Division(s): N/A

PENSION FUND COMMITTEE – 25 JUNE 2010

ASSESSMENT AGAINST THE SIX PRINCIPLES FOR PENSION FUND INVESTMENT

Report by Head of Finance & Procurement

Introduction

1. Following a review of the original 10 Myners's principles (published in 2001) administering authorities are required by the Department for Communities and Local Government (CLG) to prepare, publish and maintain a statement of compliance against a set of six principles for pension fund investment.

2. CIPFA has published guidance on the new principles as an aid to administering authorities in maintaining and updating their statements. Annex 1 to this report includes a proposed assessment of the extent to which the Fund complies with the principles.

Assessment

3. Overall the Committee is largely compliant, although there are a few areas where improvements could be made. It is proposed that improvements should only be made where they would be for the benefit of the fund rather than simply complying with the guidance.

4. The following improvements are proposed:

Improvement Proposed	Paragraph	Priority
Role of officers should be set out clearly	1.2, 1.6	Medium
Skills and knowledge audit should be undertaken against CIPFA framework and a training plan developed	1.7, 1.12	High
Members should be given a handbook with committee terms of reference, standing orders and operational procedures	1.9	Medium
An improved medium term business plan should be developed for the fund	1.16, 4.17	Medium
Review of administration strategy documents	1.17	Low
Consider risk controls for fund manager targets	3.2, 4.1, 4.3	Medium

A risk assessment should be undertaken for each of the fund's activities and risks mitigated	3.12	High
A performance framework should be developed for the actuary	4.12	Low
Review the need to review key decisions formally	4.15, 4.16, 4.18	Medium
Determine the circumstances when managers would intervene in a company	5.3	Low
Review stakeholders, their interests and the extent of their involvement in the committee's functions, including consultation	6.3	Low
Continue to review other fund's publications for examples of best practice.	6.4, 6.6	Medium
Further review of the Statement of Investment Principles as part of the next fundamental review	6.7, 6.9	Medium

5. The improvements have been given a priority rating. This is to reflect the fact that there are a significant number and prioritising enables officers to manage the programme of improvements over the next year or so. A number of the improvements are time critical. For example, the business plan is produced each year in February/March. It is proposed therefore to make improvements to the medium term business plan early in 2011 for reporting to the Committee in March 2011.

RECOMMENDATION

6. **The Committee is RECOMMENDED to:**

(a) review the assessment of compliance against the six principles for pension fund investment at Annex 1;
(b) subject to any changes the Committee wishes to make, agree the assessment;
(c) agree the programme of proposed improvements set out in paragraph 4.

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Background papers: CIPFA publication: Investment Decision Making and Disclosure

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ANNEX 1

Six Principles of Pension Fund Investment (Updated Myners's Principles)

Statement of Compliance

	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 make them effectively and 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.**
	Regulatory framework
	Elected members have a fiduciary duty to the fund, scheme members and local tax payers. They can delegate functions to officers but they retain overall responsibility for the management of the fund and its investment strategy.
	Investment Regulations permit administering authorities to appoint one or more investment managers, provided the investment managers are suitably qualified.
	Administering authorities are required to take proper advice to enable them to fulfil their obligations.
	Persons entrusted with discretion must direct themselves properly in law. They must act reasonably paying attention to relevant considerations and avoiding matters that are irrelevant.
	Every Local Authority must make arrangements for the proper administration of its financial affairs and ensure that one of its officers has responsibility for the administration of those affairs.

	Key Issues to Consider	
1.1	There should be a designated group of elected members appointed to a committee to whom responsibility for the management and admin of the fund has been assigned.	Compliant
1.2	The roles of chief finance officer, monitoring officer and clerk to the committee should be set out clearly. The framework for the committee's conduct of business should include a process for declaring conflicts of interest.	Partially compliant, some improvement required
1.3	Authorities are required to prepare, publish and maintain statements of compliance against a set of good practice principles for scheme governance and stewardship.	Partially compliant, improvement required
1.4	Authorities are required to publish a governance compliance statement.	Compliant
1.5	Wherever possible, appointments to the committee should be based on consideration of relevant skills, experience and continuity.	Compliant
1.6	The committee should be governed by specific terms of reference, standing orders and operational procedures that define those responsible for taking decisions, including officers and/or external investment managers. These should be included in the constitution and record of delegated powers, as well as in public documents such as the SIP.	Partially compliant, improvement required
1.7	The committee should ensure that it has the appropriate skills and conduct skills and knowledge audits of its membership at regular intervals.	Partially compliant, improvement required
1.8	Adopting a training plan and an annual update of training and development needs is good practice. The Annual Report should contain a statement of actions taken and progress made.	Partially compliant, improvement required
1.9	The committee should review its structure and composition regularly and provide each	Partially compliant,

	member with a handbook containing the committee's terms of reference, standing orders and operational procedures.	improvement required
1.10	The committee may wish to consider establishing subcommittees and/or panels to progress significant areas of activity between committee meetings, e.g. performance meetings.	Compliant
1.11	The committee should obtain proper advice from suitably qualified persons, including officers and external investment managers. The chief finance officer should assess the need for proper advice and recommend the committee as appropriate.	Compliant
1.12	The chief finance officer should provide a training plan for members to help them make effective decisions, and ensure they are aware of their statutory and fiduciary duties.	Compliant, but improvement required
1.13	There should be a published allowances scheme which should be reviewed regularly.	Compliant
1.14	Employees appointed as member representatives should be allowed adequate time off from their normal duties to read papers and attend meetings.	Compliant
1.15	Committee papers should be clear, comprehensive and circulated well before meetings.	Compliant
1.16	The chief finance officer should ensure that a medium term business plan is created for the fund. It should contain major milestones, issues to be considered by the committee and financial estimates for the investment and administration of the fund.	Partially compliant, improvement required
1.17	The fund's administration strategy documents should refer to all aspects of the committee's activities relevant to the relationship between the committee and the employing authorities, including references to governance and improving the skills and knowledge of the committee.	Partially compliant, improvements to be considered.

	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 taxpayers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisors and investment managers.
	Regulatory framework
	The LGPS (Administration) Regulations 2008 requires each administering authority to obtain an actuarial valuation of the assets and liabilities of the pension fund every three years
	In determining the common rate of employer's contribution, the actuary must have regard to the existing and prospective liabilities of the fund arising from circumstances common to all employers and to the need to maintain as nearly constant rate as possible.
	Investment regulations require administering authorities to publish their policy on risk in their SIP.
	Administration authorities should consider a strategic asset allocation under the investment regulations.
	The Investment Regulations require the fund's investment policy to have regard to the advisability of investing fund money in a wide range of investments and to the suitability of particular investments.
	Investment Regulations do not prescribe in detail the way in which mandates for investment managers should be agreed.

	Key Issues to Consider	
2.1	In setting an overall investment objective for the fund, consideration should be given to: • The fund's liabilities in the context of expected net contribution inflows • The adequacy of the fund's assets to meet its liabilities • The maturity profile of the fund's liabilities and its cash flow situation.	Compliant
2.2	The committee should demonstrate it has sought proper advice, including from specialist independent advisors, as to how this might be expressed in terms of the required annual return on the fund and how it should be measured against stated benchmarks.	Partially compliant, to be revisited in the fundamental review in early 2011
2.3	The committee should consider risk appetite when considering advice on the mix of asset classes and on active and passive mandates. In making asset allocation decisions, all asset classes currently available should be considered.	Partially compliant, to be revisited in the fundamental review in early 2011
2.4	Peer group benchmarks should be for comparison only, not to define overall fund objectives.	Compliant
2.5	The committee should seek to achieve value for money in all aspects of its operation.	Compliant
2.6	Consideration of the impact of the funding level and contribution rate on council tax levels.	Compliant
2.7	Consider different sub-funds for different employers with different investment objectives.	Compliant
2.8	The committee should consider undertaking asset/liability studies.	Compliant
2.9	The committee should evaluate the split between equities and bonds in the light of the fund's liabilities before considering any other asset class. It should consider which assets to include	Compliant

	in the strategic asset allocation and why some asset classes have been excluded. The committee should consider diversification and suitability in reaching its allocation decision. The attention given to strategic asset allocation should fully reflect the contribution it makes towards achieving the investment objectives.	
2.10	The committee should take proper advice. Advisors should be appointed in open competition. The committee should set them clear strategic investment performance objectives. The committee should state clearly how the advisers' overall performance will be measured and the relevant short, medium and longer term performance measurement framework. All external procurement of advisers should be through EU procurement regulations.	Compliant
2.11	The committee should understand the transaction related costs incurred and have a strategy for ensuring these costs are controlled.	Compliant
2.12	Understanding transaction-related costs should be a clear consideration in letting and monitoring a contract for investment management, particularly in relation to transition.	Compliant

	Principle 3: Risk and Liability
	In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of their liabilities **These include the implications for local tax payers, the strength of covenant for participating employers, the risk of their default and longevity risk.**
	Regulatory framework
	The LGPS Investment regulations provide a framework within which investments are to be managed and include measures intended to manage risk.
	CIPFA has published guidance to funds undertaking liability studies to inform their investment strategies.
	The 2008 Regulations set out the provisions for admitted bodies and in particular the requirement for securing guarantees.
	The 2008 Regulations set out the arrangements for Fund valuations, reminding actuaries of the desirability of maintaining a constant employer contribution rate.

	Key Issues to Consider	
3.1	The committee should set out an overall investment objective for the fund that: • Represents its best judgement of what is necessary to meet the fund's liabilities • Takes account of the committee's attitude to risk, and specifically its willingness to accept underperformance due to market conditions.	Compliant
3.2	The committee should be aware of its willingness to accept underperformance due to market conditions. If performance benchmarks are set against relevant indices, variations in market conditions will be built in, and acceptable tolerances above and below market returns will be stated explicitly.	Partially compliant
3.3	Some benchmarks may also be stated in terms of absolute returns, in which case the committee must believe that a certain rate of return is acceptable and feasible, regardless of market conditions, from certain classes of asset.	Compliant
3.4	The Fund's Statement of Investment principles should include a description of the risk assessment framework used for potential and existing investments.	Compliant
3.5	Objectives for the overall fund should not be expressed in terms that have no relationship to the fund's liabilities, such as performance relative to other pension funds, or to a market index.	Compliant
3.6	The committee should state whether a scheme specific benchmark has been considered and established and at what level of risk is acceptable to it.	Compliant
3.7	The committee should receive a risk assessment in relation to the valuation of its assets and liabilities as part of the triennial valuation. Where there is any doubt about valuations at any	Compliant

	stage, the chief financial officer should ensure a risk assessment is reported to committee.	
3.8	The committee should, at the time of the valuation, analyse factors affecting long-term performance and receive advice on how these impact on the scheme and its liabilities. The committee should ask questions about this during discussions on performance.	Compliant
3.9	The committee should use reports from internal and external auditors to satisfy itself about the standards of internal control on administration and investment operations.	Compliant
3.10	The committee should that its investment strategy is suitable for its objectives and takes account of the ability to pay of employers in the fund.	Compliant
3.11	The committee should consider the extent to which cash flow from the assets should match liabilities and the volatility of returns it is prepared to accept.	Compliant
3.12	The annual report should include an overall risk assessment for each of the fund's activities and factors expected to impact on the financial and reputational health of the fund. An analysis of the risks should be reported periodically to the committee, together with actions to mitigate risk.	Not compliant, to be reviewed

	Principle 4: Performance assessment
	Arrangements should be in place for the formal measurement 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.**
	Regulatory framework
	Administering authorities should be considering the appropriateness of their index benchmarks as part of the requirement under the investment regulations to seek proper advice.
	Under the investment regulations, the performance of individual investment managers is subject to periodic review and the investments made must be reviewed every three months.
	Under the investment regulations, administering authorities are required to prepare, publish and maintain statements of compliance against a set of good practice principles for scheme governance and stewardship. These principles include reference to elected representatives receiving adequate training to discharge their duties.

	Key Issues to Consider	
	Investments	
4.1	The committee should: • Consider in consultation with investment managers, whether the index benchmarks are appropriate, and whether the index creates incentives for sub-optimal strategies • If setting limits for divergence from an index, ensure they reflect the approximate nature of indexes. • Consider for each asset class whether active or passive management is appropriate • Where active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving managers the freedom to pursue genuinely active strategies	Compliant Compliant Compliant Partially compliant
4.2	The mandate instructs the manager as to how the portfolio is to be managed, covering the objective, asset allocation, benchmark flexibility, risk parameters, performance targets and measurement timescales.	Compliant
4.3	Where active management is selected, divergence from a benchmark should not be so constrained as to imply index tracking or so widely as to imply unconstrained risk.	Not compliant, improvement to be considered
4.4	Performance targets should be related to clear time periods and risk limits and monitoring arrangements should include reports on tracking errors.	Compliant
4.5	Investment activity in relation to the benchmark should be monitored regularly to check divergence and any impact on overall asset allocation strategy.	Compliant

4.6	Investment returns should be measured to enable regular monitoring against benchmarks	Compliant
4.7	The return achieved in each asset class should be measured so that the impact of different choices can be assessed.	Compliant
4.8	Although returns will be measured quarterly, a longer timeframe should be used to assess the effectiveness of the fund management arrangements and to review the compatibility of the asset/liability profile.	Compliant
4.9	Returns should be obtained from specialist independent performance management agencies.	Compliant
4.10	Investment manager returns should be independently measured against their benchmark and variations should be attributed to asset allocation, stock selection etc.	Compliant
	Advisors	
4.11	When assessing managers and advisors it is necessary to consider the extent to which decisions have been delegated and advice heeded by officers and elected members.	Compliant
4.12	The committee should devise a performance framework against which to measure the cost, quality and consistency of advice from its actuary.	Not Compliant, to be developed
4.13	It is necessary to distinguish between qualitative assessments and quantitative reviews.	Compliant
4.14	Consultants should be assessed on: • appropriateness of asset allocation recommendations; • quality of advice in choosing benchmarks and any related performance targets; • the quality and appropriateness of investment managers recommended; • the proactivity and consistency in recommending subsequent changes.	Compliant

	Decision-making bodies	
4.15	The process of self-assessment involves both officers and members of the committee reviewing a range of items, including manager selection, asset allocation decisions, benchmarking decisions, employment of consultants and best value outcomes.	Partially compliant, options for improvement to be considered
4.16	The objective of the reviews would be to consider whether the outcomes were as anticipated, were appropriate or could have been improved.	Not compliant, to be considered in future
4.17	The committee should set out its expectations of its own performance in its business plan. This could include expected progress on certain matters, review of governance and performance and attendance targets. It should include standards relating to the administration of the committee's business such as: • attainment of standards set out in CIPFA's knowledge and skills framework; • achievement of required training outcomes; • achievement of administrative targets such as issuing agendas and minutes.	Partially compliant, improvement required
4.18	This assessment should be included in the fund's annual report to its stakeholders.	Not compliant, improvement required

	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.**
	Regulatory framework
	The Investment regulations require the publication of the fund's policy on the exercise of rights attaching to investments and the inclusion of the policy in the statement of investment principles (SIP).
	The regulations also require funds to disclose in the SIP the extent to which social, environmental, or ethical considerations are taken into account in the selection, retention and realisation of investments.
	In taking forward any such policy the regulations required the administering authority to make clear in their terms of engagement with investment managers that they comply with the decision-making bodies instructions.

	Key Issues to Consider	
5.1	Policies regarding responsible ownership must be disclosed in the SIP in the Annual Report.	Compliant
5.2	The committee should discuss the potential for consideration of environmental, social and governance issues to add value when selecting and monitoring investment managers.	Not Compliant
5.3	The committee should ensure that investment managers have an explicit strategy, setting out when they would intervene in a company, which is acceptable to the committee.	Not Compliant

	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** • **provide regular communication to scheme members in the form they consider most appropriate.**
	Regulatory framework
	CLG issued guidance in 2007 regarding the requirement to complete a governance compliance statement. The CIPFA / SOLACE publication *Delivering Good Governance in Local Government: Framework (2007)* illustrates best practice for developing and maintaining a local code of governance. CIPFA issued *Delivering Good Governance in Local Government Pension Funds* in 2009 as the application of the CIPFA/SOLACE framework to the management of LGPS Funds.
	The 2008 Regulations contain requirements relating to policy and strategy statements. In relation to governance, investment and transparency, they are as follows: • pension funds governance compliance statement –must be submitted annually to the secretary of state • pension fund annual report – the content that must be included is set out in the Regulations.
	The LGPS regulations provide a statutory framework from which the administering authority is required to prepare a funding strategy statement (FSS). The key requirements are: • the administering authority will publish the funding strategy after consulting with relevant interested parties. • In preparing the FSS, regard must be made to the guidance issued by CIPFA and the scheme's SIP. • The FSS must be revised whenever there is a material change in the policy matters set out in the FSS or the SIP.
	The 2008 Regulations require the administrator to prepare, maintain and publish a written policy on communication with: • Members;

	• Representatives of members • Prospective members • Employing authorities.
	The Investment Regulations require the preparation and publication of a statement of investment principles (SIP). Authorities are required to set out in their SIP the extent to which they comply with the updated Myners principles and give reasons for any non-compliance.
	The Investment Regulations require authorities to consult with appropriate persons before publishing their SIP.
	In the SIP, authorities are required to prepare written statements of the principles governing their decisions on investments.
	Although the SIP does not have to be sent to scheme members, it is expected to be published in the annual report.

	Key Issues to Consider	
6.1	The Committee should ensure that its governance compliance statement is maintained regularly. It should challenge any non-compliance and be clear about its reasons for this.	Compliant
6.2	The fund's communication statement must set out the administering authorities policy on: • The provision of information and publicity about the scheme to members and employers • The format, frequency and method of distributing such information or publicity • The promotion of the scheme to prospective members and their employing authorities.	Compliant
6.3	The committee should have a view of who its stakeholders are and the nature of the interests they have in the scheme and the fund. There should be a clearly stated policy on the extent to which stakeholders will take a direct part in the committee's functions and those matters on	Partially compliant, to be reviewed

	which they will be consulted or informed.	
6.4	The committee should have an integrated approach to its own governance and communicating all aspects of its work to its stakeholders.	Not compliant, improvement required
6.5	The committee should seek examples of good practice from the published reports and communications policies of other pension funds.	Compliant, but room for improvement
6.6	The committee should ensure its annual report complies with the regulations on content, agreeing action plans to rectify any non-compliance. The committee should ensure the content is useful and relevant to stakeholders.	Partially compliant, improvements planned
6.7	The funding strategy statement and statement of investment principles should include: • A description of how day to day investment decisions are delegated and authorised • The role of members, officers, external advisers and managers • The process for monitoring actions, decisions and performance of advisers and managers • How the overall asset allocation is determined and assumptions as to future returns • A description of individual manager mandates.	Partially compliant, some improvements required
6.8	Fee structures should include the scale of charges, whether ad valorum or fixed. Where there is a performance element, consideration should be given to risk control implications.	Compliant
6.9	A copy of the SIP should be made available to members on request and its availability should be made clear in the publication process.	Partially Compliant, improvement required
6.10	The governance compliance statement should include details of any delegation of functions to a sub-committee or to officers	Compliant

6.11	The governance compliance statement must include whether any delegation complies with CLG guidance.	Compliant
6.12	Where there is non-compliance, reasons must be given.	Compliant
6.13	A copy of the statement must be sent to the CLG.	Compliant