanding of the contributions likely to be received from employer(s) and employees; and*
- *Takes account of their attitude to risk, specifically their willingness to accept underperformance due to market conditions*

Objectives for the overall fund should not be expressed in terms, which have no relationship to their fund's liabilities, such as performance relative to other pension funds, or to a market index.

√ Full Compliance

The aims and objectives of the Fund are set out within the Funding Strategy Statement and within paragraph 2 of the SIP. The main fund objective is to meet the cost of pension liabilities. Following the 2004 valuation an investment strategy review was undertaken and the approach of the Fund's advisors is an on-going review of the strategy.

3. **Focus On Asset Allocation**

Strategic asset allocation decisions should receive a level of attention (and, where relevant, advisory or management fees) that fully reflect the contribution they can make towards achieving the fund's investment objective. Decision-makers should consider a full range of investment opportunities, not excluding from consideration any major asset class, including private equity. Asset allocation should reflect the fund's own characteristics, not the average allocation of other funds.

√ Full Compliance

Opportunities to invest in new asset classes have been presented to the Committee and investments in Infrastructure and Currency have been undertaken.

The Investment Allocation of the fund is set to maximise the potential to close the funding deficit over future years. The current allocation is outlined in paragraph 3 of the SIP.

4. **Expert Advice**

Contracts for actuarial services and investment advice should be opened to separate competition. The fund should be prepared to pay sufficient fees for each service to attract a broad range of kinds of potential providers

√ Full Compliance

A tender exercise was undertaken during 2006 for both actuarial and investment advisory services. In line with Myners' recommendation the Fund now has separate contracts for Actuarial & Investment Advisory services.

5. **Explicit Mandates**

Trustees should agree with both internal and external investment managers an explicit written mandate covering agreement between trustee and managers on:

- An objective, benchmark(s) and risk parameters that together with all other mandates are coherent with the fund's aggregate objective and risk tolerances;
- The manager's approach in attempting to achieve the objective; and
- Clear timescale(s) of measurement and evaluation, such that the mandate will not be terminated before the expiry of the evaluation timescale for underperformance alone.

The mandate and trust deed and rules should not exclude the use of any set of financial instruments, without clear justification in the light of the specific circumstances of the fund.

√ Full Compliance

The investment manager contract includes reference to specific targets to either track or exceed the benchmark as appropriate with the manager's style and risk parameters.

Trustees or those to whom they have delegated the task, should have a full understanding of the transaction-related costs they incur, including commissions. They should understand all the options that are open to them in respect of these costs, and should have an active strategy- whether through direct financial incentives or otherwise- for ensuring that these costs are properly controlled without jeopardising the fund's other objectives. Trustees should not, without good reason, permit soft commissions to be paid in respect of their fund's transactions.

√ Full Compliance – Investment & Accounts Committee members receive

quarterly monitoring reports of the Fund's investments, which include analysis of trading and other costs. Transaction audit facilities are available on-line via the custodian.

6. **Activism**

The mandate and trust deed should incorporate the principle of the US Department of Labour Interpretative Bulletin on activism. Trustees should also ensure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and how they measure effectiveness of this strategy.

√ Full Compliance.

The Fund is committed to making full use of its shareholder rights. The approach used is outlined in paragraph 8 of the SIP.

7. **Appropriate Benchmarks**

Trustees should:

- *Explicitly consider, in consultation with their investment manager(s), whether the index benchmarks they have selected are appropriate; in particular, whether the construction of the index creates incentives to follow sub-optimal investment strategies;*
- *If setting limits on divergence from an index, ensure that they reflect the approximations involved in index construction and selection;*
- *Consider explicitly for each asset class invested, whether active or passive management would be more appropriate given the efficiency, liquidity and level of transaction costs in the market concerned; and*
- *Where they believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving the managers the freedom to pursue genuinely active strategies*

√ Full Compliance

The benchmark of the fund is frequently assessed. The benchmarks used are tailored to meet the fund liabilities. The overall benchmark for the fund is determined to meet the fund's investment objectives. Fund managers with differing risk strategies are employed to provide a range of investment/risk styles to increase potential for the fund to increase in value. A full review of investment strategy was undertaken in 2005 and on-going reviews are undertaken by the new Advisor.

Managers are allowed some discretion in the allocation of fund assets within certain limits. This enables managers to use their expertise to increase the potential for above benchmark performance.

8. **Performance Measurement**

Trustees should arrange for measurement of the performance of the fund and make formal assessment of their own procedures and decisions as trustees.

They should also arrange for a formal assessment of performance and decision making delegated to advisors and managers

√ Full Compliance –

Performance of the Fund is measured monthly and reported quarterly to the Investment &

Accounts Committee. Formal assessment is undertaken through Committee procedures, analysis from specialist performance companies, specialist Investment advice and interim and triennial valuations.

9. **Transparency**

A strengthened Statement of Investment Principles should set out:

- *Who is taking which decisions and why this structure has been selected;*
- *The fund's investment objective;*
- *The fund's planned asset allocation strategy, including projected investment returns on asset class, and how the strategy has been arrived at;*
- *The mandates given to all advisors and managers; and*
- *The nature of the fee structures in place for all advisers and managers, and why this set of structures has been selected*

√ Full Compliance

The SIP outlines the Pension Fund decision making process, the Fund's investment objectives, the asset allocation strategy, expected returns and the appointed fund managers mandates. The current SIP will continue to be developed to incorporate new principles and support the FSS.

10. **Regular Reporting**

Trustees should publish their Statement of Investment Principles and the results of their monitoring of advisors and managers. They should send key information from these annually to members of these funds, including an explanation if why the fund has chosen to depart from any of these principles.

√ Full Compliance

The Statement of Investment Principles and a financial summary of the Pension Fund Account are published on the Council website. The availability of these is publicised to Fund Members – printed copies of the reports are available upon request. A Communication Policy was implemented in 2005.

The performance of the fund managers is included within the Investment & Accounts Committee agenda. These reports are available on the Council website.