



Statement of investment principles

ENDORSED BY PENSION FUND PANEL: 16 JUNE 2010

1. INTRODUCTION

- 1.1 The London Borough of Hounslow (LBH) operates the Local Government Pension Scheme which was established in accordance with statute to provide death and retirement benefits to all eligible employees of the Council and its admitted bodies.
- 1.2 The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999 require administering authorities to prepare and review from time to time a written statement recording the investment policy of their Pension Fund. The purpose of this document is to satisfy the requirements of these Regulations, and to explain to Fund members, employees and other interested parties how the Fund is managed, and the factors taken into account in doing so.
- 1.3 The Council have delegated the investment management of the scheme to its Pension Fund Panel. The ultimate responsibility for the investment strategy lies with them.
- 1.4 The Pension Fund Panel (PFP) have appointed professional fund managers Blackrock, and Aberdeen Asset Managers to manage the Pension Fund's investment. The managers' activities are constrained by their detailed Investment Management Agreements, which incorporate the statutory restrictions.
- 1.5 The Pension Fund Panel have appointed an independent advisor to advise on investment strategy, oversee the activities of the investment managers, and be generally available for consultation on fund investment matters.
- 1.6 Barnett Waddingham have been appointed as actuaries to the Fund.
- 1.7 Northern Trust has been appointed as the custodian to the Fund.
- 1.8 This document outlines the broad investment principles governing the investment policy of the LBH Pension Fund, and comments on the compliance with the '10 Investment Principles' identified in the Myners Review of Institutional Investment in the UK.

2. AIMS AND OBJECTIVES OF THE FUND

- 2.1 The aim of the Fund is to provide a pool of assets sufficient to meet the long-term pensions and benefits liabilities (as prescribed by the Local Government Pension Scheme Regulations) for the members of the Fund.
- 2.2 The current investment objective is defined as a return of 1% per annum (Aberdeen Asset Managers) and a return of 1.25% per annum (Blackrock) above the WM Local Authority Universe Average (ex property) over rolling three-year periods. The investment strategy proposed by the Fund Managers is reviewed at regular meetings of the Pension Fund Panel (each Manager attends every other meeting of the PFP). WM attend the autumn meeting of the Pension Fund Panel to overview each Fund Manager's annual performance.
- 2.3 The LBH Pension Fund is a long term Fund, and the investment strategy must reflect this. Ultimate responsibility is to present and future pensioners. Responsibility to Council Taxpayers is secondary, and the Fund should never fall below unmanageable funding levels.

3. INVESTMENT RESPONSIBILITIES

- 3.1 LBH is the Administering Authority and is responsible for managing the Fund in accordance with the Regulations. The Statement of Corporate Governance gives details of the membership and operation of the Pension Fund Panel. Trustees include Councillors, an employer's representative, and a staff representative. The Panel meets at least quarterly.
- 3.2 The Terms of Reference of the Pension Fund Panel are: -
 1. To consider on the advice of the Director of Finance and Council's Fund managers, the Council's general policy with regard to Pension Fund Investments;
 2. To make arrangements for the management of the Fund in line with the Statement of Investment Principles;
 3. To monitor the performance of the Fund and its Managers; and
 4. To exercise the Council's voting rights at AGM's and EGM's of companies in which the Fund has holdings, after considering the advice of the Director of Finance and appropriate Manager (s).
- 3.3 The Fund Managers are responsible for:-

- a) attending meetings with the Pension Fund Panel and with officers, as requested;
- b) the investment of the Pension Fund assets in compliance with prevailing legislation, the constraints imposed by this document and their detailed Investment Management Agreements;
- c) security selection within asset classes; and
- d) active management of their cash balances.

3.4 The Custodian is responsible for:-

- a) its own compliance with prevailing legislation;
- b) providing the administering authority with monthly valuations of the Scheme's assets and details of all transactions during the month; and
- c) collection of income and tax reclaims.

3.5 The Independent Advisor is responsible for:-

- a) provision of expert advice, for example on tendering procedures for professional services, on the Statement of Investment principles and on other compliance issues;
- b) provision of expert advice on Pension Fund performance i.e. investment selection, and research into specific issues;
- c) attendance at each meeting of the Pension Fund Panel; and
- d) liaison with Trustees and officers of the LBH Pension Fund.

3.6 The Actuary is responsible for:-

- a) undertaking a triennial valuation of the Fund; and
- b) providing advice as to the maturity of the Scheme and its funding level, in order to aid the Pension Fund Panel in balancing the short term and long term objectives of the Pension Fund.

3.7 The Director of Finance is responsible for:-

- a) acting as professional advisor to the Fund;
- b) the appointment of any professional external consultants, as required, and subject to the approval of the Pension Fund Panel;

c) alerting the Pension Fund Panel and the Executive of any problems in the funding level or administration of the Fund (in his capacity as the Council's Section 151 Officer); and

d) ensuring compliance with this document and bringing breaches thereof to the attention of the Pension Fund Panel.

4. DESCRIPTION OF THE FUND'S LIABILITIES

4.1 The LBH Pension Fund is a defined benefit scheme which provides benefits related to a final salary for members. Each member's pension is specified in terms of a formula based on salary and service and is unaffected by the investment return achieved on the Scheme's assets. Full details of Scheme benefits are set out in the LGPS regulations.

4.2 Active members make pension contributions based on a percentage of their pensionable pay (5.5% to 7.5% depending on salary). The Council is responsible for meeting the balance of costs necessary to finance the benefits payable from the Scheme. Employers' contribution rates are determined triennially, based on the advice of the Scheme's actuary. The Council therefore has a financial responsibility for the investment return achieved on the Scheme's assets.

4.3 The most recent actuarial valuation was based on 2007 values. At 31 March 2007 the Fund had a deficit of £85m, and was funded to 84%. To restore the funding level to 100% within the recovery period of 15 years the total employer contribution rate for the period 1 April 2008 to 31 March 2011 has been set at 20.8%. The next valuation date is 31 March 2010.

5. INVESTMENT POLICY

5.1 The investment objectives are to maximise returns over the long term within acceptable risk tolerances. Investment returns are defined as the overall rates of return (capital growth and income combined). The LBH Fund is split between two fund managers, property is currently managed internally, and private equity is currently managed internally. The limits for the latter two are below:-

Category	Limit of fund
property	8% target 10% max limit
private equity (incl commitments)	5% max limit

5.2 The Pension Fund Panel have appointed two professional fund managers Blackrock, and Aberdeen Asset Managers to manage the

Pension Fund's other investments. The managers' activities are constrained by their detailed Investment Management Agreements, which incorporate the statutory restrictions. Their performance benchmarks are referred to above in para 2.2. LBH has adopted an active balanced approach with its Fund Managers in order to give diversification and spread of risk. Hence both Fund Managers have discretion to determine tactical asset allocation and individual stock selection within specified control ranges (see below). The investment strategy proposed by the Fund Managers is reviewed at regular meetings of the Pension Fund Panel (each Manager attends every other meeting of the PFP). WM attend the autumn meeting of the Pension Fund Panel to overview each Fund Manager's annual performance.

5.3 The Fund Managers are required to determine a suitable asset mix (equities, fixed interest and cash) to meet their performance benchmark. The limits on individual investments are those specified in Schedule 1 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2003. Acceptable asset classes are:-

- * UK equities
- * UK fixed interest (gilts and corporate bonds)
- * UK index linked gilts
- * Overseas equities, major classes being

North America
Europe
Japan
Pacific Rim
Emerging markets
- * Global fixed interest
- * Unquoted securities via pooled funds
- * Cash

5.4 Investment Constraints

5.4.1 The Pension Fund Panel had a detailed discussion on stock lending at its meeting 15 April 2009. The Panel agreed not to pursue stock lending.

5.4.2 Underwriting is permitted provided that the underlying stock is suitable on investment grounds and complies with existing investment criteria

5.4.3 Use of direct derivatives (including options, futures and contracts for differences) is not allowed.

5.4.4 Any instrument not explicitly permitted under para 5.3 may only be purchased for the Fund with the express written consent of the Chairman of the Pension Fund Panel and the Director of Finance.

5.4.5 Limitations on the discretion of the investment managers are in the following table. These must be in accordance with the current requirements of the LGPS Regulations. Current maximum limits are as

follows. It is proposed in the interests of flexibility and diversity that these limits are adopted. References to percentages are to percentages of the total value of all existing investments of the Fund before making the investment which is subject to the limit. Such limits only apply at the time the investment is made.

	Max permitted under Regs
1. Any single sub-underwriting contract	5%
2. Contributions to any single partnership	5%
3. All contributions to partnerships	15%
4. All deposits with any local authority, or similar	10%
5. All investments in unlisted securities of companies.	15%
6. Any single holding in unlisted securities	10%
7. All deposits with any single bank, institution or person (other than NSB)	10%
8. All sub-underwriting contracts	15%
9. All investments in units subject to the trusts of unit trust schemes and all investments in open-ended investment companies, where the unit trust schemes and the collective investment schemes constituted by those companies are managed by any one body	35%
10. Any single insurance contract	35%

6. SOCIAL, ENVIRONMENTAL AND ETHICAL CONSIDERATIONS

- 6.1 The authority's primary responsibility is to secure the best returns for the Fund in the interest of its taxpayers. The Pension Fund Panel has considered Socially Responsible Investment in the context of the investment strategy and acknowledges the difficulties in defining 'ethical' investment. The Panel adopts a critical engagement policy as detailed in the paragraphs below. By adopting corporate governance principles the Fund encourages corporate social responsibility.
- 6.2 The authority does not impose either negative or positive restrictions on Fund Managers' choice of investments. However, we expect the Fund Managers to encourage best corporate practice in companies' management of their social, environmental and ethical activities. They seek to encourage this by engaging in positive dialogue with companies

to encourage them to pursue such activities provided that it would not have any detrimental impact on the investment return or risk of the portfolio. In addition both fund managers have signed up to the United Nations Principles for Responsible Investment.

- 6.3 The LBH Pension Fund is a member of the Local Authority Pension Fund Forum. This currently comprises 48 local authority pension funds. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders in promoting corporate social responsibility and high standards of corporate governance amongst the companies in which they invest.
- 6.4 The LBH Pension Fund is also a member of the Institutional Investors Group on Climate Change (IIGCC). The IIGCC seeks to promote a better understanding of the implications of climate change amongst its members and other institutional investors, and to encourage companies and markets in which its members invest to address any material risk and opportunities to their businesses associated with climate change and a shift to a lower carbon economy.

7. EXERCISE OF RIGHTS (INCLUDING VOTING RIGHTS) ATTACHING TO INVESTMENTS

- 7.1 The LBH Pension Fund exercises its voting rights at the Annual/Extraordinary General Meetings of all UK companies within the FTSE 350, European companies within the Eurotop 300, and US companies in the S & P 500, in which the Fund has shareholdings. The voting policy is based on best practice, as agreed in previous meetings of the PFP. Such practice encompasses the Combined Code of Best Practice arising from Cadbury, Greenbury, Hampel, Higgs and Smith Committees relating to corporate governance and corporate responsibility. The voting system is operated by templates monitored by Manifest. For controversial issues the views of the PFP will be sought.
- 7.2 With regard to other rights such as the taking up of rights issues this is left for investment managers to decide in the light of their assessment of market conditions at the time.

8. REALISATION OF INVESTMENTS

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

9. RISK

Pension Funds operate in an environment of risk. It is not efficient to eliminate all risk. The aim is to have reasonable risk management strategies in place. Risk can be categorised, and where possible meaningful measures have been put in place to manage risk.

Investment risk - diversification of assets

- 9.1 The Council has appointed two Fund Managers, with balanced mandates, to secure diversification of investment strategies and investments across UK equities, overseas equities and fixed interest investments. The Fund also invests directly in property, and in private equity type investments, which adds to the diversity. Any instrument not explicitly permitted under para 5.3 may only be purchased for the Fund with the express written consent of the Chairman of the Pension Fund Panel and the Director of Finance.
- 9.2 The LGPS Regulations contain restrictions on the proportions of the Fund which can be invested in certain types of assets - see para 5.4.5 above.

Performance risk and its management

- 9.3 Asset allocation benchmarks are used. Performance is currently monitored relative to the WM Local Authority Universe. This ensures that Fund Managers do not deviate significantly from the Panel's intended approach, whilst permitting flexibility to manage their portfolios and enhance returns over the longer term.

Funding and asset/liability mismatch risk

- 9.4 The actuarial valuation measures the overall funding levels of the Fund. As para 4.3 above demonstrates at the last valuation date employer contributions were set to eliminate the deficit within 15 years. A new actuarial valuation is being carried out at March 2010. This will be reported to the autumn 2010 Pension Fund Panel. An asset liability review will then be undertaken to address future funding targets.

10. COMPLIANCE WITH MYNERS PRINCIPLES - NEW - FOR APPROVAL

Under Regulation 12(3) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 the Council is required to state the extent to which it complies with the six principles of investment practice identified by Myners. Local authorities are to refer to guidance issued by the Chartered Institute of Public Finance and Accountancy in making their disclosures. The principles, together with the Council's position on compliance (in italics) are set out below.

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.

Compliant

PFP has clear Terms of Reference. Hounslow's Statement of Investment Principles and Statement of Corporate Governance detail decision-making processes. All PFP Members are expected to undertake a formal training programme run by Local Government Employers. The Fund has appointed an independent external adviser who also is identifying training opportunities.

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 employees, and these should be clearly communicated to advisers and investment managers.

Compliant

The Fund's triennial actuarial valuation sets out the overall funding objective for the Fund. The 2007 objective was to achieve 100% funding by 2023. The 2010 actuarial valuation will be evaluated in autumn 2010 and a full review of strategic asset allocation will then be undertaken. It is also intended that an asset/liability review will be commissioned to give

further information on the credibility of reaching funding targets. The Funding Strategy Statement will be revised when this work has been completed.

Risk is covered in section 9 of the Statement of Investment Principles. Officers hold quarterly meetings with the fund managers and the adviser at which fund objectives are discussed, and performance monitored. The outcomes of these meetings are reported to each meeting of the PFP.

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 taxpayers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

Compliant

Section 9 of the Statement of Investment Principles covers the Fund's approach to risk. The triennial actuarial valuation assesses the liabilities of the fund against the context of investment values. The employers' contributions are calculated to ensure that the Fund will meet its liabilities after an agreed period. For the 2007 actuarial valuation the objective was to break even after 15 years, from 2008 i.e. to achieve 100% funding by 2023. This target will be reviewed when the results of the 2010 valuation are available.

The Fund is regularly audited by its internal auditors, and such reports discussed at the Audit Committee. External auditors report on the final accounts, to the Audit Committee, the Pension Fund Panel, and Borough Council. Both internal and external audits ensure effective internal controls are in place.

When participating employers join the Fund a risk assessment is undertaken of the risk of default. Where relevant such employers are expected to take out bonds to protect the pension fund in the event of their default.

The Pension Fund's Risk Register is attached at Appendix 1.

4. Performance Assessment

Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.

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.

Compliant

Active management is adopted with appropriate risk controls as reflected in a well-diversified portfolio of investments. The current investment objective is defined as a return of 1% per annum (Aberdeen Asset Managers) and a return of 1.25% per annum (Blackrock) above the WM Local Authority Universe Average (ex property) over rolling three-year periods. Performance is monitored quarterly and reported to the PFP. The benchmark will be revised as part of the strategic asset allocation review following on from the 2010 actuarial valuation.

The investment performance of the fund and its managers is measured by the independent WM Company. The latter does an annual presentation to the PFP each autumn. Individual managers are measured separately against the local authority peer group.

The investment adviser has produced a detailed work programme, which is monitored to ensure achievement. The investment adviser's role is particularly to monitor and to challenge the fund managers, and her independence from the council is valued.

The administering authority produces an Annual Report, which includes performance. It also holds an Annual General Meeting to which all scheme members (actives/deferreds/pensioners) are invited, to review performance and ensure accountability to members. Further work is under consideration for the PFP to be able to assess its effectiveness as a decision making body.

5. Responsible Ownership

Administering authorities should:

- * adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee (ISC) 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.

Compliant

Both Aberdeen and BlackRock have confirmed that they have adopted the existing Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents. Section 6 of the Statement of Investment Principles details the Fund's approach to social, environmental and ethical considerations.

Section 7 of the Statement of Investment Principles explains how the Fund exercises voting rights at the Annual/Extraordinary General Meetings of all UK companies within the FTSE 350, European companies within the Eurotop 300, and US companies in the S & P 500, in which the Fund has shareholdings.

Manifest produces an independent annual report to the PFP on how the Fund has exercised its voting rights over the previous year. This report is on the open part of the Agenda and is available to fund members and the public.

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.

Compliant

The Fund has a Communications Policy Statement which is available on the website. This details the scheme booklets, annual benefit statements, and consultative documents that are produced both for scheme members and employing bodies. The Fund has a dedicated website, run by itself. The Fund produces an Annual Report, which is available in both hard copy and on the website.

An Annual General Meeting is also held to which all scheme members (actives/deferreds/pensioners) are invited, to review performance and ensure accountability to members.

The Fund publishes its Statement of Investment Principles, its Governance Compliance Statement, and its Funding Strategy Statement on its website.

All Part 1 Agenda reports are available to scheme members and the public on the authority's website.