Nottinghamshire County Council

Nottinghamshire Pension Fund

July 2014

STATEMENT OF INVESTMENT PRINCIPLES

Introduction

1. The County Council is an administering authority of the Local Government Pension Scheme (the "Scheme") as specified by the Local Government Pension Scheme Regulations 2013 (the LGPS Regulations). It is required by Regulation 53 of the LGPS Regulations to maintain a pension fund for the Scheme.

2. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the "Investment Regulations") govern the management of the pension fund and the investment of fund money. According to Regulation 12 of the Investment Regulations an administering authority is required to prepare, maintain and publish a Statement of Investment Principles (SIP).

3. The SIP must cover policy on:
    - the types of investment to be held
    - the balance between different types of investments
    - risk, including the ways in which risks are to be measured and managed
    - the expected return on investments
    - the realisation of investments
    - the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments
    - the exercise of the rights (including voting rights) attaching to investments
    - stock lending.

4. The SIP must also state the extent to which the administering authority complies with relevant guidance given by the Secretary of State, and give reasons for any areas of non-compliance. The relevant guidance is published by CIPFA in the *Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012*. This provides best practice for managing investments and includes a guide to the application of the 2008 *Investment Governance Group Principles* to LGPS funds.

Purpose of the Fund

5. The purpose of the Fund is to:
    - Pay pensions, lump sums and other benefits provided under the LGPS Regulations
    - Meet the costs associated in administering the Fund
    - Receive contributions, transfer values and investment income
    - Invest any Fund money not needed immediately to make payments.

Principles

6. The following principles underpin the Fund’s investment activity:
   - The Fund will aim to be sufficient to meet all its obligations on a continuing basis.
   - The Fund will be invested in a diversified range of assets.
   - Proper advice on the suitability of types of investment will be obtained and considered at reasonable intervals.
   - The Fund will aim to conduct its business and to use its influence in a long term responsible way.

Key Parties

7. The key parties involved in the Fund’s investments and their responsibilities are as follows.

The Administering Authority

8. The Administering Authority for the Pension Fund is Nottinghamshire County Council. Under the terms of the Council’s constitution, the functions of the Council as administering authority are delegated to the Nottinghamshire Pension Fund Committee supported by two Sub-Committees. The full governance arrangements of the Fund are detailed in the Fund’s Governance Compliance Statement.

9. The members of the Committees act in a quasi-trustee capacity and are hereafter referred to as “Trustees”.

Trustees

10. The Trustees recognise their full responsibility for the oversight of the Fund, and operate to a Code of Conduct. The Trustees shall:
    - Determine the overall investment strategy, and what restrictions, if any, are to be placed on particular types and market locations of investments
    - Determine the type of investment management to be used and appoint and dismiss fund managers
    - Receive quarterly reports on performance from the main fund managers and question them regularly on their performance
    - Receive independent reports on the performance of fund managers on a regular basis
    - Be encouraged to receive suitable training to help them discharge their responsibilities and attend such training courses, conferences and meetings that deliver value for money to the Fund.

Chief Finance Officer

11. Under the Council’s constitution, the Service Director (Finance & Procurement) is designated the Council’s Chief Finance Officer (also known as the Section 151 Officer). The Group Manager (Financial Strategy & Compliance) is the deputy Section 151 Officer. Financial Regulations specify that the Section 151 Officer is responsible for arranging the investment of the Pension Fund. Operational matters falling under this responsibility are exercised by the Senior Accountant (Pensions & Treasury Management).

12. Authorised signatories for operational matters relating to pension fund investments are:
    - Service Director (Finance & Procurement)
    - Group Manager (Financial Strategy & Compliance)
    - Group Manager (Financial Management)
    - Senior Accountant (Pensions & Treasury Management)
    - Investments Officer

13. Representatives of the Service Director (Finance & Procurement) provide advice to the Trustees and attend meetings of the Pension Fund Committees as required.

Independent Adviser

14. The Fund has an Independent Adviser who attends meetings of the Pensions Investment Sub-Committee, Pensions Sub-Committee and Pensions Working Party as required.

15. The independent adviser is engaged to provide advice on:
    - the objectives and policies of the fund
    - investment strategy and asset allocation
    - the fund's approach to responsible investment
    - choice of benchmarks
    - investment management methods and structures
    - choice of managers and external specialists
    - activity and performance of investment managers and the fund
    - the risks involved with existing or proposed investments
    - the fund's current property portfolio and any proposals for purchases, sales, improvement or development
    - new developments and opportunities in investment theory and practice.

Asset Allocation

16. It is widely recognised that asset allocation is the most important factor in driving long term investment returns. The balance between different asset classes depends largely on the expected returns from each asset class and the target return for the Fund. It is also recognised that investment returns play a significant role in defraying the cost of providing pensions by mitigating the contributions required from employers.

17. Employers' contributions are determined as part of the triennial actuarial valuation of the Fund. The actuarial valuation involves a projection of future cash flows to and from the Fund and its main purpose is to determine the level of employers' contributions that should ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund.

18. The Fund Actuary estimates the future cash flows which will be paid from the Fund for the benefits relating to service up to the valuation date. They then discount these projected cash flows using the discount rate to get a single figure for the value of the past service liabilities. This figure is the amount of money which, if invested now, would be sufficient to make these payments in future provided that the future investment return was equal to at least the discount rate used.

19. The discount rate is based on the expected long term future investment returns from various asset classes. At the latest valuation, these were as follows:

Asset Class	Expected Return (pa)
Equities	6.7%
Gilts	3.3%
Corporate Bonds	3.9%
Property	5.8%
Cash	3.1%
Discount Rate	**6.0%**

20. At the latest valuation, the Fund was assessed to have a deficit of £620m and a funding level of 85%. Deficit recovery contributions have been certified for the majority of employers but any returns in excess of the discount rate will help to recover the Fund to a fully funded position.

21. The agreed asset allocation ranges for the Fund are shown below along with the Fund's strategic benchmark and liability based benchmark.

Asset Class	Allocation Ranges	Strategic Benchmark	
Equities	55% to 75%	FTSE All World	65.0%
Property	5% to 25%	IPD annual universe	15.0%
Bonds	10% to 25%	FTSE UK Gilt All Stock	17.5%
Cash	0% to 10%	LIBID 7 Day	2.5%

Liability Based Benchmark	FTSE UK Gilts IL > 5 Yrs	100.0%

22. These ranges will be kept under regular review. If it appears likely that these limits might be breached because of market movements, reference will be made to a meeting of the Pensions Working Party for advice. The proportions are those aimed at achieving best returns within acceptable risk parameters. The Fund will vary between the asset classes according to market circumstances, relative performance and cash flow requirements.

23. The asset allocation currently favours "growth assets" (equities and property) over "defensive assets" (bonds and cash) as the former are expected to outperform the latter over the long term. Although net additions from members (contributions received less benefits paid) are now expected to be negative for the foreseeable future, the Fund receives significant investment income and a recent report by the Fund Actuary shows that the Fund is unlikely to need to sell assets to pay benefits for at least 20 years. This allows the Fund to continue to implement a long term investment strategy.

24. As the funding level approaches 100%, the asset allocation will be reviewed to consider whether it is appropriate to change the mix of growth versus defensive assets.

Investment Policy

25. The policy of the Fund will be to treat the equity allocation as a block aimed at maximising the financial returns to the funds (and thus minimising employers' contributions) consonant with an acceptable level of risk. The block of Bonds, Property and Cash is aimed at lowering overall risk (at the cost of anticipated lower return).

26. The Trustees have agreed an allocation to private equity and infrastructure. This will be effected principally through fund of funds arrangements to increase diversification and reduce risk. The allocation is based on *committed* amounts and, owing to the nature of these funds, the actual net investment level will be significantly lower. New investments will be made over time to target a commitment level of 10% of the Fund (within an allocation range up to 15% to allow for movements in market value).

27. Investments, such as private equity and infrastructure, that fall outside the high level asset classes will be included within the most appropriate class for reporting purposes and assessed against the relevant part of the strategic benchmark.

28. Cash will be managed and invested on the Fund's behalf by the County Council in line with its treasury management policy. The policy is to invest surplus funds prudently, giving priority to security and liquidity rather than yield. If losses occur, however, the Fund will bear its share of those losses.

29. Pension fund cash is separately identified each day and specific investment decisions will be made on any surplus cash identified, based on the estimated cash flow requirements of the Fund. As the majority of cash is allocated to individual investment managers and may be called by them for investment at short notice, it is expected that the majority of cash will be placed on call or on short-term fixed deposits. Unallocated balances may be placed directly with the Fund's custodian.

30. Joint investments using a combination of Fund cash and County Council cash may be made where this is in the best interests of the Fund. In considering such investments, guidance issued by the Department for Communities and Local Government will be followed and the Fund will receive its fair share of interest in proportion to the share of cash invested.

31. Other asset classes, such as hedge funds and currency, will be reviewed as part of the regular asset allocation strategy review and, if a decision to invest in other assets is made, the Statement of Investment Principles will be revised accordingly.

Risk Management

32. The Fund has adopted a Risk Management Strategy to:
    a) identify key risks to the achievement of the Fund's objectives
    b) assess the risks for likelihood and impact
    c) identify mitigating controls
    d) allocate responsibility for the mitigating controls
    e) maintain a risk register detailing the risk features in a)-d) above
    f) review and update the risk register on a regular basis
    g) report the outcome of the review to the Nottinghamshire Pension Fund Committee.

33. The Risk Register is a key part of the strategy as it identifies the main risks to the operation of the Fund, prioritising the risks identified and detailing the actions required to further reduce the risks involved.

34. A key part of managing the investment risk is by ensuring an adequate number of suitably qualified investment managers and by requiring managers to hold a diversified spread of assets, which will be reviewed regularly by the Pensions Investment Sub-committee. The level of risk in the equities block will be managed by a balance between passive and active management that may be varied from time to time, according to performance and emerging knowledge and experience of the market.

35. It is believed that active management can add value to the Fund but only over the long term, and decisions to appoint or dismiss fund managers will be given careful consideration. It is accepted that investment performance (particularly from equities) can be volatile but, as a long term investor, the Fund can ride out this volatility as long as projected net cash flow continues to be positive.

36. The correlation between UK and overseas markets has increased significantly over recent time, reflecting the increasing globalisation of the market. The Fund will therefore make no distinction between the relative holdings of UK and overseas equities, but will take into account exchange rate risks when deciding the balance. As a long term investor, the Fund does not undertake currency hedging. Individual managers may hedge currency risks but only with prior approval from the Fund.

37. In addition, the following constraints will apply. These constraints will be reviewed from time to time, and if changes are made, these will be incorporated into a revised Statement of Investment Principles, and amendments will be published.
    - Not more than 10% of the Fund to be invested in unlisted securities.
    - Not more than 10% of the Fund to be invested in a single holding.
    - Not more than 25% of the Fund to be invested in securities which are managed by any one body, i.e. in a unit trust type arrangement.
    - Not more than 15% of the Fund to be invested in partnerships, with not more than 2% in any one partnership.
    - Not to enter into any stock lending arrangements.
    - No underwriting without prior approval.
    - No involvement in derivatives (including currency options) without prior approval.

Other Issues

38. The Fund's assets are held in custody by a combination of an independent custodian, investment managers and in-house. The performance of fund managers will be measured against individual benchmarks, and the overall fund, including cash returns, against the strategic benchmark. Performance will be measured by an independent agency. The statement of accounts will be audited by the County Council's external auditors.

39. The Fund has an independent adviser who will be present at meetings of the Sub-Committee along with appropriate officers of the administering authority. This is considered best practice in accordance with the requirements for "proper advice" in the governing regulations.

40. The investment management arrangements of the Fund can be found in the latest annual report (available on the Fund's website, www.nottspf.org.uk). The Fund also publishes details of its holdings on the website on a quarterly basis.

41. This Statement of Investment Principles will be kept under review and will be revised following any material changes in policy.

42. The following appendices are attached:
    - Appendix A – the Fund's Statement on Responsible Investment
    - Appendix B – compliance with the *Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012*.

Nottinghamshire County Council Pension Funds
Statement on Responsible Investment

1. Statement of Principles

1.1 The Nottinghamshire Fund adopts a long term approach to responsible investment. The Trustees recognise their full responsibility for the oversight of the Funds and are charged with determining the overall investment strategy and the type of investment management used. The investment strategy is aimed at achieving best returns whilst minimising risk and overall variability in future employers' contribution rates. Environmental, social and governance (ESG) issues will be taken into account where these are considered likely to impact on returns.

1.2 The Fund supports best practice in corporate governance and adopts the Stewardship Code as recommended by the *Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012*. The Code states that institutional investors should:

- Publicly disclose their policy on how they will discharge their stewardship responsibilities.
- Have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
- Monitor their investee companies.
- Establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.
- Be willing to act collectively with other investors where appropriate.
- Have a clear policy on voting and disclosure of voting activity.
- Report periodically on their stewardship and voting activities.

1.3 The Fund has adopted a number of specific policies to implement its approach to long term responsible investment and its responsibilities under the Stewardship Code.

2. Policies Adopted

2.1 The Fund adopts a policy of positive engagement with the companies in which it invests in order to promote high standards of corporate governance. It believes that this will help to raise standards across all markets and that this is in the best long term interests of the Fund, its beneficiaries and other stakeholders.

2.2 Investment performance is monitored on a quarterly basis and the Fund expects investment managers to engage with companies to address concerns affecting performance. The Fund also holds a number of investments that specifically focus on engaging with the management of under-performing companies in order to generate superior returns.

2.3 The Fund believes that the greatest impact on behaviour can be achieved when working together with others. It is a member of the Local Authority Pension Fund Forum (LAPFF) which exists to promote the investment interests of local authority pension funds and to maximise their influence as shareholders in promoting corporate social responsibility and high standards of corporate governance amongst the companies in which they invest. The Fund actively supports the work of LAPFF and sees this as an important element of its stewardship responsibilities.

2.4 The Fund continues to exercise its ownership rights by adopting a policy of actively voting stock it holds. The Fund retains responsibility for voting (rather than delegating this to investment managers) and proxy votes are submitted for the majority of its global equity holdings.

2.5 Voting is in line with corporate governance best practice and the Fund subscribes to independent research services for voting advice. Voting activity is reported to the Pensions Sub-Committee and disclosed on the Fund website. In exceptional circumstances the Fund will combine with others on a specific issue but only after appropriate consultation.

2.6 In order to ensure ownership rights can be exercised, the Fund holds and will continue to hold, investments in its own name where possible, rather than in the name of investment managers. It will continue to oppose those processes, such as stock lending, which also deprive the Fund of the ability to meet its corporate governance objectives.

Summary of Compliance with the Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012

Principle	CIPFA Guidance Key Issues	Compliance	Proposed Actions
1. Effective Decision Making a) Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation. b) Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.	• Separate Committee responsible for the Pension Fund. • Governance Compliance Statement published. • Roles of Members, officers, external advisors and managers defined. • Committee has specified appropriate skills. • Skills and knowledge audit of Committee's membership occur. • Committee has sub committees or a panel to progress significant areas between meetings of the Committee. • Committee obtains proper advice from officers and external investment managers. • Training plan for Members in place. • Papers and reports should be clear and comprehensive and circulated in advance of meetings. • A medium term business plan for the Pension Fund should be in place.	Generally compliant	1. A training needs assessment will be carried out with members of the Committees.

Principle	CIPFA Guidance Key Issues	Compliance	Proposed Actions
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 taxpayers, 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.	• In setting objectives, the Committee has considered: ▪ the fund's liabilities ▪ the adequacy of assets ▪ the maturity of the Fund's liabilities ▪ its cashflow and has sought proper advice. • Risk is considered as part of the asset allocation strategy. • Funding levels and employer contribution rates are considered and the advice of the Actuaries sought. • The Committee considers whether to request an Asset Liability Study. • The Committee states the range of investments it is prepared to include in its asset allocation and say why some asset classes may have been excluded. • The Committee takes proper advice, including from specialist independent advisors where appropriate. • Advisors are appointed in open competition and are set performance objectives. • The Committee understands transaction related costs incurred, including commission, and has a strategy for ensuring these costs are properly controlled.	Generally compliant	2. A report is provided to a future Sub-Committee on transaction related costs.

Principle	CIPFA Guidance Key Issues	Compliance	Proposed Actions
3. Risk and Liabilities a) In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities. b) These include the implications for local taxpayers, the strength of the covenant for participating employers, the risk of their default and longevity risk.	• The Committee sets an overall investment objective for the fund that represents its best judgement of what is necessary to meet the fund's liabilities and takes account of the Committee's attitude to risk. • Appropriate performance benchmarks have been set. • The Statement of Investment Principles includes a description of the risk assessment framework used for potential and existing investments. • The triennial valuation includes a risk assessment in relation to the valuation of its liabilities/assets and factors affecting long term performance. • The Committee uses internal and external audit reports to satisfy itself on the fund's internal controls. • The Investment Strategy is suitable for the fund's objectives and takes account of the ability to pay of the employers in the fund. • The Annual Report includes an overall risk assessment in relation to each of the fund's activities.	Generally compliant	3. The triennial valuation report is presented to the Pensions Investment Sub-Committee highlighting key factors such as the need for risk assessments in relation to the Fund's liabilities and assets. 4. Relevant Audit reports be presented to future Sub-Committees as appropriate. 5. Undertake employer risk analysis and consider actions arising to mitigate risks to the Fund.

Principle	CIPFA Guidance Key Issues	Compliance	Proposed Actions
4. Performance Assessment a) Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors. b) 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.	• The Committee should consider whether existing index benchmarks are appropriate and consider whether active or passive management are appropriate for managing the Fund's assets. • Performance targets in relation to a benchmark should specify clear time periods and risk limits, and monitoring arrangements should include reports on tracking errors. • In addition to overall Fund returns, the return achieved in each asset class should be measured so that the impact of different investment choices can be assessed. • Although returns will be measured quarterly, a longer timeframe (typically 3–7 years) should be used to assess the effectiveness of Fund management arrangements. • Returns should be obtained from specialist performance measurement agencies independent of the fund managers. • Actuarial services should be market tested periodically. • When assessing managers and advisors, the extent to which decisions have been delegated should be considered. • The Committee should set out its expectations of its own performance in its business plan which should be assessed and reported in the fund's Annual Report.	Generally compliant	6. Reports on Fund performance from the Fund's performance measurement agency are presented to the Pensions Sub-Committee. 7. The Fund's strategic and portfolio benchmarks to are kept under regular review. 8. The Sub Committees to consider setting a performance framework to help assess their own performance.

Principle	CIPFA Guidance Key Issues	Compliance	Proposed Actions
5. Responsible Ownership Administering Authorities should:- a) adopt, or ensure their investment managers adopt, the Institutional Shareholders Committee (ISC) Statement of Principles on the responsibilities of shareholders and agents b) include a statement of their policy on responsible ownership in the Statement of Investment Principles c) report periodically on the discharge of such responsibilities.	• Policies regarding responsible ownership must be disclosed in the statement of Investment Principles. • The Committee should ensure that investment managers have an explicit strategy, setting out the circumstances in which they will intervene in a company that is acceptable within the Committee's policy. • Funds should be aware of the ISC Code on the Responsibilities of Institutional Investors and the United Nations Environment Programme Finance Initiative. • Authorities may wish to consider seeking alliances with other pension funds to enhance its influence on environmental, social and governance issues e.g. LAPFF.	Compliant	9. The Statement on Responsible Investment within the Statement of Investment Principles to be updated as necessary to reflect guidance available and presented to the Pensions Sub-Committee as appropriate.

Principle	CIPFA Guidance Key Issues	Compliance	Proposed Actions
6. Transparency and Reporting Administering Authorities should:- a) act in a transparent manner, communicating with stakeholders on issues relating to their management of investments, its governance and risks, including performance against stated objectives. b) provide regular communication to scheme members in the form they consider most appropriate.	• The Governance Compliance Statement should be maintained regularly. • The Communication Statement should contain sufficient information. • The Annual Report should be compared to the regulations setting out the required content. • The content of the Statement of Investment Principles, the Funding Strategy Statement and the Governance Compliance Statement should comply with the relevant guidance and requirements.	Compliant	10. The core source documents namely the Statement of Investment Principles, Funding Strategy Statement, Governance Compliance Statement and the Communication Statement continue to be updated as necessary to reflect guidance available and presented to the Pensions Sub-Committee as appropriate.