Report No. DR10081	**London Borough of Bromley**	**Agenda Item No. 10**

PART 1 - PUBLIC

Decision Maker:	**Pensions Investment Sub-Committee**
Date:	**8th September 2010**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**NEW INVESTMENT REGULATIONS AND MYNERS PRINCIPLES**
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Chief Officer:	Director of Resources
Ward:	All

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1. Reason for report

1.1 To advise the Committee of the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 and to propose changes to the Pension Fund Statement of Investment Principles to meet the requirements of the new regulations, including the level of compliance with the Myners' Principles.

RECOMMENDATIONS

2.1 The Sub-Committee is asked to note the report and agree the revised Statement of Investment Principles set out in Appendix 1.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: No cost

2. Ongoing costs: Recurring cost. Total fund administration costs £2.9m in 2009/10 (includes fund manager/actuary fees, Liberata charge and officer time)

3. Budget head/performance centre: Pension Fund

4. Total current budget for this head: £31.4m expenditure in 2009/10 (pensions, lump sums, admin, etc); £40.8m income (contributions, investment income, etc); £446.4m total fund value at 31st March 2010)

5. Source of funding: Contributions to Pension Fund

Staff

1. Number of staff (current and additional): 0.6 fte (current)

2. If from existing staff resources, number of staff hours: c21 hours per week

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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2007 and LGPS (Administration) Regulations 2008

2. Call-in: Call-in is not applicable.

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,360 current employees; 4,413 pensioners; 3,607 deferred pensioners (as at 31st March 2010)

Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.

2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

3.1 The new Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 were brought into force on 1st January 2010 and the Myners' Principles on institutional investment have been updated and adjusted to reflect the Local Government Pension Scheme. Pension Funds are required to disclose their level of compliance with the principles in their Statement of Investment Principles. The new regulations require a statement on the Fund's stock lending activities and its policy on responsible ownership to be included in the Statement of Investment Principles.

3.2 The legal framework for the investment of Local Government Pension Scheme (LGPS) monies is set out in the LGPS (Management and Investment of Funds) Regulations. Until 31st December 2009, the set of regulations in place dated back to 1998 and had become out of date. In response to this, the Communities and Local Government Department brought a new set of regulations into force from 1st January 2010.

3.3 In 2001, following a review of institutional investment, a set of ten principles was developed for all institutional investors to work to. Lord Myners conducted the review and the principles became known as the "Myners' Principles". The principles were revised during 2008 and a new set of six principles was published. In December 2009, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued statutory guidance for Local Government Pension Schemes to determine their level of compliance with the principles.

Regulatory Framework for LGPS Investments

3.4 The LGPS Management and Investment of Funds regulations set out the framework within which the investment of LGPS monies can take place. The regulations define investments, investment managers, and specify the need for diversification, risk management and professional advice.

3.5 The revised regulations, which came into force on 1st January 2010, made a number of minor technical changes to bring them up to date. The changes are not considered to be significant. Three changes have been made, which are brought to the attention of the Pension Investment Sub-Committee to take action:

- Pension fund cash held by the Council for the payment of benefits will be subject to a separate treasury management strategy and cannot be lent to the Council. This is being updated through a revised approach to separation of funds.
- The Statement of Investment Principles should include a statement of the extent to which the Fund complies with the statutory guidance on the six new "Myners' Principles".
- The Statement of Investment Principles should now include a reference to the Fund's stock lending activities and the policy on responsible ownership.

Statutory Guidance on the Application of the Myners' Principles

3.6 The Myners' Principles were first established in 2001 following a review of institutional investment in the UK initiated by HM Treasury. Following the publication of the Principles, the LGPS investment regulations were amended in 2002 to require Pension Funds to publish their level of compliance with the Principles. This has been part of the Fund's Statement of Investment Principles and the annual report presented to the Investment Sub-Committee annually since that time.

3.7 In October 2008, HM Treasury published a new set of six principles for investment. These principles were reviewed by a working group in 2009 and adjusted to reflect the specific nature of the LGPS. In December 2009, CIPFA produced statutory guidance for Local Government Pension Schemes to determine their level of compliance with the new principles. The new LGPS investment regulations require Funds to publish their level of compliance with the principles by 1st July 2010. This has been delayed due to the formation of a new Sub-Committee and the schedule of meetings.

3.8 The draft Statement of Investment Principles attached at Appendix 1 shows the Principles and the Fund's level of compliance. There are areas where developments are required for the Fund to fully comply with the Principles. The table included after the compliance statement in Appendix 1 summarises these and suggests actions and timescales to enable compliance to be achieved. The majority of these will form part of a review of working practices which will take place over the next 12-18 months to be completed by December 2011.

Statement of Investment Principles

3.9 As is outlined above, the new regulations require the Fund to publish its compliance with the new Myners' Principles in its Statement of Investment Principles. They also require the Fund to publish details of its policy on the lending of stock and the ways the risks associated with it are measured and managed. This is not currently applicable to Bromley's fund. A revised version of the Statement of Investment Principles is attached at Appendix 1.

3.10 Principle 5 – Responsible Ownership – requires Funds to include a statement of their policy on responsible ownership in the Statement of Investment Principles. The voting and social, ethical and environmental considerations statements from the previous versions have been combined to meet this requirement.

4. POLICY IMPLICATIONS

4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

5. FINANCIAL IMPLICATIONS

5.1 None at this stage.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	LGPS Regulations 2007. LGPS (Administration) Regulations 2008. LGPS (Management & Investment of Funds) Regulations 2009.

APPENDIX 1

LONDON BOROUGH OF BROMLEY PENSION FUND
STATEMENT OF INVESTMENT PRINCIPLES 2010

Introduction

This statement has been produced in accordance with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ("the Regulations"). The Regulations provide that an administering authority must, after consultation with such persons as they consider appropriate, prepare, maintain and publish a written statement of the principles governing their decisions about investments. The Regulations specify seven issues that must be addressed in the statement. The following sections of this statement address these issues in turn.

(a) The types of investment to be held
The fund's investment managers are authorised to invest in all assets permitted under the Regulations, subject to the provisions of their benchmarks and certain minor restrictions. Details of the Investment Guidelines and Restrictions are included below.

(b) The balance between different types of investments
The broad balance between different types of investments is defined in the investment managers' benchmarks, which were last comprehensively revised in 2006. Details of the two balanced managers' benchmarks are shown below. The Pension Investment Sub-Committee will review its asset allocation strategy every three years.

(c) Risk
At the last full valuation of the Fund (as at 31st March 2007), the actuary valued the fund's assets at 81% of the fund's liabilities. He determined employers' contribution rates with a view to achieving 100% solvency over a 12-year period, assuming a broad 75:25 asset allocation between equities and bonds as at the valuation date. The Pension Investment Sub-Committee has adopted a slightly more aggressive 80:20 allocation in the benchmarks for its two balanced managers and has set targets to out-perform the benchmarks by between 1% and 1.9%. It believes that the risks associated with a high allocation to equities are justified by the need to improve its funding level.

Other key risks that could have an adverse impact on the achievement of the fund's funding strategy and target funding levels are analysed in the fund's Funding Strategy Statement, where they are analysed over financial, demographic, regulatory and governance risks.

(d) The expected return on investments
The fund's investment strategy is based on the long-term returns assumed by the actuary in the 2007 actuarial review. The nominal and real returns assumed per annum were:

Expected returns	Nominal	Real
	%	%
Equities	7.6	4.3
Gilts	4.7	1.3
Corporate Bonds	5.4	2.0
Overall Returns (discount rate)	6.9	3.5

(e) The realisation of investments
The investment managers have full discretion to make decisions on the realisation of investments having regard to their benchmarks and their investment targets.

(f) The extent to which social, environmental or ethical considerations are taken into account in investments

The authority has been advised that its primary responsibility is to secure the best returns for the fund in the interests of its council taxpayers. The Council has decided to take no action at this time in developing an ethical investment policy, having also considered:

- the difficulties involved in identifying companies meeting any ethical investment criteria;
- the possibility of judicial review in the case of any company included in error;
- the difficulty and cost of monitoring any policy;
- the unpredictable impact on investment performance;
- the complications that would arise in relation to performance measurement; and
- the lack of support for such a policy from other employers in the fund.

The authority therefore does not impose any obligation on the investment managers to take account of such considerations in making investments. However, the managers seek to encourage best corporate practice in companies' management of the social, environmental and ethical impact of their activities. They seek to achieve this by engaging in dialogue with companies in which they invest in order to encourage them to improve policies and practices. In their investments they seek to favour those companies that pursue best practices provided it does not act to the detriment of the return or risk of the portfolio. They also take account of any social, environmental or ethical factors that they consider to be relevant to investment risk.

(g) The exercise of the rights (including voting rights), if any, attaching to the investments

The investment managers have been authorised to exercise voting rights on behalf of the Council unless specifically instructed to vote in a particular way on any individual resolution. In exercising those rights, they will have regard to the Combined Code issued by the Hampel Committee on Corporate Governance. They have been instructed to report back to the Council's Pension Investment Sub-Committee every quarter on any material divergence from the recommendations of the Combined Code by companies in which the Council is invested and on action taken by them in response to the divergence. They have also been instructed to report to the Sub-Committee at least every six months on their corporate governance activities generally, including their dialogue with companies' management to encourage sound social, environmental and ethical practices in their activities. The Sub-Committee will issue instructions on individual matters only in exceptional circumstances, when asked for instructions by a manager or when a specific resolution is brought to their attention.

With regard to other rights such as the taking up of rights issues, this is left for the investment managers to decide in the light of their assessment of market conditions at the time.

(h) Stock lending

The Council's Pension Fund does not currently operate a stock lending programme through its custodian bank.

INVESTMENT GUIDELINES AND RESTRICTIONS

General

Investment is permitted in all classes of assets, subject to the limits imposed by the Regulations on the proportion of the fund which may be invested in certain investments and certain other restrictions imposed by the authority. In addition, the investment managers do not use certain investments as a matter of policy.

All references to percentages in this appendix are to percentages of the total value of all existing investments in the fund before making the investment which is subject to the limit. The limits only apply at the time the investment is made.

Limits imposed by the Regulations

- All contributions to any single partnership: 2%
- All contributions to partnerships: 5%
- All deposits with any local authority or precepting body which is an exempt person (within the meaning of the Financial Services and Markets Act 2000) in respect of accepting deposits as a result of an order made under section 38(1) of that Act, and all loans: 10%
- All deposits with any single bank, institution or person (other than the National Savings Bank): 10%
- All investments in unlisted securities of companies: 10%
- Any single holding in unlisted securities: 2% (limit imposed by the authority)
- Any other single holding, apart from investments in OEICs and unit trusts: 10% (there is no limit on investment in single OEICs or unit trusts apart from the total limit below)
- All investments in unit trusts and open-ended investment companies (OEICs) managed by any one body: 35% [N.B. In practice, because neither of the investment managers will use unit trusts or OEICs managed by the other, they may invest up to 70% or thereabouts of their own portfolios in their own unit trusts and OEICs]
- Any single insurance contract: 25%
- All securities transferred under stocklending arrangements: 25%

Other restrictions imposed by the authority

- Cash held at custodian's bank is not to exceed £2,500,000, with any excess placed on the money market with the main clearing banks or placed in institutional cash funds approved by the authority
- No sub-underwriting
- Certain limits on use of futures and options are recorded in the relevant investment management agreements and fund prospectuses

Benchmarks for the Balanced Managers

(a) Baillie Gifford

Asset class	Allocation	Range	Index
	%	%	
Equities	(80)	70-90	
UK	25		FTSE All Share
Overseas	(55)		
US	18		FTSE AW North America
Europe	18		FTSE W Europe ex UK
Dev Asia (inc Japan)	9.5		FTSE AW Developed Asia Pacific ex Japan
Emerging	9.5		FTSE Emerging
Bonds	(18)	10-30	
UK gilts	9		FTSE Government Securities UK Gilts All Stocks
Other	9		Merrill Lynch Sterling Non Gilt
Cash	2		
Total	100		

Baillie Gifford's performance target is to exceed the composite benchmark returns by 1.0-1.5% per annum gross over rolling three-year periods.

(b) Fidelity

Asset class	Allocation	Range	Index
	%	%	
Equities	(80)		
UK equities	35	30-40	FTSE All Share
Overseas	(45)		
US	12.5	7.5-17.5	S&P 500
Europe	12.5	7.5-17.5	MSCI Europe ex UK GDR
Japan	5	0-10	TOPIX
Asia	5	0-10	MSCI AC Asia Pacific ex Japan
Global	10	5-15	MSCI World GDR
Bonds	(20)		
UK aggregate	20	5-15	Iboxx Sterling Overall Bond
Total	100		

Fidelity's performance target is to exceed the composite benchmark returns by 1.9% per annum over rolling three-year periods.

Compliance with Myners Principles

The Principles, together with the Council's position on compliance *(in italics)*, are set out below:

Principle 1. Effective decision-making
Administering authorities should ensure that:

- **Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and to monitor their implementation; and**
- **Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive and manage conflicts of interest.**

Bromley complies with this principle in all major respects. As a statutory scheme, it does not have trustees but its Pension Investment Sub-Committee performs functions similar to those of trustees. The training requirements of Pension Investment Sub-Committee members are reviewed on an ongoing basis. The Funding Strategy Statement serves as the fund's business plan.

Principle 2. Clear objectives
An overall investment objective(s) should be set out for the fund that takes account of:

- **the scheme's liabilities;**
- **the potential impact on local tax payers;**
- **the strength of the covenant for non-local authority employers; and**
- **the attitude to risk of both the administering authority and scheme employers.**

These should be clearly communicated to advisors and investment managers.

The fund's overall investment objective, as recorded in its Funding Strategy Statement, is to achieve 100% funding of its liabilities by 31 March 2019, compared with 81% as at 31 March 2007.

Principle 3. Risk and Liabilities

In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities. These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

The Fund's main investment objective, as set out in this Statement of Investment Principles, acknowledges the need to meet the Fund's liabilities and states that the aim is to ensure the impact on local tax payers in minimised.

Principle 4. Performance Assessment

Arrangements should be in place for the formal measurement of the performance of the investments, investment managers and advisors. Administering authorities should also periodically make a formal assessment of their own effectiveness as decision-making bodies and should report on this to scheme members.

The investment performance of the fund and its managers is measured by the independent WM Company and is reported quarterly to the Pension Investment Sub-Committee. No arrangements are in place for formal assessment of the Sub-Committee's own procedures and decisions.

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; and**
- **report periodically to scheme members on the discharge of such responsibilities.**

The Pension Fund's investment managers have adopted the Institutional Shareholders' Committee Statement of Principles. A statement regarding responsible ownership is included in the Statement of Investment Principles. This forms part of the Annual Report published on the Council website, which is accessible to all scheme members.

Principle 6. Transparency and Reporting

Administering authorities should:

- **act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives; and**
- **provide regular communication to scheme members in the form they consider most appropriate.**

Bromley's SIP is published on the Council's website. The results of the monitoring of the fund managers are published in the public agendas of the Pension Investment Sub-Committee, which are also published on the website. It is not Bromley's policy to communicate directly with scheme members on investment issues, because their contributions and benefits are determined by statute and are not linked to investment returns. The fee structures in place for the two balanced fund managers provide for fixed percentage fees calculated by reference to the total value of funds under their management at the end of each quarter, supplemented in the case of one of the managers by a performance related fee payable when investment returns exceed the benchmark returns in any 3-year period ending on 31st March.

Potential action plan for Myners' Principles compliance for development / discussion

Myners' Principle	Development Area	Action
1 – Effective decision making	Consider means of assessing members' and officers' skills, etc in order to develop a training plan.	Undertake self-assessment of knowledge and skills using CIPFA Knowledge & Skills Framework and use to develop a training plan. Agree a business plan of key priorities over the coming 2-3 years along with any investment strategy review following the forthcoming valuation results.
2 – Clear objectives	Review the Fund's attitude to risk and how this feeds into the Fund's objectives.	Carry out review and provide clear definition of attitude to risk in SIP.
3 – Risk and liabilities	Consider the form and structure of liabilities as well as non-investment risks more explicitly in the next review of investment strategy.	Update the risk register.
4 – Performance assessment	Consider options to formally measure the performance of the Fund's advisors and for the Pension Investment Sub-Committee to assess its own effectiveness.	Officers to consider options to measure advisors' performance. Effectiveness of Pension Investment Sub-Committee to be considered after self-assessment has been done and training plan is in place.