

Shetland Islands Council Pension Fund

Statement of Investment Principles

1.0 Introduction

- 1.1 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 requires administering authorities of the Local Government Pension Scheme (LGPS) to prepare, maintain and publish a Statement of Investment Principles (SIP) governing their decisions about investments.
- 1.2 A SIP must state the extent to which the administering authority comply, or give the reasons where they do not do so, with the six principles of investment practice set out in the document called “CIPFA - Investment Decision Making and Disclosure in the Local Government Pension Scheme. A Guide to the Application of the Myners Principles”.
- 1.3 A copy of this statement is provided to the Fund’s investment managers, who are required to follow the principles that it sets out.

2.0 Administration

- 2.1 The Shetland Islands Council is the administering authority of the Shetland Islands Council Pension Fund.
- 2.2 The Council has set up the Pension Fund Management Consultative Committee comprising three councillors, one representative of the Admitted Bodies’ employers, three employee representatives (one representing the Admitted Bodies’ employees) and a retired beneficiary. This committee discusses, comments and makes recommendations to the Executive Committee on all Pension matters relating to the operation of the Pension Scheme.

3.0 Objective of the Fund

- 3.1 The Fund’s investment objectives are as follows:
 - To secure and maintain sufficient assets to meet liabilities which fall due by the Fund under the Local Government Pension Scheme.
 - To minimise the risk of assets failing to meet these liabilities
 - To maximise investment returns within an acceptable level of risk whilst, at the same time, providing stability in the level of employers’ contribution rates

4.0 Types of Investments

- 4.1 All investments and investment limits will comply with the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.
- 4.2 UK Equities provide an equitable share in the assets and profits of listed UK companies. Income is provided through share dividends, which, although variable in amount from year to year, have historically over the longer term risen above inflation. Equities produce capital gains/losses as share prices reflect investors' expectations of the prospects of a specific company, sector or market.
- 4.3 International Equities are similar to UK Equities but with exposure to the currency of the market where the share is listed. The investment returns can be enhanced, or reduced, by the appreciation or depreciation respectively of the market currency against sterling.
- 4.4 Bonds are debt instruments issued by Governments and other borrowers. Bonds provide a fixed rate of interest and are generally redeemed at par by the issuer at a pre-determined future date. The price primarily reflects the fixed level of interest, the term to redemption and the overall return (the yield) demanded by investors. Prices of bonds tend to fluctuate less than the prices of equities.
- 4.5 Index Linked bonds are issued by the UK Government. They provide interest and redemption value directly linked to price inflation as measured by the Retail Price Index (RPI). Similar index linked securities are issued by a number of overseas governments but they have additional exposure to fluctuations in the exchange rate.
- 4.6 Property is investment in land and/or buildings such as Offices, Retail and Industrial. The income comes from the rents payable. Property prices primarily reflect the rents they are able to produce and investor demand. Investors can invest either directly in individual properties or alternatively through a stake in collective investment vehicles set up to invest in a portfolio of property assets.
- 4.7 Cash is usually deposited with institutions for short periods and will attract interest at market rates.

5.0 Balance Between Different Types of Investment

- 5.1 The Pension Fund places emphasis over the long term in equities, which are most likely to maximise long-term returns. However, the Fund is diversified to include other assets such as Bonds, Property and Cash.
- 5.2 The fund is measured against a customised benchmark, which is as follows:

Asset Class	Allocation %	Benchmark
UK Equities	40	FTSE All Share
Overseas Equities	40	MSCI Relevant Indices
UK Gilts	5.0	FTSE Gilts All Stocks
UK Corporate Bonds	5.0	IBoxx £ non Gilts
Property	10	IPD Pooled Property

6.0 Risk

- 6.1 The fund seeks to control risk through investing in a diverse range of asset classes, over a long-term investment horizon. Presently the fund has mostly passive investments, which has a market risk but removes manager risk. Property is the only active asset class but diversification is increased through a fund of funds approach.
- 6.2 The current Pension Fund managers, their mandates, percentage of reserves at 31 December 2011 and benchmarks are as follows:

Manager	Mandate	% of Reserves	Benchmark
BlackRock Passive	Equity and Bonds (Passive)	91%	Customised Index benchmark
Schroders Active Fund of Funds	Property (Active)	9%	Customised benchmark +1% p.a (net of fees)

- 6.3 An independent performance analyst company WM Company reviews the managers' performance and provides quarterly reports on each manager.
- 6.4 An independent investment consultant company Hymans Robertson was appointed to provide specialist advice on all aspects of the Pension Fund's investments.
- 6.5 Northern Trust is the sole custodian for the Pension Fund's assets.

7.0 Expected Return on Investments

- 7.1 Investment Managers will be held accountable for their performance through a regime of performance measurement against targets.

- 7.2 The benchmark and performance target set for each Manager are intended to ensure that the Fund investment returns achieved are in excess of that assumed in the Actuarial Valuation.

8.0 Realisation of Investments

- 8.1 The Fund will hold sufficient cash in its bank account to meet the likely benefit payments. Additionally, the majority of the Fund's assets are held in assets that are readily realisable within a couple of weeks, to meet any unexpected cashflow requirements.

9.0 Responsible Investment

- 9.1 Whilst the Fund managers have delegated powers for the acquisition and realisation of investments, fund managers will be expected, as part of their investment process, to consider all factors, including the social, environmental and ethical policies of companies in which they may invest to the extent that these may materially affect the long term prospects of such companies. The Fund managers will also be expected to enter into dialogue with companies in which they invest in relation to the pursuance of socially responsible business practices, and report on these activities.
- 9.2 Corporate Governance is a key responsibility for institutional shareholders and as a matter of principle; the Fund will seek to exercise all of its voting rights in respect of its shareholdings. It is recognised, however, that, in practical terms, this may not always be possible for overseas holdings. However, for UK stocks, all voting rights will be exercised in a positive fashion, i.e. no abstentions.
- 9.3 The fund managers, who will act in accordance with this policy, will exercise voting.
- 9.4 Both Fund managers have signed up to the United Nations Principles on Responsible Investment. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfill their fiduciary (or equivalent) duty. The Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices and so better align their objectives with those of society at large.

10.0 Securities Lending

- 10.1 Stock lending involves the lending of certain investments to a counterparty (subject to strict credit rating controls) for a period of time in return for a payment of commission. Northern Trust the Pension Fund's custodian undertakes stock lending on behalf of the fund, within

strict guidelines to reduce the risk of financial loss to the fund in the event of default.

- 10.2 All the Pension Fund investments are currently invested in unitised products, which Northern Trust cannot lend, but the fund manager may undertake an element of lending on behalf of the unit holders in the fund.

11.0 Compliance

The Statement of Investment Principles must also state the extent to which the authority complies, and to the extent it does not so comply, with the guidance given by the Scottish Ministers in regard to the six principles of investment practice set out in the document called “CIPFA - Investment Decision Making and Disclosure in the Local Government Pension Scheme. A Guide to the Application of the Myners Principles”. The Fund’s compliance with the guidance is provided in Schedule 1.

Schedule 1

Compliance with Myners Principles

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

The ultimate responsibility for all decisions relating to the Shetland Islands Council Pension Fund rests with the full Council.

The Council set up the Pension Fund Management Consultative Committee. This representative committee ensures broader input to the process from the fund's admitted bodies, employees, trade union and pensioners. This committee reviews, discusses and makes recommendations on all Pension related matters.

The committees' knowledge is supported by advice from Council staff, external analysts and investment consultants.

The Council and the Pension Fund Management Consultative Committee receive presentations on an annual basis from all Pension Fund Managers along with comments from an external performance analyst.

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, and these should be clearly communicated to advisors and investment managers

The Statement of Investment Principles and the Funding Strategy Statement define the Fund's primary funding objectives.

The setting of the Funding Strategy recognises the need to maintain stability of employer contribution rates over time.

Reviews of investment strategy focus are undertaken with investment consultants and focus on the split between the main asset classes (equities, bonds, property and cash).

Investment and actuarial advisers are appointed under separate contract, in line with the EU procurement regulations.

Each Investment Management Agreement has clear benchmarks and risk parameters and where necessary individual targets for each mandate.

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 takes advice from the scheme's actuary regarding the nature of its liabilities.

The actuarial valuation includes the risk of default and longevity risk in analysing the liabilities of the scheme. Investment consultant advice is sought periodically, to ensure the fund is aware of the levels of risk within the asset mix and to assess the suitability of the structure in relation to outperforming its liabilities.

The Executive Manager Finance has responsibility for ensuring appropriate controls are in place for the Pension Fund. Controls are subject to periodical checks from internal and external audit and any issues brought to the attention of the relevant committee.

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

An independent external analyst company measures the overall investment performance of the Fund and the individual managers.

Fund manager performance reports for half yearly, annual and longer-term periods are considered by the Pension Fund Management Consultative Committee, and also the Executive Committee.

A Governance Compliance Statement in the Pension Fund Accounts measures the Fund's governance arrangements against the standards set out in the guidance, with an action plan in place for ongoing issues.

Over the long-term, Fund performance against benchmark and the contribution to the overall funding level is attributable to the investment manager appointments and the investment strategy, and it is the Council that made the investment manager appointments and approved the investment strategy.

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

The Fund's managers have adopted the Institutional Shareholders' Committee Statement of Principles.

The Fund's policy on responsible ownership is contained in the Fund's Statement of Investment Principles.

A summary on responsible ownership will be included in the annual investment report, which the Consultative Committee and the Council will review.

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

The Fund's Committee papers and minutes are available via the Council committee management system website.

As well as reporting Scheme changes through the Pension Fund Management Consultative Committee and the full Council, members of the scheme (active, deferred and pensioners) are kept up to date with changes through an annual Pensions Newsletter.

A hard copy of the full version of the Fund's Annual Report and Accounts is provided to the scheduled and active admitted bodies of the scheme and a summary of the review to all Fund members.