Dyfed Pension Fund

Statement of Investment Principles (SIP)

2015

1. Introduction

The Dyfed Pension Fund adopts as best practice the production, publication and regular review of a Statement of Investment Principles (SIP). The Fund will continue this practice in response to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

1.1 With effect from 1 July 2000, Carmarthenshire County Council as the local authority responsible for the administration of the Dyfed Pension Fund (Superannuation Act 1972, 1995 Regulations) has been required to publish a SIP, which must include:

- The types of investments held
- The balance between different types of investments
- Risk
- The expected return on investments
- The realisation of investments
- The extent to which Socially Responsible Investment (SRI) is taken into account in investments
- The exercise of the rights (including voting rights) attaching to investments

1.2 Carmarthenshire County Council in drawing up this statement has consulted its independent investment adviser and has liaised with its investment managers, particularly on the aims and objectives of the Fund and the manner in which the Fund wishes to achieve these objectives.

1.3 The overall investment policy falls into two parts:

- The **strategic management** of the assets which is fundamentally the responsibility of the Pension Panel. The Pension Panel consists of 3 Elected Members of Carmarthenshire County Council (and 1 substitute member) nominated with delegated powers from Carmarthenshire County Council, who are advised by an independent investment adviser, and the Director of Resources of Carmarthenshire County Council. This strategic management is driven by the investment objectives laid out in section 2.

- The **day to day management of the assets** which is delegated to professional investment managers and is described in section 4.

2. <u>Strategic Objectives of the Dyfed Pension Fund</u>

2.1 The Pension Panel have adopted the following objectives in consideration of their strategic management of the Fund:

- To ensure that the assets of the Fund match or exceed its liabilities, i.e. the Fund remains solvent

- To establish a strategic asset allocation benchmark which is expected to deliver the required investment return, at an accepted level of risk, in the long term

- To minimise the employers contribution rate, whilst avoiding volatility.

2.2 In investing, the Fund is exposed to a number of risks.

The following are considered to be the most significant:

- **Funding Risks**
    - Financial mismatch - The risk that Fund assets fail to grow in line with the developing cost of meeting Fund liabilities and the risk that unexpected inflation increases the pension and benefit payments and the Fund assets do not grow fast enough to meet the increased cost.
    - Changing demographics – The risk that longevity improves and other demographic factors change increasing the cost of Fund benefits.
    - Systemic risk – The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial "contagion", resulting in an increase in the cost of meeting Fund liabilities.

  The Panel measures and manages financial mismatch in two ways. It has set a strategic asset allocation benchmark for the Fund and assesses risk relative to that benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. It also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

  The Panel keeps under review mortality and other demographic assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation.

  The Panel seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise.

- **Asset Risks**
    - Concentration – The risk that significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
    - Illiquidity – The risk that the Fund cannot meet its liabilities because it has insufficient liquid assets.
    - Manager underperformance – The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

  To manage asset risks the Panel provides a practical constraint on fund investments deviating greatly from the intended approach by setting itself diversification guidelines and by investing in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrain risk within the Panel's expected parameters. By investing across a range of assets, including quoted equities and bonds, the Panel has recognised the need for some access to liquidity in the short term. In appointing several investment managers, the Panel has considered the risk of underperformance by any single investment manager.

- **Other provider risk**
    - Transition risk – The risk of incurring unexpected costs in relation to the transition of assets among managers. To date, no significant transitions have taken place within the Fund but if they were undertaken in future the Panel would take professional advice and consider the appointment of specialist transition managers.
    - Custody risk – The risk of losing economic rights to Fund assets, when held in custody or when being traded.
    - Credit default – The possibility of default of a counterparty in meeting its obligations.

  The Panel monitors and manages risks in these areas through a process of regular scrutiny of its providers and audit of the operations they conduct for the Fund.

3. Strategic Management

3.1 It is the Pension Panel's policy to regularly monitor in consultation with the actuary the likely position regarding the solvency ratio in order that the risk of deterioration of the solvency ratio below 100% is minimised. The Pension Panel may consider amending the Investment Strategy should they be advised at some future stage that this would be the only acceptable route to avoid under funding.

3.2 The Pension Panel, following an asset liability study, has set a benchmark mix of asset types and ranges within which the investment managers may operate with discretion. This is shown in section 4.1. The Panel believes that this mix of assets will fulfil the assumptions within the valuation undertaken in March 2013, as well as taking account of the liability profile of the Fund. This mix will also help to control the risks outlined in section 2.2.

4. The Day to Day Management of the Assets

4.1 Where Investment Management Agreements (IMAs) between Carmarthenshire County Council and investment managers are appropriate they lay out the terms and conditions of the day to day management of their investments in the Dyfed Pension Fund. The current asset allocation determined following the appointment of global equity managers in 2013 is as follows:

	Benchmark (%)	**Range (%)**
UK Equities	25.0	23.5 – 26.5
Overseas Equities	25.0	23.5 – 26.5
Global Equities	19.0	10.0 – 30.0
Pan European Property	10.0	5.0 – 15.0
Bonds	20.0	18.5 – 21.5
Cash	1.0	0.0 – 10.0
TOTAL	**100.0**	

Overseas Equities	**Benchmark (%)**	**Range (%)**
North America	10.00	5.00 - 15.00
Japan	3.50	0.00 - 8.50
Developed Pacific (excl. Japan)	3.25	0.00 - 8.25
Emerging Markets	8.25	3.25 - 13.25
TOTAL	**25.00**	

Bonds	**Benchmark (%)**	**Range (%)**
Index Linked Gilts	10.0	5.0 - 15.0
UK Corporate Bonds	10.0	5.0 - 15.0
TOTAL	**20.0**	

Additional Restrictions are as follows:-

Overseas Bonds	0 - 7%
Total Overseas Exposure	43.0 – 53.0%

The investment managers are allowed to vary the percentage allocations within the ranges indicated above. In exceptional circumstances, and within legal constraints, these percentages may be varied with the prior agreement of the Pension Panel. Although the investment managers are able to extend to 10% cash within the range allowed, they will advise the Panel when they go over 5% cash. There is a small amount of cash held locally at Carmarthenshire County Council in order to pay all non trading expenses of the Fund.

4.2 The restrictions faced by the investment managers are contained within Investment Management Agreements (IMAs). The following investments are allowable for the Dyfed Pension Fund:

- Units in active and passive funds, including GTAA.
- Shares, convertibles and warrants quoted on any UK exchange.
- Shares included in the FT/S&P or MSCI World Indices.
- Pan European Property either directly or through pooled funds
- Sovereign issue debt.
- Corporate debt – bonds to have a minimum credit rating of either Aa3 or AA- by Moody's Investor Services or Standard and Poors
- Derivatives on any of the above shares or markets with prior permission, with the constraint that they should not gear the portfolio.
- Life Funds - up to a limit of 35% of the Fund.
- Currencies of any market in the FT/S&P or MSCI World Index.

All investments, excluding property holdings, are readily realisable.

The investment manager has confirmed that within UK Corporate Bonds, the use of derivatives will be for the purposes of efficient portfolio management only, and will not be used for speculative purposes or to leverage the portfolio.

The restrictions of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) are included in the IMA and are of course of relevance to the SIP also.

4.3 The requirement is for the investment managers to outperform their respective benchmarks. The target given to BlackRock is to seek to outperform its benchmark by 0.4% pa over rolling 3 years, using a weighted contribution of mid targets (1.5) of 1-2% pa for active equities and 1% pa for active bonds.

The target given to Schroders is to seek to outperform the AREF / IPD UK Quarterly Property Fund Index All Balanced Funds Weighted Average by 0.75% pa over a rolling 5 year period.

The target given to Partners Group is to seek a 12% pa gross absolute return (with a secondary benchmark of 200 basis points pa above the AREF / IPD UK Quarterly Property Fund Index All Balanced Funds Weighted Average) over any 3 year rolling period.

The target given to Baillie Gifford and Columbia Threadneedle is to seek to outperform the MSCI All Country World Index by 2-3% pa over a rolling 5 year period.

4.4 The Pension Panel, assisted by the independent adviser and the Head of Financial Services, meet regularly with the investment managers to review performance, to decide on any appropriate investment changes and to monitor all aspects of the investment function.

The current managers, advisers and consultants to the Dyfed Pension Fund are:

Investment Managers – **Blackrock, Schroders, Partners Group, Baillie Gifford and Columbia Threadneedle**

Independent Investment Adviser - **Mr Eric Lambert**

Performance measurement company - **WM Performance Services**

Actuary - **Mercer**

Custodian - **Northern Trust**

5. Social, Environmental and Ethical Considerations

The Pension Panel recognises that social, environmental and ethical considerations are among the factors which investment managers will take into account, where relevant, when selecting investments for purchase, retention or sale. The managers have produced statements setting out their policies. The managers have been delegated by the Panel to act accordingly.

6. Exercise of Voting Rights

The Panel has delegated the exercise of voting rights to the investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly the managers have produced written guidelines of their process and practice. The managers are encouraged to vote in line with its guidelines in respect of all resolutions at annual and extraordinary general meetings of companies. See Appendix A.

7. Stock Lending

The policy on stock lending reflects the nature of the mandates awarded to investment managers by the Panel, which include both pooled and segregated mandates.

Within segregated mandates, the Panel has absolute discretion over whether stock lending is permitted. The Panel has considered its approach to stock lending, taking advice from its investment adviser. After consideration of that advice, the Panel has decided not to permit stock lending within any of its segregated investment mandates.

The managers of pooled funds may undertake a certain amount of stock lending on behalf of unit holders in the fund. Where a pooled fund engages in this activity, the extent to which it does is disclosed by the manager. The Panel has no direct control over stock lending in pooled funds, nevertheless, it is comfortable that the extent and nature of this activity is appropriate to the circumstances of the Fund.

The Panel reviews its policy on stock lending on a regular basis.

8. Myners 6 Principles and Compliance Checklist

See Appendix B

9. Compliance with this Statement

The Pension Panel will monitor compliance with this statement annually. The investment managers will confirm annually in writing that they have complied with this statement and should this statement materially change the investment managers will be informed promptly.

10. The Review of this Statement

A review of this statement will take place in response to any valuation, asset liability study, or any other material event that would influence the policies of the Fund.

This includes changes to the liabilities, the finances, regulations or risk acceptance of the Fund. This review will take place every year at a minimum, or sooner if the situation warrants it. All relevant parties will be involved in the review.

Statement by the Fund Managers

Blackrock, Schroders, Partners Group, Baillie Gifford and Columbia Threadneedle confirm that they have been made aware of any changes to the Statement of Investment Principles (SIP) and have complied with the SIP over the past year.