

# APPENDIX 2

## **CUMBRIA LOCAL GOVERNMENT PENSION SCHEME**

### **STATEMENT OF INVESTMENT PRINCIPLES – NOVEMBER 2007**

Administering Authorities have to prepare, maintain and publish Statements of Investment Principles under the Local Government Pension Scheme Management and Investment of Funds (Amendment) Regulations 1999. The Cumbria Fund was restructured following a Strategic Investment Review in 2006. The latest version was approved by the Pensions Committee held on 20<sup>th</sup> November 2007. The fund employs two independent Investment Advisers, to give independent advice on the investments carried out on behalf of the fund. The Pensions Committee is advised by Cumbria County Council's Deputy Chief Executive/Corporate Director - Finance and Central Services. Services are also provided by the scheme actuary Mercers, and by other consultants for investment management services.

### **TYPES OF INVESTMENTS TO BE HELD**

The fund will hold UK Equities, overseas equities, index-linked securities, fixed interest securities, managed funds (in particular unit and investment trusts), alternatives (e.g. venture capital, hedge funds, infrastructure, commodities, forestry, emerging market debt), certain derivatives, direct property, cash and other assets as determined from time to time by the Pensions Committee.

### **BALANCE BETWEEN DIFFERENT TYPES OF INVESTMENTS**

The fund employs eight managers to diversify the investment manager risk. The percentage allocated to each manager is reviewed periodically by the Pensions Committee including a specific allocation to the property manager.

The Strategic Investment Review recommended that the Scheme adopt a scheme-specific benchmark for the investments, with long-term allocations to the various asset classes, which reflect the circumstances of the Scheme. The benchmark in place, excluding the direct property allocation and alternatives is as follows:

Asset Class	Percentage	Control Range + or - %	Index
UK Equities	31.25	2.0	FTSE All Share
Overseas Equities	31.25	2.0	FTSE World North America FTSE World Europe ex UK FTSE World Japan FTSE Developed Asia Pacific ex Japan S&P IFC Investable Composite
North American			
Europe ex UK			
Japan			
Pacific ex Japan			
Emerging Markets			

Fixed Interest	25.0	2.0	
UK Fixed Interest	12.5		FTSE-A Govt (Over 15 year)
Corporate Bonds	12.5		iBoxx £ Non-Gilt
Index-Linked	12.5	1.5	FTSE-A Index-Linked (Over 5 year)
<b>TOTAL</b>	<b>100.0</b>		

### **ITEMS MANAGED OUTSIDE THE BENCHMARK**

Property has a monetary target held separately from the strategic benchmark and compared to the IPD Monthly Property Index. The portfolio was at £104 million. The alternatives portfolio managed by Blackrock is benchmarked against the LIBOR plus 3% and was valued at £121 million. The currency portfolio managed by Bank of New York Mellon was valued at £13 million. All values are at 30th September 2007.

### **ASSETS MANAGED BY PENSION FUND INVESTMENT MANAGERS**

<u>Manager</u>	<u>Percentage of total fund September 2007</u>	<u>Mandate</u>
Schroder (UK Equities)	12.5	To outperform the FTSE All Share Index by 1 % after fees over rolling three-year periods.
Insight (Bonds)	9.2	To outperform by 0.75% after fees a weighted bond index over rolling three-year periods.
Newton (Global Equities)	12.5	To outperform the FTSE World index by 2% p.a. gross of fees over rolling three-year periods.
GMO (Overseas Equities)	13.2	To outperform by 2 % after fees an overseas equity weighted index over rolling three-year periods.
BlackRock (Alternatives)	9.9	To achieve an absolute return of three month sterling LIBOR plus 3% net of fees on an annualised basis over rolling three year periods.
Mellon (Active Currency)	1.1	To achieve 24% gross of all fund fees and expenses over a rolling three-five year period.
Legal and General Passive (Multi Asset)	33.0	To keep tracking error within set limits per annum to the appropriate index, 2 years in three. (UK equities 2.0%, overseas equity 2.0%, gilts 1.0%, corporate bonds 1.0%, index-linked bonds 1.5%)
Credit Suisse (UK Property)	8.6.	To outperform the Monthly IPD Property Index by 1 % before fees over rolling three-year periods.
<b>TOTAL</b>	<b>100.0</b>	

Investment managers are paid fees and are expected to achieve an investment target. As fees are based on the value of funds under management, growth in the portfolio would lead to an increase in fee, providing an element of performance incentive.

Where performance is unsatisfactory and targets are not met, fees may be renegotiated and where performance remains unsatisfactory, managers can be removed and the mandates awarded to other managers. The above allocation will be reviewed periodically, but will only be adjusted by the Pensions Committee or Director of Corporate Finance on an annual basis. The most recently appointed managers i.e. Newton, BlackRock & Mellon are also remunerated according to performance.

### **LIMITS ON INVESTMENTS**

The powers and duties of the fund to invest monies are set out in the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2003. The amended regulations provide the opportunity to increase exposure to certain types of investments specified in Schedule 1 of the regulations where proper advice has been obtained.

The Pension Committee of the Cumbria Local Government Pension Scheme has decided, having taken proper advice, to adopt the 35 % limit for: Any single Insurance Contract. This allows increased flexibility to the fund in respect of passive investments. The decision complies with the requirements of the Regulations.

### **RISK**

The return of the fund is to be achieved by the investment managers without exposing the Fund to excessive risk and with regard to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998.

Risk is managed by diversification by:

- The appointment of more than one manager, and managers with different investment styles.
- The use of different asset classes including alternatives.
- For each manager, where appropriate, reviewing the achieved variation in investment return from the benchmark, and also the forecast range of return for each future quarter.

Managers' performance targets are set to avoid undue exposure to risk and investment performance is measured over a three year period, but it is monitored quarterly with managers attending the Pensions Committee regularly and normally at least once in a twelve month period. The benchmark asset allocation, as revised in light of the Strategic Investment Review, is a key indicator of the level of risk that is acceptable.

Mercer have estimated the Value at Risk of the fund. The One-year Value at Risk of the fund (95<sup>th</sup> percentile) is the potential worst-case scenario (with a 5 % probability) increase in the deficit over a one-year period. The Value at Risk of the revised strategy is estimated at £ 239 million, this is a reduction from the previous strategy's Value at Risk of £258 million.

### **THE OBJECTIVES OF THE FUND**

- The very long-term objective is to achieve an investment return in the order of 6.5 % per annum (to match the actuary's long term assumptions for future service) over a twenty-five year period from April 2007. This

target may be reviewed after periodic actuarial valuations and consultation with scheme employers.

- The funding level of the scheme to move towards 100 % over twenty-five years from April 2007. This target may be reviewed after periodic actuarial valuations and consultation with scheme employers.
- The target investment return for the fund as a whole is to be 0.6 % per annum ahead of the fund's customised benchmark return over rolling five-year periods.
- As the fund has adopted a scheme specific benchmark, it is not appropriate to compare the fund directly with the WM Local Authority Universe return. Nevertheless, regard will still be paid to this Universe over the longer term.

## **REALISATION OF INVESTMENTS**

Investment managers are free to realise investments to maximise the benefit to the Fund. Transactions have, however, to be reported quarterly to the Pensions Committee.

The property manager is instructed to notify the Deputy Chief Executive/Corporate Director - Finance and Central Services before they make any sales or purchases.

## **CORPORATE GOVERNANCE AND ETHICAL INVESTMENT**

### 1. CORPORATE GOVERNANCE

The overriding objective of the fund is to obtain its stated performance targets. However, investment managers are expected to combine the primary aim of out-performance with the need to take a responsible attitude as longer-term shareholders in companies, and to maximise long term shareholder value.

Where, however, two investments are evenly balanced environmental or ethical considerations could be a deciding factor.

The responsibility for the exercise of rights (including voting rights) attaching to investments is delegated to the investment managers who are expected to approach the subject of voting with the same care and attention as other matters which influence investment decisions. Voting should be undertaken where it is believed it to be in the best interests of the Fund.

Where a resolution is put forward which is particularly controversial the manager should liaise with the authority as appropriate. Investment managers need not vote on routine issues.

The investment managers are required to report quarterly on their voting actions for every appropriate investment. Any responses received from companies concerned should also be reported. A full voting audit trail should be available. The outcome of voting actions should also be shown if possible. In endeavouring to invest in the best financial interests of the beneficiaries, the Trustees have also elected to invest in pooled indexed funds and cannot therefore directly influence the social, environmental and ethical policies and practices of the companies in which the pooled funds invest. The Trustees are satisfied that the Fund Managers Corporate Governance policy reflects the key principles of Socially Responsible Investment.

## 2. SOCIAL, ENVIRONMENTAL AND ETHICAL INVESTMENT

Ethical investment is defined as “the practice of selecting or deselecting investments by reference to any criteria other than financial ones” (1).

The investment guidelines issued to managers of the Cumbria scheme’s investments stress the overriding importance of financial considerations in selecting investments. Social environmental and ethical considerations are important where, in the view of the manager, such considerations may add to the risk of comparative under-performance perhaps because of change to the regulatory regime of an industry in which a particular company operates. Equally, where a manager has a view, that a positive social, environmental and ethical stance by a company will add to its relative performance, that would be an appropriate factor for the manager to take into account in stock selection.

The legal duties of trustees and elected members are not clear-cut. However, following legal advice the fund believes the above statement complies with the legal duty placed on pension fund trustees.

NOTE (1) CIPFA PENSIONS PANEL: MANAGEMENT AND INVESTMENT OF FUNDS SHAREHOLDER RESPONSIBILITIES.

**APPENDIX COMPLIANCE OF CUMBRIA FUND WITH MYNERS REPORT  
(AS PER THE LOCAL GOVERNMENT PENSION SCHEME  
(MANAGEMENT AND INVESTMENT OF FUNDS) (AMENDMENT)  
REGULATIONS 2002)**

<b><u>Myners' Report</u></b>	<b><u>Cumbria Current Position</u></b>
<b>Effective Decision Making</b>	
<p>(a) Decisions should only be taken by persons or organisations with skills, information and resources necessary to take them effectively.</p> <p>(b) Appropriate in-house support staff should be available.</p> <p>(c) Trustees should be paid.</p> <p>(d) There will be an Investment Sub-Committee.</p> <p>(e) Trustees should have the appropriate skills.</p> <p>(f) Forward looking business plan.</p>	<p>The fund has a clear scheme of delegation and arrangements for provision of management and advice. Funds are managed by eight national/international organisations in the City of London. Two independent Investment Advisers normally attend Pension Committee meetings.</p> <p>A small team of professional investment and support staff is provided.</p> <p>Members' Allowance Scheme operates.</p> <p>Pensions Committee established in 2001. The predecessor to the Pensions Committee the Investment Advisory Group had been in existence since 1974.</p> <p>The Myners' Report proposes that members of the Investment Sub-Committee have their skills and experience developed. This is done through presentations, seminars and visits on a regular basis.</p> <p>A process of undertaking a strategic review every three years is established following the actuarial valuation which aims to set simple and clear objectives (last major review took place in 2006.)</p>
<b>Clear Objectives</b>	
<p>(a) Clear investment objectives should be set that take into account investment risks and fund's liabilities.</p>	<p>Detailed in Fund's Statement of Investment Principles.</p>

**Focus On Asset Allocation**

- (a) Strategic asset allocation should receive a high level of attention.
- (b) Full range of investment opportunities considered including private equity.
- (c) Asset allocation should reflect a fund's own characteristics, not the average allocation of other funds.

A review will be undertaken every three years, together with quarterly reporting and annual performance review covering short and long term investment returns and risks by the Pensions Committee.

All significant investment opportunities are considered and taken where appropriate. Stock Lending was approved during 2004. An alternatives manager was appointed in 2007.

The fund has its own investment benchmark although regard is paid to the Local Authority Universe allocation to comply with Best Value methodology. The fund's liability profile will normally be considered in relation to its benchmark every three years.

**Expert Advice**

- (a) An appropriate range of expert advice should be secured.

This has always been the fund's policy and in summary is as follows:

Officers of the Council provide advice on a day-to-day basis.

Two independent investment advisers are available at Pensions Committee meetings.

The Chairman and members can contact officers and independent advisers on an ad hoc basis as and when required.

Expert consultants are also used by the fund as required.

**Explicit Manager Mandates**

- (a) Explicit written mandates should operate for all managers that cover objectives, benchmarks and risk, manager's approach linked to Fund's aggregate objectives and risk tolerance.
- (b) Mandates should not be terminated without due cause.
- (c) The mandates should not exclude any set of financial instruments without clear justification.
- (d) Management fees should be inclusive of internal research, information and transaction services.

All mandates are governed by the Fund's strategic objectives, and are reviewed regularly by officers and the Pension Committee. Performance contribution is reviewed quarterly and there is a detailed annual review of performance.

The Fund operates on a general principle of a three-year rolling review approach subject to regular presentations to the Pensions Committee. Over the last six years, two managers have been replaced.

This principle is followed having regard to the Pension Investment Regulations and strategic objectives of the fund.

The fund has agreements in place that clearly define fee scales.

**Activism.**

<p>(a) Funds should adopt the principle of the US Department of Labour Interpretative Bulletin on activism *.</p> <p>(b) Managers should have an explicit strategy for company interaction.</p>	<p>The Fund's corporate governance policy and approach is approved by the Pension's Committee as appropriate to the Cumbria Fund. It complies with the US Department of Labour Interpretative Bulletin on activism *.</p> <p>The policies have been obtained from and discussed with the equity investment managers, and the quarterly reports detail the interaction and dialogue with company management.</p>
<p><b>Appropriate Benchmarks.</b></p>	
<p>(a) Trustees should explicitly consider benchmarks selected and their suitability, any unusual movements of an index, the nature of the index relative to the investment requirements and achievability of performance targets relative to the index.</p>	<p>These matters are carefully considered when managers are appointed or briefs changed. They are linked to the Fund's strategic objectives and benchmark. They are regularly reviewed with managers and overall on an annual basis.</p>
<p><b>Performance measurement.</b></p>	
<p>(a) Trustees should arrange for the performance of its strategy, benchmark, policy, managers and advisors to be measured.</p>	<p>The fund carries this out through a regular annual review report based upon the performance measurement service supplied by WM Company. Mercer's have developed a tool to measure the success of advice given. The Investment Advisers attend each meeting of the Pensions Committee and the members are surveyed for their views on quality of advice given.</p>
<p><b>Transparency</b></p>	
<p>(a) The Statement of Investment Principles (SIP) should set out: -</p> <ul style="list-style-type: none"> <li>• Who is taking which decisions</li> <li>• Why structure was selected</li> <li>• The Fund's investment objective</li> <li>• The Fund's planned asset allocation strategy including projected investment returns on each asset plan</li> <li>• How strategy has been arrived at</li> <li>• Mandates given to advisors and managers</li> <li>• Nature of fee structures and why selected</li> </ul>	<p>The Fund's current SIP covers the major points raised. Further information is provided on request.</p> <p>Yes.</p> <p>Yes</p> <p>Yes</p> <p>Yes</p> <p>Yes</p> <p>Yes</p> <p>Yes</p>
<p><b>Regular Reporting</b></p>	
<p>(a) Trustees should publish their SIP and results of monitoring of advisers and managers. This should be sent to members</p>	<p>The SIP is included in the Fund's Annual Report. All members of the fund also receive a summarised copy. Investment performance is included in the Annual Report. Adviser</p>

<p>of the fund annually.</p> <p>(b) Statement should explain why a fund has decided to depart from any of these principles.</p>	<p>performance measurement will be included.</p> <p>The Fund will provide such a statement, if necessary.</p>
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**\* The US Department of Labour Interpretative Bulletin requires:**

- Proxies to be voted on issues that may affect the value of the fund's investments.
- Activities intended to monitor or influence the management of companies to be undertaken where there is a reasonable expectation of enhancing the value of an investment.
- Such activities to include correspondence, meetings and exercise of shareholder rights and should take into account the cost of such action.
- Relevant factors which affect the fund's investments to be considered and the interests of stakeholders not to be subordinated to unrelated objectives.

[File: Appendix 2 Statement of Investment Principles.doc](#)