

Statement of Investment Principles

Introduction

The Statement of Investment Principles sets out the arrangements which the Lancashire County Pension Fund has in place to manage its investments and the controls within those arrangements.

This statement of Investment Principles, (SIP) complies with the LGPS regulations 1998 and subsequent amendments, (SI 2002/1852 and SI 2009/3093).

The SIP has been produced following consultation with the Fund's Investment Panel, and a representative of the Fund's Actuary. The Statement is reviewed each year in the light of any new policy developments.

Responsibility for Investment Management

Lancashire County Council is responsible for administering the Fund under the Pension Scheme regulations 1997 (as amended). It delegates responsibilities to:

- The Pension Fund Committee and its Sub-Committee,
- The Fund's Investment Panel;
- The Fund's Investment Managers.
- The Fund's Custodian
- The Treasurer to the Fund.

The division of responsibility is outlined in detail in the Governance Policy Statement. The full terms of reference and delegated authority are set out in the Constitution of Lancashire County Council. Please see the link below for further information:

[Constitution](#)

In summary, the responsibilities are set out below:

Pension Fund Committee

The Pension Fund Committee has overall responsibility for investment policy and for monitoring overall performance. The Committee meets four times a year, and currently comprises 14 elected County Councillors, 4 representatives of the District Councils and Unitary Authorities within the Fund, 2 Trade Union representatives and a representative of the Higher and Further Education Sectors in Lancashire.

Investment Panel

The Investment Panel consists of two independent advisors, the Treasurer to the fund (as Chair), the officer of the County Council fulfilling the role of Chief Investment Officer for the Fund and an officer of the County Council identified by the Treasurer to the Fund to oversee investment activities.

The Panel will meet at least quarterly, or otherwise as necessary. The Panel may operate through sub groups to undertake particular tasks, but will formulate recommendations to the Treasurer to the Fund and or the Pensions Fund Committee through meetings of the full Panel.

The Panel is required to provide advice to the Treasurer of the Fund regarding:

- a. Recommendations to the Pension Fund Committee in relation to the Investment Strategy for the Fund;
- b. The performance management of Investment Managers;
- c. The broad composition of the Fund's investment portfolio, management style and types of investment;
- d. The proposed procurement process, tender award criteria and evaluation methodology for external advisers and other external assistance including investment managers, property agents and advisors, corporate governance adviser, Fund Custodian, performance measurement advisers, the Fund Actuary and the Fund's AVC Provider ("external support") to enable the Treasurer to the Fund to seek the approval of the Pension Fund Committee to commence the procurement of any required external support.
- e. The selection and appointment of any required external support (subject to the role of the Pension Fund Committee), their terms of office and remit;
- f. The allocation of ranges and thresholds within which the Investment Managers should operate;
- g. Review of the Statement of Investment Principles and compliance with investment arrangements;
- h. Recommendations on the detailed management of the investment portfolios and to respond to requests from investment managers to vary certain aspects of their mandates;
- i. The performance management of any internally managed investments; and
- j. The securing of specialist advice within allocated budgets.

Investment Managers

The management of the Fund's investments is structured so as to provide diversification of management style and produce an acceptable spread of risk across the portfolio whilst maximising returns.

The Fund's current investment managers are:

- Legal and General Investment Management who are responsible for an index tracking portfolio (passive portfolio) across all asset classes apart from property, private equity and hedge funds.

The Fund's specialist managers are:

- Newton Investment Management - Global Equities
- J P Morgan Asset Management - UK Equities
- UBS Global Asset Management - Bonds

- Knight Frank- Direct Property
- Capital Dynamics - Private Equity
- Gottex Fund Management – Hedge Fund of Funds

The Fund Managers have full discretion to invest within the policy limits laid down by the Pension Fund Committee and the Investment Panel, subject to restrictions set out later in this document.

Investment Objective

The Fund has two objectives in terms of its investment activities:

- a) To ensure that resources are available to meet the Pension Fund's liabilities through achieving investment performance at least in line with actuarial assumption.
- b) To achieve full funding (i.e. no funding deficit) over a period no longer than the current recovery period.

The current funding target assumptions include an assumed investment return (discount rate) of a yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") of 2.5% p.a. for the period pre-retirement and 1.0% p.a. post-retirement.

The asset out-performance assumption represents the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date.

The allowance for this out-performance is based on the liability profile of the Scheme, with a higher assumption in respect of the "pre-retirement" (i.e. active and deferred Pensioner) liabilities than for the "post-retirement" (i.e. pensioner) liabilities. This approach thereby allows for a gradual shift in the overall equity/bond weighting of the fund as the liability profile of the membership matures over time.

Types of Investment

The Investment Panel ("the Panel") will provide expert professional advice to the Pension Fund Committee in relation to investment activities, including the following categories of investment:

- a. Fixed interest securities managed by Investment Managers;
- b. UK equities managed by the Investment Managers;
- c. Overseas equities and bonds managed by Investment managers;
- d. Local investment in the acquisition and development of property in accordance with the investment strategy approved by the Pension Fund Committee;

- e. UK and overseas unquoted investments via venture capital funds and other local arrangements;
- f. Acquisition of land and premises and the development of such land and improvements, refurbishment and modernisation of such premises;
- g. Indirect pooled property investments;
- h. Designated index linked funds;
- i. Investments managed internally and not by Investment Managers; and
- j. Any other monies to be invested other than in the above categories.

Provided that in all cases the investment activity is consistent with the investment strategy approved by the Pension Fund Committee.

Underwriting is permitted provided that the investment complies with the existing investment policy.

Balance between Different Types of Investment

The managers, with the exception of the Property Manager have full discretion to invest within each investment category for which they are responsible, subject to statutory limits and any asset allocation ranges, around the benchmark, agreed between the Investment Panel and the managers. The Property Manager's mandate is advisory with final decisions being taken by the Treasurer to the Fund based upon that advice.

The Fund Specific Structure/Benchmark of the Fund was reviewed in 2010 and the Pension Fund committee agreed a new investment Strategy in December 2010. Implementation of this revised strategy began in 2010/11 and will continue through 2011/12. The Committee agreed a range based benchmark for asset classes allowing flexible asset allocation. The agreed ranges are:

Asset Class	Range %
Global Equities – Active and Passive, Physical and Index. Private and Publicly Quoted	40-60
Diversified Property –UK and Overseas. Direct and indirect.	10-20
Lower Volatility Strategies - (including but not exclusively, Fixed Income, PFI, Credit strategies, Infrastructure, Currency, Commodities, Absolute Return, Cash, funds and index, Local development/PPP type allocations)	20-40

The following interim benchmark is in place until the investment strategy is fully implemented and is subject to change following further consideration by the Investment Panel on allocations to future mandates.

Structure of the Fund (Benchmark %) - Interim Benchmark

Asset Class	Total	Benchmark Index
Equities	60	FTSE All World
Private Equity	7	BVCA Median
Property	10	IPD
Hedge Fund of Funds	3	Interbank Bid 7 Day Notice Rate
Bonds	18	FTSE A All Stocks Gilts
Cash	2	7 Day Notice Rate
Total	100	

Stock Lending

Stock lending is undertaken up to the 35% limit as permitted under the Local Government Pension Scheme Management and Investment of Funds (Amendment) Regulations 2009. The programme is monitored for performance, limit and counterparty credit adherence, and voting requirements, via the Fund custodian and the Stock Lending manager's online reporting packages.

Investment Limits imposed under the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2003

The limits shown in Column 1 are those laid down under the 1998 Regulations. The limits in Column 2 are those allowed under the 2003 Regulations and may be used by Local Authority Pension Funds if, following proper advice, they have sought approval by their Pension Fund Committees for the increases and the reasons for adopting the increases are detailed in the Statement of Investment Principles.

The Lancashire County Pension Fund's Investment Panel and Pension Fund Committee has reviewed the 1998 Regulations limits and have adopted the increased limits for any single insurance contract and also for all contributions to partnerships.

	Column (1) Limits under regulation 14 (2)	Column (2) Limits under regulation 14 (3)
1. Any single sub-underwriting contract.	1%	5%
2. All contributions to any single partnership.	2%	5%
3. All contributions to partnerships.	5%	15%
4. with the sum of - (a) all loans (but see paragraph 1); and (b) and deposits with - (i) any local authority, or (ii) any body with power to issue a precept of requisition to a local authority, or to the expenses of which a local authority can be required to contribute, which is an exempt person (within the meaning of the Financial Services and Markets Act 2000(a)) in respect of accepting deposits as a result of an order made under section 38(1) of that Act, and all loans (but see paragraph 12).	10%	-
5. All investments in unlisted securities of companies.	10%	15%
6. Any single holding (but see paragraphs 2 and 3).	10%	-
7. All deposits with any single bank, institution or person (other than the National Savings Bank).	10%	-
8. All sub-underwriting contracts.	15%	-
9. All investments in units or other shares of the investments subject to the trusts of unit trust schemes managed by any one body (but see paragraph 3).	25%	35%
9a. All investments in open-ended investment companies where the collective investment schemes constituted by the companies are managed by any one body.	25%	35%
9b. All investments in units or other shares of the investments 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 (but see paragraph 14).	25%	35%
10. Any single insurance contract.	25%	35%
11. All securities transferred (or agreed to be transferred) by the authority under stock lending arrangements.	25%	35% *

* The Local Government Pension Scheme Management and Investment of Fund's (Amended) Regulations 2005 allow administering authorities to

increase the limit on their investments in securities transferred by the authority under stock lending arrangements from 25% to 35% of the total of their Pension Fund investments.

Investment Performance Targets and Benchmarks

- The UK and Global Equity specialist managers are expected to outperform the Fund Specific Benchmark performance return by 1.5% (net of fees) on a rolling three year basis.
- The Bonds specialist manager is expected to outperform the Fund Specific Benchmark performance return by 0.75% (net of fees) on a rolling three year basis.
- The Private Equity Manager is expected to outperform the median return in the British Venture Capital Association (BVCA) survey of Private Equity returns by 3%.
- The Index Tracking Manager is expected to achieve the index return for each asset class under its management.
- The property manager is expected to outperform the IPD Small Funds Benchmark (£10m to £300m) return by 1% on a rolling three year basis.
- The Hedge Fund of Funds manager is expected to outperform the London Interbank Bid 7 day notice rate by 6% per annum (net of fees) over a rolling three year period.
- The WM survey of Local Authority Pension Fund returns is also used by the Fund for comparative information purposes. In the WM analysis, private equity returns are compared to the FTSE all share returns as BVCA data is not available on a regular quarterly basis.

Policy on Risk

The overriding objective of the Lancashire County Pension Fund in respect of its investments is to minimise risk and maximise return while reducing volatility. The structure of the investment management arrangements has been implemented in order to produce a balanced spread of risk for the portfolio.

Within this the managers, in particular, are regularly questioned by the Investment Panel about the risk profile of their Lancashire portfolios.

Policy on Realisation of Investments

The Fund Managers are responsible for the realisation of investments and reinvestment of the proceeds. The proceeds from the realisation of investments are invested by the Fund Managers as cash deposits, until required for reinvestment in equities or fixed interest stocks. However, as the custody arrangements for the property portfolio and private equity portfolio are

administered by Lancashire County Council, the realisation of investments for these asset classes are invested as cash deposits by the County Council until required for reinvestment in new properties or Private Equity Funds. As the Fund is cash flow positive, there is no need to realise investments in order to pay for benefits.

Monitoring and Review

The investment activities of the Fund's Investment Managers are reviewed at each Panel meeting and reported to the Pension Fund Committee. At these meetings, asset allocation and investment performance of the Investment Managers is reviewed.

The Fund's Actuary carries out a triennial review of the Fund and sets the employers' contribution rates for each three year period. Details of investment strategy and activity are an important element of the actuarial review.

The Annual Report is produced by the Treasurer for all employing bodies within the Fund, and this report, together with various information bulletins produced in respect of the Pension Scheme, provides details of Investment Policy and performance relating to the Investment Managers. Extracts from the Report are circulated to all members with the Fund's newsletter and are posted on the Fund's web site (www.yourpensionservice.org.uk).

Social, Environmental and Ethical Considerations

In general, the Fund takes an active stance on corporate governance issues. It is a client of Pensions Investment Research Consultants (PIRC), who advises the Fund on Socially Responsible Investment issues. It is also a member of the Local Authority Pension Fund Forum, which is a group of local authorities that meet to discuss and act / engage in respect of Socially Responsible Investment and Corporate Governance issues.

Policy on Voting

- The Pensions Investment Research Consultants (PIRC) shareholder principles and voting guidelines are used as general guidance for the exercise of the Fund's voting rights. (The Fund currently subscribes to the PIRC FTSE All Share, The European and US Voting Service.)
- The Fund's Investment Managers exercise the Fund's voting rights on the Committee's behalf, having regard to the PIRC guidelines, but also taking account of the particular circumstances of individual companies.
- The Committee delegates its agreement of any significant departure from the guidelines, proposed by the managers, to the Treasurer as Chairman of the Investment Advisory Panel.
- In all voting decisions the long-term financial interests of the Lancashire County Pension Fund are paramount.

Custody of the Fund

- The Fund's Global Custodian is BNY Mellon Asset Servicing. This service will transfer to Northern Trust by August 2011.
- The Custody for the Private Equity portfolio and the Property portfolio is currently administered by Lancashire County Council.
- The Fund's Index Tracking Manager (Legal and General Investment Management) invest Fund's with Legal and General Assurance (Pensions Management) Ltd in a unitised policy of assurance (Pooled Funds).
- The Custody of the Hedge Fund of Funds portfolio is administered by Citco Fund Services (Europe) BV.
- Details of Custody fees are held within the Treasurer's office and are generally based on the volume of transactions.
- The title deeds in respect of the Fund's property holdings are held by Lancashire County Council and its property solicitors.

Fee Structure

Details of fees paid to individual Fund managers are subject to confidentiality agreements and are generally linked to the value of Fund's under management. As part of the Fund's desire to ensure Fund Management agreements reflect transparency in respect of fee structures, the Fund managers have either removed or are in the process of phasing out soft commission arrangements.

Role of Lancashire County Council staff in respect of the accounts and investments of the Pension Fund

Under the Lancashire County Council Scheme of delegation to Chief Officers, the Treasurer to the Fund is responsible for carrying out, in consultation with the Investment Panel, the County Council's duties under the Local Government Pension Scheme (Management and Investment of Fund's) Regulations 1998, (as amended) with regard to the requirement to review the investments made by the Fund Managers. She reports at each meeting of the Pension Fund Committee.

The Treasury and Investment Team within the County Treasurer's Department supports the Treasurer in respect of her Pension Fund investment and accounting responsibilities and provide the following services:

- Production of the Pension Fund Annual Report;
- Preparation and maintenance of the accounts and balance sheet of the Pension Fund;

- Verification and monitoring of the investment data produced by the Fund managers to independent custodian records;
- Production of Pension Fund Business Plan;
- Completion of various statistical questionnaires;
- Preparation of agenda, working papers and reports for the Investment Panel meetings, Pension Fund Committee meetings and other miscellaneous investment meetings;
- Maintenance of Pension Fund internal cash account and investment of Pension Fund Cash not held by the investment managers;
- Provision of accounting data for IAS19 calculations;
- Monitoring compliance with policy laid down by the Investment Panel and Pension Fund Committee;
- Maintenance of regular dialogue with investment managers and custodians;
- The provision of data for performance monitoring and interpretation of performance results;
- The conducting of procurement exercises to secure the services of Investment Managers and other service providers on behalf of the Fund;
- The identifying of and conducting of due diligence on individual investment opportunities for consideration by the Investment Panel;
- Monitoring voting action by the managers;
- Advice to the Treasurer on Pension Fund Investment issues;
- Verification, monitoring and payment of Pension Fund fee invoices;
- Monitoring the receipt of income due to the Fund;
- Representing the Treasurer at the Local Authority Pension Fund Forum meetings and other relevant Pension Fund Investment meetings;
- Interpretation and implementation of the requirements of new legislation relating to Pension Fund accounting and investments;
- Attendance at various seminars covering new developments in respect of Pension Fund Investment issues; and
- Research initiatives.

Myners Principles of Investment Practice

The Myners Review of Institutional Investment in the UK

The Local Government Pension Scheme (Management and Investment of Fund's) Amendment Regulations 2002 came into force on 9 August 2002. It requires administering authorities to publish, in their Statement of Investment Principles, the extent to which the authority complies with the 10 Principles of Investment Practice and to give reasons for any non-compliance. The 10 principles were replaced by six new principles in 2009; a summary of compliance with these principles is outlined below:

Principle 1: Effective Decision Making

Fully compliant: The decision making process is fully outlined in the Governance Policy Statement, Governance Compliance Statement and Statement of Investment Principles. A Pension Fund Business Plan is approved by the Pension Fund Committee on an annual basis.

Principle 2: Clear Objectives

Fully compliant: The overall objective for the Fund is outlined in the Statement of Investment Principles. A Fund Specific Benchmark was introduced from 1 July 2002.

Principle 3: Risk and liabilities

Fully compliant: The Investment Panel and Pension Fund Committee have considered the appropriate assets for the Fund, following Asset/Liability studies. The Fund has considered all major asset classes and has made commitments to Private Equity, Property and Hedge Fund of Funds. The new Investment Strategy identifies scope for allocation to further alternative asset classes.

Principle 4: Performance assessment

Fully compliant: Performance of the managers is assessed on a quarterly basis, with a detailed formal review of annual and long-term performance undertaken annually and reported to the Pension Fund Committee. Performance is measured by the WM Company, and Investment Property Databank. Regular monitoring of the performance of the Committee and the advisors commenced during 2007/08. Two new independent advisers were appointed in May 2009.

Principle 5: Responsible ownership

Partially compliant: The Fund votes all its shares, utilising the PIRC Voting Guidelines, and is a member of the Local Authority Pension Fund Forum, which is primarily concerned with Corporate Governance issues and shareholder activism. Voting action is monitored on a quarterly basis. Although the Fund does not specifically incorporate the principle of the US Department of Labor Interpretative Bulletin on activism, required for full compliance, the Fund's Corporate Governance and Activism policies achieve similar aims.

Principle 6: Transparency and reporting

Fully compliant: The Statement of Investment Principles outlines who is responsible for strategic and asset allocation decisions for the Fund and the reasons behind this Structure. It contains the current investment objective and details of the operational aspects of the Fund's investments.

In addition to the Annual Report, which is distributed to all member bodies within the Fund as a matter of course and is available on request to any Scheme Member, the Fund operates a web site (www.yourpensionservice.org.uk) and provides all of its Members with regular information bulletins.