



City of Westminster

Pension Board

Date:	9 May 2017
Classification:	General Release
Title:	Scrutiny of changes to Investment Regulations Implemented on the 1st April 2017 – The Investment Strategy Statement
Report of:	Steven Mair <i>City Treasurer</i>
Wards Involved:	All
Policy Context:	Effective control over Council Activities
Financial Summary:	There are no financial implications arising from this report

1 Executive Summary

- 1.1 The Pension Fund Committee was required as of the 1st April 2017 to implement Investment Strategy Statements (ISS) and Funding Strategy Statements (FSS) to replace existing Funding Statements. The ISS and updated FSS were approved at the Pension Fund Committee on the 21st March 2017.
- 1.2 The investment environment under the new regulations is one of increased freedom but with more onerous justification of investment policy together with greater requirements to consult with interested parties and to report on the application of policy.
- 1.3 The Pension Fund Committee has not had to alter its current investment strategy. It may well have to consider the extent of diversification and the adequacy of risk management, which were already anticipated post the actuarial review which has taken place over the last year.
- 1.4 The new ISS sets out the Council's policy on ethical, social and corporate governance issues for both its own investments and also those being managed through the London CIV.

- 1.5 The Pension Board must scrutinise the document fulfil its remit and ensure that the document is compliant to the relevant legislation and fit for purpose

2 Recommendation

- 2.1 That the Board scrutinise the new ISS to ensure that it is:
 - a. Compliant with the legislative changes;
 - b. Fit for purpose;
 - c. Transparent and easy to understand.
- 2.2 That the Board reports back to the Pension Fund Committee on it's findings

3 Background

The Legislation

- 3.1. The Government issued revised investment regulations in September 2016, to have effect from 1st November 2016. The centre piece of the regulations was the replacement of the Statement of Investment Principles (SIP) with a requirement to prepare and operate in accordance with an ISS. Each scheme was required to have an ISS by 1st April 2017.
- 3.2. The ISS (Appendix 1) sets out the requirements of the legislation and the Investment Committee's terms of reference. The overall legislation is summarised in Appendix 2. The six main objectives of the legislation are detailed in relation to Westminster City Council's Pension Fund policies and strategies. These are:
 - 3.3 Objective 7.2 (a): A requirement to invest fund money in a wide range of instruments – This sets out how the investment strategy deals with diversification and return to meet the long term objectives of the fund;
 - 3.4 Objective 7.2(b): The authority's assessment of the suitability of particular investments and types of investment – this sets out how the Investment Committee assesses the suitability of Investments and measures their suitability;
 - 3.5 Objective 7.2(c): The authority's approach to risk, including ways in which risks are to be measured and managed – this sets out how the Investment Committee assesses the different types of risk in order to establish what is acceptable to ensure that the fund meets its obligations;

- 3.6 Objective 7.2(d): The authority's approach to pooling investments, including the use of collective investment vehicles – this sets out the Investment Committee's approach to pooling and also what the London Collective Investment Vehicle (CIV) can offer in terms of Investment opportunities;
- 3.7 Objective 7.2(e): How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments – this sets out how the fund meets these obligations and also how potential investments with the London CIV will comply with these obligations;
- 3.8 Objective 7.2(f): The exercise of rights (including voting rights) attaching to investments - this sets out how the fund meets these obligations and also how potential investments with the London CIV will be dealt with.

Construction of the ISS

- 3.9 A draft ISS was provided by the Pension Fund's Actuary Barnett Waddington. The same draft has been used across all three Councils to ensure standardisation.
- 3.10 The Committee's terms of reference are used in the document. These terms of reference might need review as they have not been refreshed for a number of years.
- 3.11 Objective 7.2(d): The authority's approach to pooling investments, including the use of collective investment vehicles has wording included from the London CIV. Is it correct for the view to be from the London CIV?
- 3.12 Objective 7.2(e): How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of Investments, and Objective 7.2(f): The exercise of rights (including voting rights) attaching to Investments both have 2 sections reflecting the fact that items are invested through Council appointed Fund Managers and also CIV appointed Fund Managers.

4 IMPLICATIONS FOR THE PENSION BOARD

- 4.1 The new investment regulations and guidance provide greater freedom to set strategy. The greater degree of explanation required in setting the investment strategy should be seen as best practice, although with an unwelcome degree of Government oversight
- 4.2 The ISS presented, sets out the requirements of the legislation in regards to the Westminster City Council's Pension Fund. It includes

elements of the London CIV's ISS which will apply, to those items the Fund has invested through the London CIV.

- 4.3 The Pension Board needs to be satisfied that the ISS implemented by the Pension meets legislative requirements and is fit for purpose.

If you have any questions about this report, or wish to inspect one of the background papers, please contact the report author:

Pete Carpenter pcarpenter@westminster.gov.uk or 020 7641 2832

BACKGROUND PAPERS:

Investment Regulations and Investment Strategy Statement, Pension Fund Committee 15th November 2016

Changes to Investment Regulations, Pension Fund Committee, 21st March 2017

APPENDICES:

Appendix 1 Approved Investment Strategy Statement

City of Westminster Pension Fund Investment Strategy Statement 2017/18

1. Introduction

- 1.1 This is the first Investment Strategy Statement (ISS) adopted by the City of Westminster Pension Fund (“the Fund”).

Under The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 the Fund is required to publish this ISS. It replaces the Statement of Investment Principles which was previously required under Schedule 1 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

The Regulations require administering authorities to outline how they meet each of 6 objectives aimed at improving the investment and governance of the Fund.

- 1.2 This Statement addresses each of the objectives included in the 2016 Regulations:

- A requirement to invest fund money in a wide range of instruments
- The authority’s assessment of the suitability of particular investments and types of investment
- The authority’s approach to risk, including the ways in which risks are to be measured and managed
- The authority’s approach to pooling investments, including the use of collective investment vehicles
- The authority’s policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments

We deal with each of these in turn below.

- 1.3 The Pension Fund Committee (the “Committee”) of the City of Westminster Pension Fund oversees the management of the Fund’s assets. Although not trustees, the Members of the 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 relevant terms of reference for the Committee within the Council’s Constitution are:

The Pension Fund Committee’s responsibilities are set out in their terms of reference and are to have responsibility for all aspects of the investment and

other management activity of the Council's Pension Fund, including, but not limited to, the following matters:

- To agree the investment strategy and strategic asset allocation having regard to the advice of the fund managers and the Investment Consultant.
- To monitor performance of the Superannuation Fund, individual fund managers, custodians, actuary and other external advisors to ensure that they remain suitable;
- To determine the Fund management arrangements, including the appointment and termination of the appointment of the Fund Managers, Actuary, Custodians and Fund Advisers.
- To agree the Statement of Investment Principles, the Funding Strategy Statement, the Business Plan for the Fund, the Governance Policy Statement, the Communications Policy Statement and the Governance Compliance Statement and to ensure compliance with these.
- To approve the final accounts and balance sheet of the Superannuation Fund and to approve the Annual Report..
- To receive actuarial valuations of the Superannuation Fund regarding the level of employers' contributions necessary to balance the Superannuation Fund.
- To oversee and approve any changes to the administration arrangements, material contracts and policies and procedures of the Council for the payment of pensions, compensation payments and allowances to beneficiaries.
- To make and review an admission policy relating to admission agreements generally with any admission body.
- To ensure compliance with all relevant statutes, regulations and best practice with both the public and private sectors.
- To review the arrangements and managers for the provision of Additional Voluntary Contributions for fund members.
- To receive and consider the Auditor's report on the governance of the Pension Fund.
- To determine the compensation policy on termination of employment and to make any decisions in accordance with that policy other than decisions in respect of the Chief Executive, Chief Officers and Deputy Chief Officers of the Council (which fall within the remit of the Appointments Sub-Committee).
- To determine policy on the award of additional membership of the pension fund and to make any decisions in accordance with that policy other than decisions in respect of the Chief Executive, Chief Officers and Deputy Chief Officers of the Council (which fall within the remit of the Appointments Sub-Committee).
- To determine policy on the award of additional pension and to make any decisions in accordance with that policy other than decisions in respect of the Chief Executive, Chief Officers and Deputy Chief Officers of the Council (which fall within the remit of the Appointments Sub-Committee).
- To determine policy on retirement before the age of 60 and to make any decisions in accordance with that policy other than decisions in respect of the Chief Executive, Chief Officers and Deputy Chief Officers of the Council (which fall within the remit of the Appointments Sub-Committee).

- To determine a policy on flexible retirement and to make any decisions in accordance with that policy other than decisions in respect of the Chief Executive, Chief Officers and Deputy Chief Officers of the Council (which fall within the remit of the Appointments Sub-Committee).
- To determine questions and disputes pursuant to the Internal Disputes Resolution Procedures.
- To determine any other investment or pension policies that may be required from time to time so as to comply with Government regulations and to make any decisions in accordance with those policies other than decisions in respect of the Chief Executive, Chief Officers and Deputy Chief Officers of the Council (which fall within the remit of the Appointments Sub-Committee).

The 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, the investment advisor(s) and any other external consultants considered necessary
- Reviewing on a regular basis the investment managers' performance against benchmarks, portfolio risk and satisfying themselves as to the managers' expertise and the quality of their internal systems and controls
- Monitoring compliance with the ISS & Funding Strategy Statement (FSS) and reviewing its contents
- Reviewing policy on social, environmental and ethical considerations, and on the exercise of voting rights

The City Treasurer 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 ISS 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 Under the previous Regulations the Statement of Investment Principles required to state how it complies with the revised six investment principles as outlined within the CIPFA Pensions Panel Principles. Although not formally required under the 2016 Regulations this information is given in Appendix A. In addition, Appendix B includes a disclosure of the Fund's policy on how the Committee discharge their stewardship responsibilities.

2. Objective 7.2 (a): A requirement to invest fund money in a wide range of instruments

2.1 Funding and investment risk is discussed in more detail later in this ISS. However, at this stage it is important to state that the Committee is aware of the risks it runs within the Fund and the consequences of these risks.

2.2 In order to control risk the Committee recognises that the Fund should have an investment strategy that has:

- Exposure to a diverse range of sources of return, such as market, manager skill and through the use of less liquid holdings.
- Diversity in the asset classes used
- Diversity in the approaches to the management of the underlying assets.

A consequence of this approach is that the Fund's assets are invested in a wide range of instruments.

2.3 This approach to diversification has seen the Fund dividing its assets across 4 broad categories; UK equities, Global equities, Fixed Income and Property. The size of assets invested in each category will vary depending on investment conditions. However, it is important to note that each category is itself diversified.

2.4 The main risk the Committee are concerned with is to ensure the long-term ability of the fund to meet pension, and other benefit obligations, as they fall due is met. As a result the Committee place a high degree of importance on ensuring the expected return on the assets is sufficient to do so, and does not have to rely on a level of risk which the Committee considers excessive.

The Fund currently has a negative cash flow position. The Committee is mindful that this position may change in future and keeps the liquidity within the Fund monitored.

At all times the Committee takes the view that their investment decisions, including those involving diversification, in the best long term interest of Fund beneficiaries.

2.5 To mitigate these risks the Committee regularly reviews both the performance and expected returns from the Fund's investments to measure whether it has met and is likely to meet in future its return objective. In addition to keeping their investment strategy and policy under regular review the Committee will keep this ISS under review to ensure that it reflects the approaches being taken.

3. Objective 7.2(b): The authority's assessment of the suitability of particular investments and types of investment

3.1.1.1.1

3.1 When assessing the suitability of investments the Committee takes into account a number of factors:

- Prospective return

- Risk
 - Concentration
 - Risk management qualities the asset has, when the portfolio as a whole is considered
 - Geographic and currency exposures
 - Whether the management of the asset meets the Fund's ESG criteria.
- 3.2 Suitability is a critical test for whether or not a particular investment should be made.
- 3.3 Each of the Fund's investments has an individual performance benchmark which their reported performance is measured against.
- 3.3 The Committee monitors the suitability of the Fund's assets on a quarterly basis. To that end they monitor the investment returns and the volatility of the individual investments together with the Fund level returns and risk. This latter point being to ensure the risks caused by interactions between investments within the portfolio is properly understood. Where comparative statistics are available the Committee will also compare the Fund asset performance with those of similar funds.
- 3.4 The Committee relies on external advice in relation to the collation of the statistics for review.

4. Objective 7.2(c): The authority's approach to risk, including ways in which risks are to be measured and managed

- 4.1 The Committee recognises that there are a number of risks involved in the investment of the assets of the Fund amongst which are the following:
- 4.2 Geopolitical and currency risks:
- **are measured by the value of assets (the concentration risk), in any one market leading to the risk of an adverse influence on investment values arising from political intervention; and**
 - **are managed by regular reviews of the actual investments relative to policy and through regular assessment of the levels of diversification within the existing policy.**
- 4.3 Manager risk:
- **is measured by the expected deviation of the prospective risk and return as set out in the manager(s) investment objectives, relative to the investment policy; and**
 - **is managed by monitoring the actual deviation of returns relative to the objective and factors inherent in the manager(s) investment process.**
- 4.4 Solvency and mismatching risk:

- **are measured through a qualitative and quantitative assessment of the expected development of the liabilities relative to the current and alternative investment policies; and**
- **are managed by assessing the progress of the actual growth of the liabilities relative to the selected investment policy.**

4.5 Liquidity risk:

- **is measured by the level of cash flow required over a specified period; and**
- **managed by assessing the level of cash held in order to limit the impact of the cash flow requirements on the investment cash policy**

4.6 Custodial risk:

- **is measured by assessing the creditworthiness of the global custodian and the ability of the organisation to settle trades on time and provide secure safekeeping of the assets under custody.**

4.7 Employer contributions are based upon financial and demographic assumptions determined by the actuary. The main risks to the Fund are highlighted within sections 12 to 15 of the Funding Strategy Statement (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

4.8 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 the Fund.

4.9 The Committee are aware investment risk is only one aspect of the risks facing the Fund. The other key risk they are aware of is the ability of the Fund to meet the future contributions, support the investment risk (i.e. the level of volatility of investment returns) and underwrite actuarial risk, namely the volatility in the actuarial funding position and the impact this has on contributions.

4.10 The Committee are of the view that the diversification of the Fund assets is sufficiently broad to ensure the investment risk is low and will continue to be low. When putting in place the investment strategy the Committee carefully considered both the individual asset risk characteristics and those of the combined portfolio to ensure the risks were appropriate.

Estimating the likely volatility of future investment returns is difficult as it relies on both estimates of individual asset class returns and also the correlation between them. These can be based on historic asset class information for some of the listed asset classes the Fund uses. However, for other private market and less liquid assets it is much more difficult.

The Committee is also mindful that correlations change over time and at times of stress can be significantly different from they are in more benign market conditions.

To help manage risk the Committee uses an external investment adviser to monitor the risk. In addition when carrying out their investment strategy review the Committee also had different investment advisers assess the level of risk involved.

- 4.11 The Fund targets a long-term return 5.1% as aligned with the latest triennial valuation from the Actuary. The investment strategy is considered to have a low degree of volatility.
- 4.12 When reviewing the investment strategy on a quarterly basis the Committee considers advice from their advisers and the need to take additional steps to protect the value of the assets that may arise or capitalise on opportunities if they are deemed suitable.
- 4.13 At each review of the Investment Strategy Statement the assumptions on risk and return and their impact on asset allocation will be reviewed.

5 Objective 7.2(d): The authority's approach to pooling investments, including the use of collective investment vehicles.

- 5.1 The Fund recognises the Government's requirement for LGPS funds to pool their investments and is committed to pursuing a pooling solution that ensures maximum cost effectiveness for the Fund, both in terms of return and management cost.
- 5.2 The Fund has joined the London Collective Investment Vehicle (CIV) as part of the Government's pooling agenda. The London CIV has been operational for some time and is in the process of opening a range of sub-funds covering liquid asset classes, with less liquid asset classes to follow.
- 5.3 The Fund has already transitioned assets into the London CIV with a value of £178m and will look to transition further liquid assets as and when there are suitable investment strategies available on the platform that meet the needs of the Fund.
- 5.4 The Fund will transition liquid assets into the London CIV when there are suitable investment strategies that meet the asset allocation and investment strategy available on the London CIV platform.
- 5.5 The Fund is monitoring developments and the opening of investment strategy fund openings on the London CIV platform with a view to transitioning liquid assets across to the London CIV as soon as there are suitable sub-funds to meet the Fund's investment strategy requirements.
- 5.6 The Fund holds 22.3% £280m of its assets in life funds and intends to retain these outside of the London CIV in accordance with government guidance on

the retention of life funds outside pools for the time being. The Fund agrees for the London CIV to monitor the passive funds as part of the broader pool.

- 5.7 The Fund holds £110m or 8.8% of the Fund held in illiquid assets and these will remain outside of the London CIV pool. The cost of exiting these strategies early would have a negative financial impact on the Fund. These will be held as legacy assets until such time as they mature and proceeds re-invest through the pool assuming it has appropriate strategies available or until the Fund changes asset allocation and makes a decision to disinvest.

City of Westminster Total Fund	Available on the CIV	Transferred
UKEquities Majedie	May-17 (£301m)	
Global Equities Baillie Gifford LGIM Longview Partners	Yes Jun-17 (£140m)	£178m
Fixed Income Insight IM (Core) Insight IM (Gilts)		
Real Estate Hermes Property Standard Life Property		
Cash In-House Cash		

- 5.8 The Committee are aware that certain of the assets held within the Fund have limited liquidity and moving them would come at a cost. Whilst it is the expectation to make use of the London CIV for the management of the majority of the Fund assets in the longer term, the Committee recognises that transitioning from the current structure to the London CIV will be a protracted exercise spread over a number of years to ensure unnecessary costs are not incurred.
- 5.9 At each review of the investment strategy, which will happen at least every three years, the investment of the above assets will be actively considered by the City of Westminster Pension Fund, and in particular whether a collective investment option is appropriate.
- 5.10 More information on the London CIV and its operation is included in Appendix D of this statement.

6 Objective 7.2(e): How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments

- 6.1 A review of the Fund's approach to Socially Responsible Investments (SRI) was completed in March 2015 and is contained in the existing SIP. The Fund adopted an SRI Policy which outlines its approach to the management of Environmental, Social and Governance (ESG) issues within its investment portfolio. The existing SRI Policy now needs reviewing as the last update was undertaken 2 years ago, although as funds are moved across to the London CIV, the Council will need to understand and apply its principles.

The Present ESG Policy

- 6.2 The Fund recognises that the neglect of corporate governance and corporate social responsibility may lead to poor or reduced shareholder returns. The Committee has considered how the Fund may best implement a corporate social responsibility policy, given the current resources available to the Fund. Accordingly, the Committee has delegated social, environmental and ethical policy to the investment managers, but also approved a Governance Strategy. The Committee believes this is the most efficient approach whilst ensuring the implementation of policy by each manager is consistent with current best practice and there is appropriate disclosure and reporting of actions taken. To that extent, the Committee maintains a policy of non-interference with the day-to-day decision making of the investment managers.

The London Collective Investment Vehicle (CIV) ESG Policy (Wording)

- 6.3 The Fund is committed to being a long term steward of the assets in which it invests and expects this approach to protect and enhance the value of the Fund in the long term. In making investment decisions, the Fund seeks and receives proper advice from internal and external advisers with the requisite knowledge and skills.
- 6.4 The Fund requires its investment managers to integrate all material financial factors, including corporate governance, environmental, social, and ethical considerations, into the decision-making process for all fund investments. It expects its managers to follow good practice and use their influence as major institutional investors and long-term stewards of capital to promote good practice in the investee companies and markets to which the Fund is exposed
- 6.5 The Fund expects its external investment managers (and specifically the London Collective Investment Vehicle through which the Fund will increasingly invest) to undertake appropriate monitoring of current investments with regard to their policies and practices on all issues which could present a material financial risk to the long-term performance of the fund such as corporate governance and environmental factors. The Fund expects its fund managers to integrate material ESG factors within its investment analysis and decision making
- 6.6 Effective monitoring and identification of these issues can enable engagement with boards and management of investee companies to seek resolution of potential problems at an early stage. Where collaboration is likely to be the most effective mechanism for encouraging issues to be addressed, the Fund expects

its investment managers to participate in joint action with other institutional investors as permitted by relevant legal and regulatory codes

- 6.7 The Fund monitors this activity on an ongoing basis with the aim of maximising its impact and effectiveness.
- 6.8 The Fund will invest on the basis of financial risk and return having considered a full range of factors contributing to the financial risk including social, environment and governance factors to the extent these directly or indirectly impact on financial risk and return.
- 6.9 The Fund in preparing and reviewing its Investment Strategy Statement will consult with interested stakeholders including, but not limited to Fund employers, investment managers, Local Pension Board, advisers to the Fund and other parties that it deems appropriate to consult with

7 Objective 7.2(f): The exercise of rights (including voting rights) attaching to investments

The Present Policy

- 7.1. The Committee has delegated the Fund's voting rights to the investment managers, who are required, where practical, to make considered use of voting in the interests of the Fund. The Committee expects the investment managers to vote in the best interests of the Fund

The London Collective Investment Vehicle (CIV) ESG Policy (Wording)

- 7.2 The Fund recognises the importance of its role as stewards of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which its investments reside. The Fund recognises that ultimately this protects the financial interests of the Fund and its ultimate beneficiaries. The Fund has a commitment to actively exercising the ownership rights attached to its investments reflecting the Fund's conviction that responsible asset owners should maintain oversight of the companies in which it ultimately invests recognising that the companies' activities impact upon not only their customers and clients, but more widely upon their employees and other stakeholders and also wider society.
- 7.3 The Fund has delegated responsibility for voting rights to the Fund's external investment managers and expects them to vote in accordance with the Fund's voting policy as set out in Sections 6.2 and 7.1.
- 7.4 The Fund will incorporate a report of voting activity as part of its Pension Fund Annual report which is published on the Pension Fund website: (we do not do this at the moment)

7.5 The Fund has reviewed the London CIV Statement of Compliance with the Stewardship Code and has agreed to adopt this Statement.

7.6 In addition, the Fund expects its investment managers to work collaboratively with others if this will lead to greater influence and deliver improved outcomes for shareholders and more broadly.

7.7 The Fund through its participation in the London CIV will work closely with other LGPS Funds in London to enhance the level of engagement both with external managers and the underlying companies in which invests (*Please insert as appropriate*)

In addition the Fund:

7.8 Is a member of the Pension and Lifetime Savings Association (PLSA) and in this way joins with other investors to magnify its voice and maximise the influence of investors as asset owners

7.9 Joins wider lobbying activities where appropriate opportunities arise.

8 Feedback on this statement

Any feedback on this investment Strategy Statement is welcomed. If you have any comments or wish to discuss any issues then please contact:

Peter Carpenter – Interim Tri-Borough Director of Pensions and Treasury

pcarpenter@westminster.gov.uk

020 7641 2832

Investment Strategy Statement: Appendix A

Compliance with CIPFA Pensions Panel Principles for investment decision making in the local government pension scheme in United Kingdom

Decision Making

Regulation 12(3) of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 requires an administering authority to report on its compliance with the six Myners' Principles, in accordance with guidance given by the Secretary of State. The guidance for the Local Government Pension Scheme is set out in the CIPFA publication "Investment Decision Making and Disclosure in the Local Government Pension Scheme in the United Kingdom 2012",

The Fund aims to comply with all of the Myners' Principles, recognising it is in all parties' interests if the Fund operates to standards of investment decision-making and governance identified as best practice. It is also recognised as important to demonstrate how the Fund meets such principles and best practice.

The Secretary of State has previously highlighted the principle contained in *Roberts v. Hapwood* whose administering bodies exercise their duties and powers under regulations governing the investment and management of Funds:

"A body charged with the administration for definite purposes of funds contributed in whole or in part by persons other than members of that body owes, in my view, a duty to those latter persons to conduct that administration in a fairly business-like manner with reasonable care, skill and caution, and with a due and alert regard to the interest of those contributors who are not members of the body. Towards these latter persons the body stands somewhat in the position of trustees or managers of others".

The Myners' Principles are seen as supporting this approach. The principles, together with the Fund's position on compliance, are set out below:

Principle 1 - Effective decision-making

Administrating 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; and**
- **Those persons or organizations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.**

Full Compliance

The Council has delegated the management and administration of the Fund to the Committee, which meets at least quarterly. The responsibilities of the Committee are described in paragraph 1.4 of the ISS.

The Committee is made up of elected members of the Council who each have voting rights.

The Committee obtains and considers advice from and is supported by the City Treasurer, Tri-Borough Director of Treasury & Pensions, and as necessary from the Fund's appointed actuary, investment managers and advisors.

The Committee has delegated the management of the Fund's investments to professional investment managers, appointed in accordance with the scheme's regulations, whose activities are specified in detailed investment management agreements and regularly monitored.

Business plans are presented to the Committee annually.

Several of the Committee members have extensive experience of dealing with Investment matters and training is made available to new Committee members.

Principle 2 - Clear objectives

An overall investment objective(s) should be set for the Fund that takes account of the pension 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.

Full Compliance

The aims and objectives of the Fund are set out within the FSS and within the ISS. The main fund objective is to meet the cost of pension liabilities and to enable employer contribution rates to be kept as nearly constant as possible at reasonable cost to the taxpayers and admitted bodies.

The investment strategy has been set with the objective of controlling the risk that the assets will not be sufficient to meet the liabilities of the Fund while achieving a good return on investment (see paragraphs 4 and 5 above). The approach taken reflects the Fund's liabilities and was decided upon without reference to any other funds. The Fund's performance is measured against the investment objective on a quarterly basis.

The Fund's strategy is regularly reviewed.

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.

Full Compliance

The Committee has, in conjunction with its advisers, agreed an investment strategy that is related to the Fund's liabilities. An actuarial valuation of the Fund takes place every three years, with the most recent triennial valuation taking place in 2016. The investment strategy is designed to give diversification and specialisation and achieve optimum return against acceptable risk.

The asset 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 4.3 of the SIP.

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

Full Compliance

The IAC has appointed investment managers with clear index strategic benchmarks (see paragraph 4.2 above) within an overall Investment objective which place maximum accountability for performance against that benchmark on the manager.

The managers are monitored at quarterly intervals against their agreed benchmarks, and independent detailed monitoring of the Fund's performance is carried out by Deloitte, the Fund's advisor and by Northern Trust, the Fund's custodian who provide the performance figures. Moreover portfolio risk is measured on quarterly basis and the risk/return implications of different strategic options are fully evaluated.

The advisor is assessed on the appropriateness of asset allocation recommendations and the quality of advice given.

The actuary is assessed on the quality and consistency of the actuarial advice received. Both the advisor and the actuary have fixed term contracts which when expired are tendered for under the OJEU procedures.

The Committee monitors the investment decisions it has taken, including the effectiveness of these decisions. In addition the Committee receives quarterly reports as to how the Fund has performed against their investment objective.

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.**

Full Compliance

The Fund is committed to making full use of its shareholder rights. The approach used is outlined in paragraph 8 of the ISS and in the Fund's SRI Policy. Authority has been delegated to the investment managers to exercise voting rights on behalf of the Fund. The investment managers are required to report how they have voted in their quarterly reports.

The Fund believes in using its influence as a shareholder to promote corporate social responsibility and high standards of corporate governance in the companies in which it invests – the Fund's approach to this is outlined in paragraph 7 of the ISS and in the Fund's SRI Policy.

Principle 6 – Transparency and reporting

Administering authorities should:

- **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.**
- **Provide regular communications to scheme members in the form they consider most appropriate.**

Full Compliance

Links to the Governance Compliance Statement, the ISS, the FSS, and the Communications Statement are all included in the Pensions Fund Annual Report which is published and is accessible to stakeholders of the Fund on the Council's web site, and a website developed specifically for the Fund.

All Committee meetings are open to members of the public and agendas and minutes are published on the Council's website and internal intranet.

Investment Strategy Statement: Appendix B

Compliance with the Stewardship Code

The **Stewardship Code** is a set of principles or guidelines released in 2010 and updated in 2012 by the Financial Reporting Council directed at institutional investors who hold voting rights in United Kingdom companies. Its principal aim is to make shareholders, who manage other people's money, be active and engage in corporate governance in the interests of their beneficiaries.

The Code applies to pension funds and adopts the same "comply or explain" approach used in the UK Corporate Governance Code. This means that it does not require compliance with principles but if fund managers and institutional investors do not comply with any of the principles set out, they must explain why they have not done so.

The seven principles, together with the council's position on compliance, are set out below:

1. **Publicly disclose their policy on how they will discharge their stewardship responsibilities.**

The Stewardship responsibilities are outlined in section 1.4 of the ISS, which outlines the terms of reference of the Committee.

Investment Managers, authorised under the regulations, are appointed to manage virtually all the assets of the Fund. The Committee actively monitor the Fund Managers through quarterly performance analysis, annual and periodic meetings with the Fund Managers and through direct monitoring by the Fund's investment advisor, which includes monitoring and reporting on:

- Fund manager performance
- Investment Process compliance and changes
- Changes in personnel (joiners and leavers)
- Significant portfolio developments
- Breaches of the IMA
- Business wins and losses; and
- Corporate and other issues.

Voting is delegated to Fund Managers through the Investment Management Agreement (IMA).

The fund will ensure that all its equity, fixed income and diversified managers sign up to the FRC Stewardship Code including: Majedie, Baillie Gifford, LGIM, Longview Partners, Insight, Hermes and Standard Life.

2. Have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

The Committee encourages its fund managers to have effective policies addressing potential conflicts of interest.

Committee members are also required to make declarations of interest prior to all Committee meetings.

3. Monitor their investee companies.

Day-to-day responsibility for managing the Fund's investments are delegated to the relevant fund managers, who are expected to monitor companies, intervene where necessary, and report back regularly on activity undertaken.

The Fund's expectations with regards to voting and engagement activities are outlined in its SRI Policy.

Fund Manager Internal Control reports are monitored, with breaches reported back to the Committee.

4. Establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

Day-to-day interaction with companies is delegated to the Fund's asset managers, including the escalation of engagement when necessary. The Fund's expectations with regards to voting and engagement activities are outlined in its SRI Policy.

The Fund Managers are expected to have their own SRI/ESG policy and to disclose their guidelines for such activities in their own statement of adherence to the Stewardship Code.

5. Willing to act collectively with other investors where appropriate.

The Fund seeks to work collaboratively with other institutional shareholders in order to maximize the influence that it can have on individual companies.

6. Have a clear policy on voting and disclosure of voting activity.









The Fund currently votes on all decisions and this is reported via Northern Trust. The Fund's approach to voting is clearly outlined in the ISS and SRI Policy,



7. Report periodically on their stewardship and voting activities.


A section on voting is included in each quarterly Business Plan Update, with a yearly review of the policy.



The Fund's annual report includes information about the Fund's voting and engagement work



Investment Strategy Statement: Appendix C – Risk Register



Ref	Risk	Mitigating Actions	Residual risk score		Risk Rating	Officer responsible	Next Review Date
			Likelihood	Impact			
1	STRATEGIC: INVESTMENT That the combination of assets in the investment portfolio fails to fund the liabilities in the long term.	<ul style="list-style-type: none"> Investment strategy in place and reviewed periodically. Performance is measured against a liability based benchmark. Fund performance is reviewed quarterly. 	2	3	Low 6 	City Treasurer	March 2016
2	STRATEGIC: INVESTMENT Fund managers fail to achieve the returns agreed in their management agreements.	<ul style="list-style-type: none"> Independent monitoring of fund manager performance by custodian against targets. Investment adviser retained to keep watching brief. Fund manager performance is reviewed quarterly. 	3	3	Low 9 	City Treasurer	March 2016
3	STRATEGIC: INVESTMENT Failure of custodian or counterparty.	<ul style="list-style-type: none"> At time of appointment, ensure assets are separately registered and segregated by owner. Review of internal control reports on an annual basis. Credit rating kept under review. 	2	3	Low 6 	City Treasurer	March 2016
4	STRATEGIC: FUNDING The level of inflation and interest rates assumed in the valuation may be inaccurate leading to higher than expected liabilities.	<ul style="list-style-type: none"> Review at each triennial valuation and challenge actuary as required. Growth assets and inflation linked assets in the portfolio should rise as inflation rises. 	4	3	Medium 12 	City Treasurer	March 2016
5	STRATEGIC: FUNDING There is insufficient cash available in the Fund to meet pension payments leading to investment assets being sold at sub-optimal prices to meet pension payments.	<ul style="list-style-type: none"> Cashflow forecast maintained and monitored. Cashflow position reported to sub-committee quarterly. Cashflow requirement is a factor in current investment strategy review. 	2	1	Very Low 2 	City Treasurer	March 2016
6	STRATEGIC: FUNDING Scheme members live longer than expected leading to higher than expected liabilities.	<ul style="list-style-type: none"> Review at each triennial valuation and challenge actuary as required. 	4	2	Low 8 	City Treasurer	March 2016
7	STRATEGIC: FUNDING Scheme matures more quickly than expected due to public sector spending cuts, resulting in contributions reducing and pension payments increasing.	<ul style="list-style-type: none"> Review maturity of scheme at each triennial valuation. Deficit contributions specified as lump sums, rather than percentage of payroll to maintain monetary value of contributions. Cashflow position monitored monthly. 	2	3	Low 6 	City Treasurer	March 2016
8	STRATEGIC: REGULATION Pensions legislation or regulation changes resulting in an increase in the cost of the scheme or increased administration.	<ul style="list-style-type: none"> Maintain links with central government and national bodies to keep abreast of national issues. Respond to all consultations and lobby as appropriate to ensure consequences of changes to legislation are understood. 	3	4	Medium 12 	City Treasurer and Acting Director of HR	March 2016



9	STRATEGIC: REGULATION Introduction of European Directive MiFID II results in a restriction of Fund's investment options and an increase in costs	<ul style="list-style-type: none"> Officers are engaging with Fund Managers to understand the position better Knowledge and Skills Policy in place for Officers and Members of the Committee Maintain links with central government and national bodies to keep abreast of national issues. 	2	2	Very Low 4 	City Treasurer	March 2016
10	OPERATIONAL: GOVERNANCE Failure to comply with legislation leads to ultra vires actions resulting in financial loss and/or reputational damage.	<ul style="list-style-type: none"> Officers maintain knowledge of legal framework for routine decisions. Eversheds retained for consultation on non-routine matters. 	2	2	Very Low 4 	City Treasurer	March 2016



11	OPERATIONAL: GOVERNANCE Committee members do not have appropriate skills or knowledge to discharge their responsibility leading to inappropriate decisions.	<ul style="list-style-type: none"> External professional advice is sought where required Knowledge and skills policy in place (subject to Committee Approval) 	3	3	Low 9 	City Treasurer	March 2016
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12	OPERATIONAL: GOVERNANCE Officers do not have appropriate skills and knowledge to perform their roles resulting in the service not being provided in line with best practice and legal requirements. Succession planning is not in place leading to reduction of knowledge when an officer leaves.	<ul style="list-style-type: none"> Person specifications are used at recruitment to appoint officers with relevant skills and experience. Training plans are in place for all officers as part of the performance appraisal arrangements. Shared service nature of the pensions team provides resilience and sharing of knowledge. 	3	3	Low 9 	City Treasurer and Acting Director of HR	March 2016
13	OPERATIONAL: GOVERNANCE Inadequate, inappropriate or incomplete investment or actuarial advice is actioned leading to a financial loss or breach of legislation.	<ul style="list-style-type: none"> At time of appointment ensure advisers have appropriate professional qualifications and quality assurance procedures in place. Committee and officers scrutinise and challenge advice provided. 	2	2	Very Low 4 	City Treasurer	March 2016



14	OPERATIONAL: GOVERNANCE London CIV has inadequate resources to monitor the implementation of investment strategy and as a consequence are unable to address underachieving fund managers.	<ul style="list-style-type: none"> Pension Fund Committee Chair is a member of the Joint member Committee responsible for the oversight of the CIV and can monitor and challenge the level of resources through that forum. Tri-Borough Director of Treasury & Pensions is a member of the officer Investment Advisory Committee which gives the Fund influence over the work of the London CIV. 	3	2	Low 	City Treasurer	March 2016
15	OPERATIONAL: FUNDING Failure of an admitted or scheduled body leads to unpaid liabilities being left in the Fund to be met by others.	<ul style="list-style-type: none"> Transferee admission bodies required to have bonds in place at time of signing the admission agreement. Regular monitoring of employers and follow up of expiring bonds. 	3	2	Low 6 	City Treasurer and Acting Director of HR	March 2016

16	OPERATIONAL: FUNDING Ill health costs may exceed "budget" allocations made by the actuary resulting in higher than expected liabilities particularly for smaller employers.	<ul style="list-style-type: none"> Review "budgets" at each triennial valuation and challenge actuary as required. Charge capital cost of ill health retirements to admitted bodies at the time of occurring. Occupational health services provided by the Council and other large employers to address potential ill health issues early. 	3	2	Low 6 	City Treasurer and Acting Director of HR	March 2016
17	OPERATIONAL: FUNDING Transfers out increase significantly as members transfer to DC funds to access cash through new pension freedoms.	<ul style="list-style-type: none"> Monitor numbers and values of transfers out being processed. If required, commission transfer value report from Fund Actuary for application to Treasury for reduction in transfer values. 	2	3	Low 6 	City Treasurer and Acting Director of HR	March 2016

18	OPERATIONAL: ADMINISTRATION Loss of funds through fraud or misappropriation leading to negative impact on reputation of the Fund as well as financial loss.	<ul style="list-style-type: none"> Third parties regulated by the FCA and separation of duties and independent reconciliation procedures in place. Review of third party internal control reports. Regular reconciliations of pension payments undertaken by Pensions Finance Team. Periodic internal audits of Pensions Finance and HR teams. 	4	2	Low 8 	City Treasurer and Acting Director of HR	March 2016
19	OPERATIONAL: ADMINISTRATION Failure of fund manager or other service provider without notice resulting in a period of time without the service being provided or an alternative needing to be quickly identified and put in place.	<ul style="list-style-type: none"> Contract monitoring in place with all providers. Procurement team send alerts whenever credit scoring for any provider changes for follow up action. 	3	1	Very Low 3 	City Treasurer and Acting Director of HR	March 2016

20	OPERATIONAL: ADMINISTRATION Failure of financial system leading to lump sum payments to scheme members and supplier payments not being made and Fund accounting not being possible.	<ul style="list-style-type: none"> Contract in place with BT to provide service enabling smooth processing of supplier payments Process in place for Surrey CC to generate lump sum payments to members as they are due. Officers undertaking additional testing and reconciliation work to verify accounting transactions 	2	2	Very Low 4 	City Treasurer	March 2016
21	OPERATIONAL: ADMINISTRATION Failure of pension payroll system resulting in pensioners not being paid in a timely manner.	<ul style="list-style-type: none"> In the event of a pension payroll failure we would consider submitting the previous months BACS file to pay pensioners a second time if a file could not be recovered by the pension administrators and our software suppliers. 	1	5	Very Low 5 	Acting Director of HR	March 2016

22	OPERATIONAL: ADMINISTRATION Failure to pay pension benefits accurately leading to under or over payments.	<ul style="list-style-type: none"> There are occasional circumstances where under or over payments are identified. Where under payments occur arrears are paid as soon as possible usually in the next monthly pension payment. Where an overpayment occurs, the member is contacted and the pension corrected in the next month. Repayment is requested and sometimes we collect this over a number of months. 	2	3	Low 6 	Acting Director of HR	March 2016
23	OPERATIONAL: ADMINISTRATION Failure of pension administration system resulting in loss of records and incorrect pension benefits being paid or delays to payment.	<ul style="list-style-type: none"> Pension administration records are stored on the surrey servers they have a disaster recovery system in place and records should be restored within 24 hours of any issue, files are backed up daily. 	1	5	Very Low 5 	Acting Director of HR	March 2016

24	<p>OPERATIONAL: ADMINISTRATION Administrators do not have sufficient staff or skills to manage the service leading to poor performance and complaints.</p>	<ul style="list-style-type: none"> Surrey CC administers pensions for Surrey, East Sussex and is taking on our Triborough partners. They have a number of very experienced administrators two of whom tupe to them from LPFA with our contract. Where issues arise the Pensions Liaison Officer reviews directly with the Pensions Manager at Surrey. More detailed performance reports are being developed. 	2	3	<p>Low 6</p> 	Acting Director of HR	March 2016
25	<p>Operational: Administration BT unable to provide monthly or end of year interface files in a format suitable for Surrey CC to update service records and undertake day to day operations. Inaccuracies in service records held on the pensions administration system may impact on the triennial funding valuation at March 2016 and notifications to starters and leavers.</p>	<ul style="list-style-type: none"> Issue has been escalated by the Chief Executive for high level resolution with BT Test files are currently with SCC Actuary undertakes data cleansing on the service records and is confident this will mitigate the inaccuracies in service records 	4	3	<p>Medium 12</p> 	Acting Director of HR	March 2016

Investment Strategy Statement: Appendix D

Information on London CIV

Stewardship Statement is attached – Other London CIV details are included in ISS main Statement

LONDON CIV DRAFT UK STEWARDSHIP CODE STATEMENT

The London Collective Investment Vehicle (CIV) was formed as a voluntary collaborative venture by the London Local Authorities in 2014 to invest the assets of London Local Government Pension Scheme (LGPS). The London CIV and its London Local Authority investors recognise the importance of being long term stewards of capital and in so doing supports the UK Stewardship Code, which it recognises as best practice.

The London LGPS CIV Limited ("London CIV") is fully authorised by the FCA as an Alternative Investment Fund Manager (AIFM) with permission to operate a UK based Authorised Contractual Scheme fund (ACS Fund). The London CIV in the management of its investments has appointed a number of external investment managers. We therefore see our role as setting the tone for the effective delivery of stewardship managers on our behalf and on behalf of our investing Funds. We are clear that we retain responsibility for this being done properly and fully in the interests of our own shareholders.

This Statement sets out how the London CIV implements the seven principles of the Code.

Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

The London CIV on behalf of its London Local Authority Shareholders recognises its position as an investor on their behalf with ultimate responsibility to members and beneficiaries and recognises that effective stewardship can help protect and enhance the long-term value of its investments to the ultimate benefit of all stakeholders in the LGPS.

As we do not invest directly in companies, we hold our fund managers accountable for the delivery of stewardship on our behalf in terms of day-to-day implementation of its stewardship activity. We require the appointed fund management teams to be responsible for holding to

account the management and boards of companies in which they invest. The London CIV believes that this approach is compatible with its stewardship responsibilities as it is the most effective and efficient manner in which it can promote and carry out stewardship activities in respect of its investments, and ensure the widest reach of these activities given the CIV's investment arrangements.

A key related area where stewardship is integrated into the wider process is in the selection and monitoring of external investment managers. When considering the appointment of external investment managers the consideration of Environmental Social and Governance (ESG) integration and stewardship activity of each investment manager is part of the selection process.

The London CIV expects its equity investment managers to adhere to the principles within the UK Stewardship Code. This position is communicated to the Fund's investment managers and forms the basis of the approach to monitoring the investment managers as outlined in this document. Whilst the Stewardship Code is primarily directed at UK equity investments, the CIV encourages its investment managers to apply the principles of the Code to overseas equity holdings where possible.

The primary mechanisms for the application of effective stewardship for the CIV are exercise of voting rights and engagement with investee companies. The CIV expects its external equity investment managers that invest directly in companies, to pursue both these mechanisms. We receive quarterly reporting from managers which includes their stewardship and voting activities where appropriate. We seek consistently to ensure that these stewardship activities are carried out actively and effectively in the furtherance of good long-term investment returns.

We expect all of the CIV's equity managers to be signatories to the Code and have publicly disclosed their policy via their Statements on how they will discharge their stewardship responsibilities. We expect managers that invest in companies directly to discharge their responsibilities by:

- having extensive dialogue with the company's management throughout the year on a range of topics such as governance, financial performance and strategy; and
- voting, either directly or via the services of voting agencies.

Principle 2

Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Day-to-day implementation of the Fund's stewardship activity has been delegated to external investment managers. The CIV expects its investment managers to document their approach to stewardship, which should include how they manage any conflicts of interest that arise to ensure that the interests of the CIV's Investors are prioritised. The CIV will review annually the conflicts of interest policy of its managers and how any conflicts have been managed during the year.

The London CIV has policies in place to manage conflicts of interest that may arise for the Board and its officers when making decisions on its behalf. The Conflicts of Interest policy is reviewed by the CIV board on a regular basis. A Conflicts of Interest Register is maintained.

Shareholders of the CIV attending the Pensions Sectoral Joint Committee are required to declare any conflicts of interest at the start of any meeting.

Principle 3

Institutional investors should monitor their investee companies.

We recognise that active and ongoing monitoring of companies is the foundation of good stewardship, reminding companies in which we invest that they have obligations to their shareholders to deliver returns over the appropriate long-term investment timeframe and, consistent with this, to manage any related environmental and social risks responsibly.

The CIV requires its external investment managers to monitor investee companies. Issues to be monitored are likely to vary, however typically these might include a company's corporate strategy, financial performance, risk (including those from environmental and social factors), capital structure, leadership team and corporate governance. The CIV encourages its investment managers to satisfy themselves that investee companies adhere to the spirit of the UK Corporate Governance Code.

The CIV reviews investment managers in this area as part of their regular meetings. For equity investment managers this includes consideration of:

- who has overall responsibility for ESG risk analysis and integration;
- resources and experience of the team;
- at what stages of the process ESG risks are considered;
- exposures to environmental, social or governance risk within the portfolio; and

- the investment manager's willingness to become an insider and, if so, whether the manager has a policy setting out the mechanisms through which this is done.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

The CIV recognises that constructive engagement with company management can help protect and enhance shareholder value. Typically, the CIV expects its investment managers to intervene with investee companies when they view that there are material risks or issues that are not currently being adequately addressed.

The CIV reviews investment managers in this area as part of their regular meeting. For equity investment managers that invest directly in Companies, this includes consideration of:

- whether voting activity has led to any changes in company practice;
- whether the investment manager's policy specifies when and how they will escalate engagement activities;
- overall engagement statistics (volume and areas of focus);
- example of most intensive engagement activity discussed as part of the manager's annual review meeting; and
- the estimated performance impact of engagement on the strategy in question.

Given the range of fund managers and Fund investments, the CIV carries out its monitoring at the manager level to identify:

- trends to ensure progress is being made in stewardship activities;
- specific managers where progress or the rate of progress is not adequate; and
- appropriate specific actions necessary.

Principle 5

Institutional investors should be willing to act collectively with other investors where appropriate.

As day-to-day management of the Fund's assets has been delegated to external investment managers, the CIV expects its investment managers to get involved in collective engagement where this is an efficient means to protect and enhance long-term shareholder value.

In addition the London CIV will work collectively with other investors including other LGPS Asset pools and the Local Authority Pension Fund Forum (LAPFF) to enhance the impact of their engagement activities.

Principle 6

Institutional investors should have a clear policy on voting and disclosure of voting activity.

The CIV has delegated its voting rights to the Fund's investment managers and requires them to vote, except where it is impractical to do so. The CIV also monitors the voting alerts of the LAPFF and where these are issued, requires the investment managers to take account of these alerts as far as practical to do so. Where the investment manager does not vote in line with the LAPFF voting alerts, the CIV will require detailed justification for non compliance.

The CIV reviews and monitors the voting policies and activities of its investment managers, this includes consideration of:

- the manager's voting policy and, what areas are covered;
- the level of voting activity
- whether the investment manager typically informs companies of their rationale when voting against or abstaining (and whether this is typically in advance of the vote or not);
- if securities lending takes place within a pooled fund for the strategy, whether the stock is recalled for all key votes for all stocks held in the portfolio; and
- whether a third party proxy voting service provider is used and, if so, how.

Principle 7

Institutional investors should report periodically on their stewardship and voting activities.

The London CIV encourages transparency from its investment managers and expects its managers to report publicly on their voting in an appropriate manner. In addition the London CIV receives reviews and monitors quarterly the voting and stewardship engagement activities of its investment managers.

The CIV reports quarterly to its investors and will include information on voting and engagement activities from investment managers where appropriate including updates as required on updated stewardship and voting policies of managers. The CIV also requires its managers to provide it with annual assurances on internal controls and compliance through recognised framework such as the AAF01/06 or equivalent.

This statement will be reviewed regularly and updated as necessary.

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Appendix 2 - Investment Regulations and Investment Strategy Statement



City of Westminster

Committee Report

Decision Maker:	PENSION FUND COMMITTEE
Date:	15 November 2016
Classification:	Public
Title:	Investment Regulations and Investment Strategy Statement
Wards Affected:	All
Policy Context:	Effective control over Council Activities
Financial Summary:	There are no financial implications arising from this report.
Report of:	Steven Mair <i>City Treasurer</i> smair@westminster.gov.uk 020 7641 2904

4 EXECUTIVE SUMMARY

- 1.6 The Government has issued guidance on the preparation of Investment Strategy Statements (ISS) as required under the soon to be released revised investment regulations. This note summarises the anticipated investment regulations and the finalised guidance.
- 1.7 The investment environment under the new regulations will be one of increased freedom but with more onerous justification of investment policy together with greater requirements to consult with interested parties and to report on the application of policy. There will also be greater Government powers of intervention, mainly but not exclusively, aimed at pooling.
- 1.8 It is not anticipated that the Committee will have to alter its current investment strategy. It may well have to consider the extent of diversification and the adequacy of risk management, which was already anticipated post the actuarial review.

- 1.9 The Committee will be required to review its policy on ethical, social and corporate governance issues and in particular to discuss oversight of voting with the London CIV.

5 RECOMMENDATIONS

- 2.3 The Committee is invited:
- a. To note that a draft Investment Strategy Statement (ISS) prepared in accordance with the revised investment regulations and guidance will be presented to the March 2017 Committee meeting.
 - b. To discuss the requirement for greater detail on environmental, social and corporate governance (voting) matters including greater consultation with interested parties, including the Pension Board, which will have to be reflected in the ISS.

6 PROPOSALS AND ISSUES

- 3.1 The Government issued revised investment regulations in September 2016, to have effect from 1st November 2016. The centre piece of the regulations was the replacement of the Statement of Investment Principles (SIP) with a requirement to prepare and operate in accordance with an ISS. Guidance has recently been issued on the preparation of an ISS. Each scheme is required to have an ISS by 1st April 2017 and a draft will be presented to the 21st March 2017 meeting of the Committee.

Overview of the Investment Regulations

- 3.2 The revised investment regulations are quite short, running to only seven pages. The key deletion is the old schedule 1 that specified limits on the allocation to particular types of assets. The main sections in the investment Regulation are:
- a) Requirement to keep the assets of the pension fund separate from those of the administering authority, to collect contributions and income and to operate separate bank accounts for the fund.
 - b) No borrowing is permitted except temporary loans (90 days max) to allow the payment of pensions.
 - c) An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued by the Secretary of State. The ISS must include:
 - a requirement to invest fund money in a wide variety of investments;

- the authority's assessment of the suitability of particular investments and types of investments;
- the authority's approach to risk, including the ways in which risks are to be measured and managed;
- the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
- the authority's policy on how social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments;
- the authority's policy on the exercise of the rights (including voting rights) attaching to investments;
- the maximum percentage of the total value of all investments of fund money that it will invest in particular investments or classes of investment (a scheme specific replacement of the old schedule 1);
- The authority must consult such persons as it considers appropriate as to the contents of its investment strategy; and
- The ISS must be reviewed at least every three years and investments must be made in accordance with the ISS.

These requirements are discussed below (paragraph 3.8). The requirements to take 'proper advice' and to invest in a wide variety of investments may potentially lead to challenge and debate with the investment advisor.

d) The Government can give directions to the administering authority if it is satisfied that the authority is not having regard to the ISS guidance. Directions may include:

- A requirement to make changes to the ISS;
- How to invest particular assets; and
- Transfer of the investment functions to the Government or nominated person.

The guidance (paragraph 3.6 below) discussed the circumstances when the powers of direction will be used. The regulations require the Government to consult with the administering authority in advance of any direction and to consider evidence as to how the fund is being managed.

e) The authority must take proper advice before making investment manager appointments. This presumably includes transferring assets to the London CIV.

4.3 The ISS requires additional details compared with the SIP (in particular on risk management, pooling, ESG and voting), which are discussed

below. As mentioned above, a draft ISS reflecting the current position of the fund will be prepared for the 21 March 2017 meeting.

- 4.4 The application of the Government's powers of direction is also discussed in the guidance. Such are the scope of the powers that it is anticipated that authorities who could not address the Government's concerns during the consultation period will take the required action in advance of a direction being issued.

ISS Guidance

- 4.5 The guidance is designed to assist in preparing the ISS. As highlighted above the ISS must be in accordance with the guidance. The guidance is summarised below.

Powers of Direction

- 4.6 The guidance refers to the new freedoms for administering authorities (no schedule 1 limitations) and the ISS being a 'prudential framework' and the powers of direction as a safeguard to ensure that this less prescriptive approach is used appropriately and in the best long term interests of scheme beneficiaries and taxpayers. The guidance refers to prior consultation and the general law principle to make investment decisions in the best long term interest of beneficiaries and tax payers.
- 4.7 The consultation previously indicated that powers of intervention were mainly aimed at authorities that did not participate in pooling. The guidance does not state this, but it presumably remains the main purpose. The Committee will need to consider the meaning of best long term interest, which presumably relates to solvency, cost and taking decisions based on long term returns. One view point is that a thoughtful Committee should not be concerned with the use of the powers. An alternative viewpoint is that future Governments may take a different (and issue specific) view of best long term interest. There is no way to prejudge how these powers will be applied by the current and future Governments. In preparing the ISS, the Committee will need to be diligent in addressing each of the bullet points in 3.2(c).

Contents of ISS

- 4.8 The guidance summarises the requirements when preparing an ISS as follows:
- Must take proper advice;
 - Must set out clearly the balance between different types of investments;
 - Must identify the risks associated with their overall investment strategy;
 - Must periodically review their policy to mitigate against any such risks;

- Should ensure that their policy on asset allocation is compatible with achieving their locally determined solvency target;
- Must periodically review the suitability of their investment portfolio to ensure that returns, risk and volatility are all appropriately managed and are consistent with their overall investment strategy;
- Should clearly state their appetite for risk;
- Should be aware of the risks that may impact on their overall funding and investment strategies;
- Should take measures to counter those risks;
- Should periodically review the assumptions on which their investment strategy is based; and
- Should formulate contingency plans to limit the impact of risks that might materialise.

4.9 None of the above should cause any concern to the Committee. If not already explicitly stated in the SIP or elsewhere (e.g. funding strategy statement) it will be implicit in the current strategy and the actions taken by the Committee. Addressing these questions is good practice.

Pooling

- 4.10 The regulations require that each Fund must commit to a [singular] pool that meets the pooling criteria issued last year, or otherwise approved. Particular requirements within the guidance are:
- To notify the Scheme Advisory Board and the Secretary of State of any changes [in pool governance structures] which result in failure to meet the criteria;
 - Set out the proportion of assets that will be invested through pooling;
 - Set out the structure and governance arrangements of the pool and the mechanisms by which the authority can hold the pool to account;
 - Set out the services that will be shared or jointly procured;
 - Provide a summary of assets that the authority has determined are not suitable for investing through the pool along with its rationale for doing so, and how this demonstrates value for money;
 - Regularly review any assets, and no less than every 3 years, that the authority has previously determined should be held outside of the pool, ensuring this continues to demonstrate value for money; and
 - Submit an annual report on the progress of asset transfers to the Scheme Advisory Board.
- 4.11 In complying with aspects of these regulations e.g. pool governance arrangements, it is expected that the London CIV will prepare standardised content. The references to assets to be pooled or excluded should cause no concern if the Committee remains comfortable with the London CIV as the platform for fund manager appointments. The reference to pooling decisions being based on 'value for money' considerations may or may not imply that it is purely the cost of

managing assets that should be considered and not potential returns. Unless the Committee has issues with pooling, the exact definition of 'value for money' has no practical implications.

Social, Environmental or Corporate Governance Considerations

- 4.12 The first part of the guidance seeks to prevent 'boycotts, disinvestment and sanctions against foreign nations and the UK defence industries' other than Government sanctions by stating the legal basis on which investment decisions must be made. These include:
- Taking proper advice and act prudently;
 - Prudently being defined as a duty to discharge statutory responsibilities with care, skill, prudence and diligence;
 - To act in accordance with ordinary public law principles, in particular, the ordinary public law of reasonableness;
 - Schemes should consider any factors that are financially material to the performance of their investments, including social, environmental and corporate governance factors over the long term.
- 4.13 None of the above appears to be different from the basis on which the Committee currently operates and thus have no immediate consequences.
- 4.14 The guidance continues "Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision." The use of non-financial considerations has to be quantified and explained in the ISS.
- 4.15 The above wording although consistent with the Committee's current approach is likely to be seen as an invitation to scheme members to express views on social and environmental aspects of investment policy. This is amplified in a discussion on social investments (where the social impact may be in addition or part substitution to the financial return) where it is stated that "these investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund." When presented with 'social investments' the Committee will have to consider whether any adverse financial consequences are 'significant' and balances by social benefits.
- 4.16 The guidance requires that when setting policy on social, environmental and corporate governance matters, the Committee should explain the extent to which the views of their local pension board and other interested parties who they consider may have an interest will be taken into account when making an investment decision based on non-financial factors. Although the Committee is at liberty to not have a

process for seeking views of interested parties, they should be wary of challenge and the Government's powers to amend the ISS. It is suggested that the policy of these issues is reconsidered from the standpoint of seeking to consult with the Pensions Board.

The Exercise of Voting Rights

- 4.17 The final section of the guidance is concerned with ensuring the highest standards of corporate governance in the companies in which funds invest. Good governance is seen as enhancing shareholder value. Stewardship activities include monitoring and engaging with companies with the aim of exerting a positive influence on companies to promote strong governance, manage risk, increase accountability and drive improvements in the management of environmental, social and corporate governance issues.
- 4.18 The Committee's current policy is that corporate governance activity, including voting, is an essential part of the decision to buy and hold investments and should be undertaken by the appointed investment managers. The guidance 'encourages' (not the same as requires?) Funds' to consider the best way to engage with companies either directly, in partnership with other investors or through their investment managers, and explain their policy on stewardship with reference to the Stewardship Code. The new requirement is that administering authorities should become Signatories to the Stewardship Code and state how they implement the seven principles and guidance of the Code, which apply on a "comply or explain" basis. A summary of the Stewardship Code is attached (Appendix 1).
- 4.19 The guidance requires a discussion within the ISS on the exercise of voting rights, including holding investment managers to account on voting records and stewardship in general. There is a suggestion on appointing an independent proxy voting agent to exercise their proxy voting and monitor the voting activity of the managers. Finally, a requirement to publish a report of voting activity as part of the pension fund annual report.
- 4.20 The current social, environmental and ethical policy as set out in the SIP is:
- "The Fund recognises that the neglect of corporate governance and corporate social responsibility may lead to poor or reduced shareholder returns. The Committee has considered how the Fund may best implement a corporate social responsibility policy, given the current resources available to the Fund. Accordingly, the Committee has delegated social, environmental and ethical policy to the investment managers. The Committee believes this is the most efficient approach whilst ensuring the implementation of policy by each manager is consistent with current best practice and there is appropriate disclosure and reporting of actions taken. To that extent, the Committee maintains

a policy of non-interference with the day-to-day decision making of the investment managers.”

- 4.21 The Committee went to considerable effort to establish a Stewardship Policy setting out the basis on which fund managers were expected to vote. In particular the policy identified common stewardship concerns (e.g. executive remuneration) and informed fund managers the issues that they should consider when voting. The policy was approved by the Committee in November 2014 and was subsequently circulated to fund managers. It includes a promise to publish annually a statement on these stewardship activities undertaken by the Committee. If the Committee follows through on the policy and signs up to the UK Stewardship Code itself, then it would be fully compliant with the guidance.
- 4.22 It is likely that the Committee’s current approach of delegation to fund managers remains valid but will have to be explained. Also that the fund managers will be required to report on voting activity, in particular failures to vote. The requirement to comment on voting in the annual report is not onerous. However, it can be expected that there will be greater interest in voting.
- 4.23 All this is either made more complicated or potentially simplified by the London CIV. With the CIV appointing fund managers they will be expected to exercise the oversight discussed above. It will not be possible within pooled funds for the Committee to operate its own voting policy. Rather pressure will be brought on the London CIV if their policy is deemed inadequate.

5 IMPLICATIONS FOR THE PENSION FUND COMMITTEE

- 4.4 Looking from a high level the new investment regulations and guidance do provide greater freedom to set strategy. However, the regulations and guidance’ requires that strategy be justified based as in the best long term interest of beneficiaries and tax payers and the management of risk explained. This should be seen as best practice, although with an unwelcome degree of Government oversight.
- 4.5 The requirements for ethical, social and corporate governance will require a review of the Committee’s current approach to these issues, in particular a discussion with the London CIV in connection with the Stewardship Code, increased reporting and greater effort to take into account the views of the Pension Board and Scheme Members. These areas will be addressed in drafting the ISS in the next few months.
- 4.6 Overall, the regulations and guidance offer the opportunity to review current investment policy and ensure that justification is adequately documented.

If you have any questions about this report, or wish to inspect one of the background papers, please contact the report author:

George Bruce pensionfund@westminster.gov.uk or 020 7641 6925

BACKGROUND PAPERS: None

APPENDICES:

Appendix 1 – Summary of UK Stewardship Code

UK Stewardship Code Summary

The Financial Reporting Council (FRC) published the UK Stewardship Code (the Code) in July 2010. The Code is designed to lay out the responsibilities of institutional investors as shareholders and provide guidance as to how those responsibilities might be met. Pension fund trustees and other investors are ‘strongly encouraged’ to ‘report if and how they have complied with the Code’

The Stewardship Code consists of seven key Principles:

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

Principle 3: Institutional investors should monitor their investee companies.

Principle 4: Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate.

Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity.

Principle 7: Institutional investors should report periodically on their stewardship and voting activities.