



STATEMENT OF INVESTMENT PRINCIPLES

NOVEMBER 2011

STATEMENT OF INVESTMENT PRINCIPLES**London Borough of Havering Pension Fund ('the Fund')****Background****Legislation**

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1999 as amended require Local Authority Pension Funds to prepare a Statement of Investment Principles (SIP) and to review it at least every three years and without delay after any significant change in investment policy. They are also required to set out a Statement of Compliance with the six Principles of Investment Management contained in the CIPFA document "Principles for Investment Decision Making and disclosure" published in December 2009.

In preparing this Statement, the Pensions Committee has considered advice from the Investment Practice of Hymans Robertson LLP.

In relation to the Myners Code of Conduct for Investment Decision Making, the extent of the Trustees compliance with this voluntary code is summarised in the Appendix to this statement.

Purpose and Scope of Scheme

The London Borough of Havering is the Administering Authority for the London Borough of Havering Pension Fund. The Fund is part of the Local Government Pension Scheme (LGPS) and provides death and retirement benefits for all eligible employees and their dependants. It is a final salary defined benefit Pension Scheme, which means that benefits are payable based on the employees' final salary. All active members are required to make pension contributions which are based on a fixed percentage of their pensionable pay as defined in the LGPS regulations. Following the changes to the benefit structure of LGPS Schemes from 1 April 2008, active members previously paying contributions of 6% will pay banded rates between 5.5% and 7.5% depending on their level of full-time equivalent pay. Manual workers in employment before 1st April 1998 who previously had a protected 5% rate will be subject to transitional rates.

The London Borough of Havering is responsible for the balance of the costs necessary to finance the benefits payable from the Fund by applying employer contribution rates, determined from time to time (but at least triennially) by the Fund's actuary.

The London Borough of Havering has a direct interest in the investment returns achieved on the Fund's assets, but the benefits paid to pensioners are not directly affected by investment performance.

Pensions Committee

A dedicated group of Councillors (the “Pensions Committee”) has been set up to deal with the majority of the Fund’s investment issues. Major investment decisions will be referred for consideration to the Pensions Committee. The Pensions Committee is made up of elected representatives of The Council who each have voting rights and Trade Union and Employer representatives who have observer status. The Pensions Committee reports to Full Council and has full delegated authority to make investment decisions. The Pensions Committee decides on the investment policies most suitable to meet the liabilities of the Havering Pension Fund and has ultimate responsibility for the governance of the Fund including Investment Strategy.

In particular, the Pensions Committee has duties that include:

- Monitoring the investment performance of the Fund on a quarterly basis;
- Determining overall strategy;
- Ensuring compliance with legislative requirements;
- Receiving the triennial valuation prepared by the Funds actuary with recommended contribution levels;
- Determining asset allocation and benchmarking;
- Appointment of Investment Managers.

The Pensions Committee is set up under the Local Government Act so that, where necessary it can exercise decision-making powers. The Pensions Committee meets at least four times per year to hear reports from its officers, investment managers, actuary, investment adviser and performance measurement provider. Additional meetings are held as required in particular to ensure the appropriate Councillor training.

The Pensions Committee also receives and considers advice from executive officers of the Council and, as necessary, from its appointed external investment adviser (including specific investment advice), the actuary to the Fund and its investment managers.

The Regulations state that the Administering Authority must, when formulating its investment policy, have regard to the advisability of investing fund money in a wide range of investments and to the suitability of particular investments and types of investments.

Fund Objective

The purpose of the Fund is:

1. To pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses;
2. To receive monies in respect of contributions, transfer values and investment income.

The overriding aims of the Fund as set out in the Funding Strategy Statement are as follows:

APPENDIX A

- To ensure that sufficient resources are available to meet all liabilities as they fall due.
- To enable employer contribution rates to be kept as nearly constant as possible and at a reasonable cost to the Scheduled bodies, Admitted bodies and to the taxpayers.
- To manage employers' liabilities effectively.
- To maximise the income from investments within reasonable risk parameters.

For active members, benefits are based on service completed but take account of future salary increases. The value of liabilities is calculated consistently on the ongoing basis set out in the formal report of the Fund's Actuary on the actuarial valuation carried out as at 31 March 2010. The fund's performance is monitored quarterly by the Pensions Committee and the funding position is formally reviewed at each triennial actuarial valuation or unless circumstances arise which require earlier action.

Investment Objective

Following a review of the Investment Strategy in 2008, the Pensions Committee have translated their objectives into a suitable strategic asset allocation benchmark for the Fund. All day to day investment decisions have been delegated to a number of authorised investment managers. The strategic benchmark is reflected in the choice and mix of funds in which the Fund invests. The Fund's benchmark is consistent with the Pensions Committee's collective view on the appropriate balance between seeking an enhanced long-term return on investments and accepting greater short-term volatility and risk.

The Committee conducted a detailed study of the Funds' investment strategy during 2008 involving an asset/liability modelling exercise ('Phase 1') and a structure modelling exercise ('Phase 2') for fine tuning of the risk return profile of the selected strategy. In selecting the investment strategy the Pensions Committee have been advised by their Investment Adviser, Hymans Robertson, and have paid due consideration to:

- Prudence – the impact on the margins included in the actuarial funding basis and the need for the actuary to adopt a prudent approach.
- Affordability – the impact on the level of Employer contributions in the longer term.
- Stability – the extent to which Employer contributions vary between actuarial valuations and the need to minimise such variations.
- Stewardship – the impact of the investment strategy on reaching target funding levels and the associated risks involved.

Asset Allocation

To achieve their objectives the Pensions Committee has agreed upon the following benchmark allocation:

Asset Class	Active	Passive	Target
	%	%	%
Property	10		10
UK Equities	17	3	20
Global Equities	17	23	40
Fixed Interest Gilts	}		}
Index Linked Gilts	} 20		} 20
Corporate Bonds	}		}
Absolute Return	10		10
Total	74	26	100

The Pensions Committee target allocation is broadly inline with the investment strategy review carried out in 2008 but now takes into account the change from active to passive management and the increase in the allocation to Absolute Return.

The underlying target return of this strategy is the return on long dated Gilts plus **2.6% p.a.** This level of performance over Gilts allows for the expected returns from the combination of asset classes net of fees, and makes a conservative allowance for active manager skill. It is consistent with the average long term return expectations underlying the modelling work supporting the strategy review.

The expected returns as used in the modelling work during the strategy review for individual asset classes were:

	Expected Rates of Return % p.a.
UK Equity (UK)	7.8%
Equity (Overseas)	7.5%
Fixed Interest Gilts	4.6%
Index-Linked Gilts	4.4%
Corporates	5.4%
Cash	4.8%
Commercial Property	5.7%
Alternative Assets	7.0%

Choosing Investments

The Pensions Committee have appointed investment managers who are authorised under the Financial Services and Markets Act 2000 to undertake investment business. The Pensions Committee have given the investment managers specific directions as to the asset allocation but investment choice has been delegated to these managers subject to their respective benchmarks and asset guidelines.

The fund has undergone some changes to its structure to align to the new benchmark allocation. Some of those changes have yet to be fully implemented but it is anticipated that this will be completed during 2011/12. The allocation of assets to each manager that the Committee aims to have in place at the end of the restructuring process is as follows:

Mandate (% of fund awarded)	Manager	Tactical Benchmark	Target
Property (10%)	UBS	IPD All balanced (property) Fund's median	To outperform the benchmark
UK Equities (Active 17%)	Standard Life	FTSE All Share	+2% net of fees
Global Equities (Active 17%)	Yet to be appointed	MSCI All Countries Index	+2.5% net of fees
UK /Global Equities (Passive 26%)	State Street Global Assets	Composite	To track the benchmark (gross of fees)
Investment grade bonds (20%)	Royal London Asset Management	Composite	+0.75% net of fees
Absolute Return (10%)	Ruffer	UK bank deposit rate	To outperform the benchmark (net of fees)

From time-to-time, particularly when implementing the changes to the strategic asset allocation, when markets are volatile or when dealing costs are high, the Committee may deviate from the long-term strategy on a temporary basis. The Committee recognises that, while it is impossible to predict short-term market movements, it should use its reasonable judgement in such circumstances. For example, this could be applied with the aim of avoiding excessive dealing costs or reducing the impact of adverse market movements by spreading changes over a number of dealing dates. In doing so, the Committee also recognises that the Fund is intended to meet the liabilities as they emerge over the longer term and hence the normal default position is to be fully invested broadly in line with the strategic benchmark.

Fees

UBS is remunerated by a fixed management fee and the expenses inherent in the management of the pooled property fund. All other fund managers are remunerated by an ad valorem scaled fee based on the market value at quarter end of the assets under management.

Investment Responsibilities

Responsibilities of the Pensions Committee

- Overall investment strategy and strategic asset allocation with regard to the suitability and diversification of investments;
- Monitoring compliance with this Statement of Investment Principles and reviewing its contents;
- Appointing investment managers, an independent custodian, the Fund actuary, external independent advisers and investment adviser;
- Reviewing investment manager performance against established benchmarks on a regular basis;
- Reviewing the investment managers' expertise and the quality and sustainability of their investment process, procedures, risk management, internal controls and key personnel;
- Reviewing policy on social environmental and ethical matters and on the exercise of rights, including voting rights;
- Reviewing the investments over which they retain control and to obtaining written advice about them regularly from the investment adviser. The Pensions Committee will also obtain written advice from the investment adviser when deciding whether or not to make any new investments or to transfer or redistribute assets within the mandates, whether due to market movements or other factors;
- Rebalancing the assets with reference to trigger points. When the Fund allocation deviates by 5% or more from the strategic allocation, the assets will be rebalanced back to within 2.5% of the strategic asset allocation. In exceptional circumstances, when markets are volatile or when dealing costs are unusually high, the Committee may decide to suspend rebalancing temporarily. The priority order for funding rebalancing is to first use surplus cash, followed by dividend and or interest income and lastly using sales of overweighted assets. The Pensions Committee will seek the written advice of the investment adviser with regard to rebalancing and detailed distribution of cash or sale proceeds.

The Pensions Committee is advised by The Council's Executive Officers, who are responsible for:

- Ensuring compliance with statutory requirements and the investment principles set out in this document and reporting any breaches to the Pensions Committee;

APPENDIX A

- Management of surplus cash, which is lent through the money markets in accordance with the Council's Treasury Management Code of Practice. Performance is measured against the 7-day London Interbank Bid (LIBID) rate;
- Investment accounting and preparing the annual report and accounts of the fund;
- Ensuring proper resources are available for the Council's responsibilities to be met.

The Investment Managers are responsible for:

- The investment of pension fund assets in compliance with the legislation and the detailed investment management agreements;
- Tactical asset allocation around the managers' strategic benchmark as set by the Pensions Committee;
- Stock selection within asset classes;
- Voting shares in accordance with agreed policy;
- Preparation of quarterly reporting including a review of past investment performance, transaction costs and future investment strategy in the short and long term;
- Attending meetings of the Pensions Committee and officers of the council as required.

The Independent Custodian is responsible for:

- Provision of monthly accounting data summarising details of all investment transactions during the period;
- Providing investment transaction details in a timely manner to the independent performance measurers;
- Safe custody and settlement of all investment transactions, collection of income, withholding tax reclaims and the administration of corporate actions;
- The separation of investment management from custody is paramount for the security of the assets of the Fund.

The Actuary is responsible for:

- Undertaking a triennial valuation of the Fund's assets and liabilities and interim valuations as required, including those to enable compliance with the reporting standard FRS17/IAS19;
- Advising on the rate of employer contributions required to maintain appropriate funding levels;
- Providing advice on the admission and withdrawal of employers to the scheme, including external employers following externalisation of services;
- Preparing the Funding Strategy Statement.

The Independent Measurers are responsible for:

- Providing the Pensions Committee and the Council's executive officers with comparative information on the Fund's performance relative to other funds and the relative performance of different types of investments.

The Investment Adviser is responsible for:

- Advising on the investment strategy of the fund and its implementation;
- Advising on the selection of investment managers, and the custodian;
- Providing investment information, investment advice¹ and continuing education to the Pensions Committee and the executive officers;
- Independent monitoring of the investment managers and their activities.

The Investment Adviser is remunerated by way of time cost fees and fixed fees within an agreed annual budget.

The Auditor

- The Fund is audited annually by the auditors appointed by the Audit Commission. The financial year end is 31st March.

The Historic Position of Fund

The Fund is unlikely to be fully funded for several years. This has arisen for a number of reasons including:

- The reduction in the funding level to 75% of liabilities as a result of government regulations prior to the introduction of the community charge;
- The cost of the redundancy programme in the mid 1990's.
(Note that since 1998 redundancies and early retirements are a charge on departmental cost centres and external employers rather than the Pension Fund).
- Overall investment returns since 1998 falling short of those anticipated in the funding strategy adopted from time to time.
- Longevity improving at a faster rate than anticipated.

At the last triennial valuation (at 31st March 2010) the funding ratio was 61%.

The Administering Authority is obliged to prepare a Funding Strategy Statement (FSS), which is published on the Council's web site at www.havering.go.uk (select Services, select 'Council and Democracy', select Pension Fund). This outlines the method by which the Fund aims to return to

¹ The Investment Adviser is authorised by and registered with the Financial Services Authority for the provision of investment advice.

an acceptable level of funding. This is expected to be achieved by a combination of increased contributions to the Fund, and achieving good long-term investment returns following the implementation of the new investment strategy in 2008.

Review

- The investment strategy is reviewed by the Pensions Committee, every three years following the actuarial valuation results and informally on an annual basis.
- The current review is based on the Actuarial Valuation 2007, a subsequent valuation in 2010 and an Asset/Liability study and ongoing advice on asset allocation from the Fund's Investment Adviser in 2008.

Reporting

The investment performance of the individual managers is reported to the Pensions Committee and Officers quarterly. Reports are received from the fund's performance measurers and investment advisers, along with executive summaries from each investment manager including details of any voting undertaken in that quarter.

Risk

The Fund is exposed to a number of risks which pose a threat to the Fund meeting its objectives. The principal risks affecting the Fund are:

Funding risks:

- Financial mismatch – 1. The risk that Fund assets fail to grow in line with the developing cost of meeting Fund liabilities. 2. 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 Committee measures and manages financial mismatch in two ways. As indicated above, it has set a strategic asset allocation benchmark for the Fund. It assesses risk relative to that benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. In 2008, following recommendations from the 2007 Actuarial Valuation and a full review of investment strategy commissioned from the Fund's investment adviser, the Pension Committee agreed to revise the investment strategy. The underlying allocation to growth assets following the review is: 75% in a mixture of equities, property and alternative assets with the remaining 25% in

lower volatility bonds. Although this is not in line with a liability-matched position, it is intended to grow the value of the assets at a managed level of risk with reduced long-term costs for the Council.

The Committee 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 Committee 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 under this heading.

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 immediate 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

The Committee manages asset risks as follows. It 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, constrains risk within the Committees' expected parameters. By investing across a range of assets, including quoted equities and bonds; the Committee has recognised the need for some access to liquidity in the short term. In appointing several investment managers, the Committee 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. When carrying out significant transitions, the Committee takes professional advice and considers 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 Committee 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.

Investments

The powers and duties of the Fund to invest monies are set out in the Local Government Pension Scheme (Management & Investment Funds)

APPENDIX A

Regulations 1998. The Fund is required to invest any monies which are not required to pay pensions and other benefits and in so doing take account of the need for suitable diversified portfolio investments and the advice of persons properly qualified (including officers) on investment matters.

Types of Investment

In broad terms investments may be made in accordance with the investment regulations in equities, fixed interest and other bonds and property and in the UK and overseas markets. The regulations specify other investment instruments may be used e.g. financial futures, traded options, insurance contracts, stock lending, sub-underwriting contracts, although historically it has not been the practice of the Fund to participate in these. Any limitations on the use of these instruments will be included within the Investment management Agreements (IMA's) or equivalent pooled fund rules.

The investment regulations also specify certain limitations on investments.

The Pensions Committee has set out control ranges and restrictions for the Fund's investments. These control ranges and restrictions have been considered when setting the benchmarks for each Manager.

Investment Management

The Investment Manager's are each bound by an investment management agreement (IMA) that takes account of:

- The benchmark set, and the allocation of assets within this benchmark;
- Cash needs;
- Risk tolerances;
- The policies on Corporate Governance and Socially Responsible Investment, given later in this document.

The Investment Manager must also select the appropriate types of investment as defined in the Regulations.

Investment Manager Controls

The Investment Managers are authorised and regulated by the Financial Services Authority (FSA), and must comply with the regulations contained within the Financial Services and Markets Act 2000 (FSMA 2000). Under these regulations, the manager must ensure that suitable internal operating procedures and risk frameworks are in place. FSMA is designed to provide a Fund such as this with an adequate level of protection, and the Investment Managers are obliged to meet their obligation imposed by this act.

The mandates set for the Investment Managers contain controls to ensure compliance with best practice and regulations. Controls on cash levels and transfers of cash and assets are also set within the IMA's or equivalent pooled fund rules.

Social Environmental and Ethical Considerations

'The Pensions Committee has considered socially responsible investment in the context of its legal and fiduciary duties, and the view has been taken that, while the non-financial factors should not drive the investment process to the detriment of the financial return of the Fund, it is appropriate for the Investment Manager to take such factors into account when considering particular investments.

Over the longer term, the Pensions Committee requires the Investment Manager(s) to consider, as part of the investment decisions, socially responsible investment issues and the potential impact on investment performance. Beyond this, the Investment Manager(s) has full discretion with the day to day decision making.'

Corporate Governance and Voting Policy

Corporate Governance Policy

'The policy of the Havering Pension Fund is to accept the principles laid down in the Combined Code as interpreted by the Institutional Shareholders Committee 'Statement of Principles'.

In making investment decisions the Council will, through its Pension Fund Investment Manager(s), have regard to the economic interests of the Pension Fund as paramount and as such

1. Will vote at all general meetings of UK companies in which the Fund is directly invested.
2. Will vote in favour of proposals that enhance shareholder value.
3. Will enter into timely discussions with management on issues which may damage shareholders' rights or economic interests and if necessary to vote against the proposal.
4. Will take a view on the appropriateness of the structure of the boards of companies in which the Fund invests.
5. Will take a view on the appropriateness of the remuneration scheme in place for the directors of the company in which the Fund invests

Beyond this, the Council will allow its Investment Manager(s) full freedom with the day to day decision making.

The Pensions Committee will, where appropriate,

6. Receive quarterly information from the Investment Manager, detailing the voting history of the Investment Manager on contentious issues.
7. Consider a sample of all votes cast to ensure they are in accordance with the policy and determine any Corporate Governance issues arising.
8. Receive quarterly information from the Investment Manager, detailing new investments made.'

Stock Lending

The Committee has considered its approach to stock lending, taking advice from its investment adviser. After consideration of that advice, the Committee has decided only to permit stock lending by the Fund's passive equity manager, State Street.

State Street has agreed to indemnify the Fund against any loss arising from insufficient collateral being posted as part of its stock lending programme.

The Committee will review its policy on stocklending from time to time.

Consultation and Publication

The Council has reviewed the Statement of Investment Principles in association with the Funds Investment Adviser and has also consulted with the employers of the fund, employee representatives and all fund managers through written correspondence.

A copy of this document together with the Myner's Statement of Compliance has been published on the Council's website www.havering.gov.uk (select Services, select, Council and Democracy, select Pension fund).

The Statement of Investment Principles will be reviewed at least annually and a revised version issued as soon as any significant change occurs. Any comments and suggestions will be considered. Please contact the Pension Fund Accountant with your views at info@havering.gov.uk .

MYNERS Principles for Investment Decision Making

The Pensions Committee will regularly review the Scheme's compliance with this Statement of Investment Principles.

The Action the Council has taken to meet the recommendations made in the Myner's report has been updated to June 2010 and is available as an appendix to this statement.