

Appendix 'A'

Lancashire County Pension Fund

**Statement of Investment
Principles**

Lancashire County Council
as administering authority of
**Lancashire County Pension
Fund**



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Lancashire County Pension Fund

Statement of Investment Principles

1. Introduction

Lancashire County Council (“LCC”) is the administering authority of the Lancashire County Pension Fund (the “Fund”). This Statement of Investment Principles (“SIP”) sets out the principles governing its decisions about investments made by the Fund. It has been prepared in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

The Fund has produced the SIP following consultation with the Fund’s Investment Panel, and a representative of the Fund’s Actuary.

2. Responsibility for Investment Management

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

- ◆ The Pension Fund Committee;
- ◆ The Fund's Investment Panel;
- ◆ The Fund's Custodian
- ◆ The Local Pensions Partnership Investments Limited (“LPP I”)
- ◆ The Head of the Fund

The division of responsibility is set out in detail in the Governance Policy Statement, which is available at www.yourpensionservice.org.uk or on request from the Fund, but in summary, responsibilities are allocated as follows:

3. Pension Fund Committee

The Pension Fund Committee has overall responsibility for investment policy and 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 representatives of scheme members and a representative of the Higher and Further Education Sectors in Lancashire.

4. Investment Panel

The Investment Panel consists of two independent advisors and the head of the Fund (as Chair),

The Panel meets at least quarterly, or otherwise as necessary. The Panel may operate through sub groups to undertake particular tasks. It formulates recommendations to the Head of the Fund and/or the Pensions Fund Committee through meetings of the full Panel.

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

- a. review the Fund's long term investment strategy and where necessary make recommendations to the Pension Fund Committee;
- b. advise on strategic asset allocations proposed by LPP I
- c. Restrict and control the range of asset allocations used by LPP I as set out in the Statement of Investment Principles
- d. consider appropriate risk management strategies to include the matching of pension liabilities with suitable investments, possibly involving derivatives, and where necessary make recommendations to the Pension Fund Committee;
- e. consider foreign exchange hedging strategies relating to the equity and/or other asset allocations and where necessary make recommendations to the Pension Fund committee;
- f. monitor and review the investment activity; and
- g. Review and report on the performance of the Fund and where necessary make recommendations to the Pension Fund Committee.
- h. The proposed procurement process, tender award criteria and evaluation methodology for external advisers and other external assistance including corporate governance adviser, Fund Custodian, performance measurement advisers, the Fund Actuary and the Fund's AVC Provider ("external support") to enable the Head of Fund to the Fund to seek the approval of the Pension Fund Committee to commence the procurement of any required external support.
- i. The selection and appointment of any required external support (subject to the role of the Pension Fund Committee), their remit and terms of office;
- j. Review of the Statement of Investment Principles and compliance with investment arrangements;

5. 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 implementation of all investments and selection of all investment managers is delegated to Local Pensions Partnership Investments Limited ("LPP I"), an FCA authorised company. The partnership was set up by the Lancashire County Pension Fund and the London Pension Fund Authority. The partnership brings the benefit of scale, improved resources, lower costs and a broader opportunity set.

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

Under the Lancashire County Council Scheme of delegation to Chief Officers, the Head of 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 Funds) Regulations 2009, with regard to the requirement to review the investments made by the Fund Managers. The Head of the Fund reports to each meeting of the Pension Fund Committee.

Staff within financial resources also support Head of the Fund in respect of their 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;
- 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 LPP I and custodians;
- The provision of data for performance monitoring and interpretation of performance results;
- The conducting of procurement exercises to secure the services of service providers on behalf of the Fund.
- Verification, monitoring and payment of Pension Fund fee invoices;
- Monitoring the receipt of income due to the Fund;
- Representing the Head of fund 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

6. Investment Objectives

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

1. To ensure that resources are available to meet the Fund's liabilities through achieving investment performance at least in line with actuarial assumptions.
2. 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 1.6% p.a.

The asset out-performance assumptions represent 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.

7. Types of Investment

The Pension Fund Committee ("the Committee") has delegated all implementation activities to Local Pensions Partnership Investments Limited ("LPP I"). LPP I manages eight different investment mandates covering a wide range of asset classes:

- Public Equities
- Private Equities
- Fixed Income
- Alternative Credit
- Property
- Infrastructure
- Total Return
- Liquidity

LPP I will also provide advice to the Committee and the Investment Panel on management of foreign exchange risk and liability hedging strategies.

8. Balance between Different Types of Investment

The investment strategy sets out a balance between different asset classes as follows. The strategic asset allocation (SAA) was approved by the Investment Panel.

Asset Class	Strategic Asset Allocation %	Tolerance range top limit
Global Equities	42.5%	50.0%
Fixed Income	2.5%	5.0%
Private Equity	7.5%	10.0%
Infrastructure	12.5%	15.0%
Alternative Credit	20.0%	25.0%
Property	15.0%	20.0%
Total Return	0.0%	5.0%
Liquidity	0.0%	5.0%
Total	100.0%	

Global Equities

The objective is to outperform the MSCI All Country World, net dividends reinvested, in GBP Index over the full market cycle which is considered to be at least seven years (the “Benchmark”). All equity investments are made via LPP I by investing in underlying funds which may be managed by LPP I (“Internal Mandates”), or by external third parties (“External Mandates”).

Fixed Income

LCPF will seek to outperform the Barclays Global Aggregate Bond Index GBP Hedged. The LPP I Pool will pursue this aim by investing in underlying funds which may be managed by LPP I (“Internal Mandates”), or by external third parties (“External Mandates”) which are consistent with the FI Pool’s investment objectives and restrictions.

Private Equity

The objective is to outperform the MSCI World, net dividends reinvested, in GBP Index and provide investors with access to attractive private equity opportunities. All new investments will include but not be limited to the following sectors: Buyout, Venture Capital, Growth Equity, Special Situations/Distressed and Upstream Energy.

Infrastructure

The objective is to gain cost effective, diversified exposure to global infrastructure assets located predominantly in OECD nations. These investments need to meet LCPF’s aims including: to generate a satisfactory risk adjusted return; improve diversification; provide predictable cash flows; and indirectly hedge against inflation.

Alternative Credit

The credit allocation will seek to gain cost effective exposure to diverse sources of return linked to global credit markets and credit instruments. The LPP I investment pool will pursue this aim primarily by allocating capital to investment vehicles, mandates or pooled funds managed by external third parties (“External Mandates”).

Property

LCPF will seek to gain cost effective, diversified exposure to UK and international property assets that meet its investment objectives: to generate a return in excess of the benchmark; earn predictable cash flows; and provide a partial hedge against

inflation. The largest exposure of the portfolio will be to traditional sectors of the UK commercial real estate market. A smaller allocation will be made to value-added and opportunistic investments.

Total Return

The LPP I total return pool seeks to gain cost effective exposure to diversifying sources of return distinct from global equity beta and bond duration. The LPP I pool will pursue this aim primarily by allocating capital to investment strategies managed by external third parties (“External Mandates”).

Cash/ Liquidity

The LPP I Liquidity pool will manage in a cost effective manner any cash balances by allocating capital to securities or funds directly in appropriate markets and in relevant currencies or hedged back to relevant currencies. The benchmark for the Liquidity pool is 1 month GBP LIBOR.

Investment Limits imposed under the Local Government Pension Scheme (Management and Investment of Fund’s) Regulations 2009

The 2009 regulations laid down the limits shown in Column 1 and Column 2 below, having consolidated the previous 1998, 2003, and 2005 Regulations. The limits in Column 2 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 Fund's Investment Panel and Pension Fund Committee have previously reviewed the 2009 Regulations limits and have adopted the increased limits for **any single insurance contract** and also for **all contributions to partnerships**.

The 2013 amendment to the 2009 Regulations increased the maximum proportion of a local government pension fund which can be invested in contributions to partnerships from 15% to 30%.

	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%	30%
4. with the sum of - (a) all loans; 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	10 %	-

	Column (1) Limits under regulation 14 (2)	Column (2) Limits under regulation 14 (3)
all loans.		
5. All investments in unlisted securities of companies.	10%	15%
6. Any single holding.	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.	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	25%	35%
10. Any single insurance contract.	25%	35%
11. All securities transferred under stock lending arrangements.	25%	35%

Stock Lending

Stock lending is undertaken up to the 35% limit above. The programme is run by the Fund's Custodian, which monitors performance, limit and counterparty credit adherence, and voting requirements.

9. Policy on Risk

The consideration of investment risk forms part of the Pension Fund's overall risk register, which is presented to Pension Fund Committee on a bi-annual basis. The key risks and associated mitigations are replicated in the Funding Strategy Statement.

The first line of defence is diversification. As described in the section on Asset Allocation, the scheme will seek to maintain a diversified exposure to several different asset classes, geographies, and currencies. The Pension Fund Committee expect this to provide (at least) two levels of protection: first, in periods of market turmoil some assets will preserve capital better than others, allowing the portfolio to better withstand a shock. Second, in periods of rising markets, some assets will do better than others, and since we don't know with absolute certainty which ones will do best, it is better to diversify.

The second line of defence at the scheme level is to examine how the portfolio would perform under different scenarios including stress scenarios. The objective is to ensure that the losses that the portfolio endures will not cause future contributions to increase.

The asset class pools described in section 7 are also subject to a number of constraints to allow for intra-asset class diversification, including sector, country, manager, and maximum exposure to a single asset. When appropriate, the pools will use value at risk or volatility measures to monitor specific investments.

Operational risk is minimised by having custody of the Fund's financial assets provided by a regulated, external, third party, professional custodian.

The Fund's Global Custodian is Northern Trust. All public market investments are held in nominee accounts of Northern Trust.

All private market investments, including interests in private equity, property and other pooled funds are held directly in the name of Lancashire County Council as administering authority of the Lancashire County Pension Fund. Northern Trust provides detailed investment accounting and reconciliation services for all private market investments.

The title deeds in respect of the Fund's property holdings are held by Lancashire County Council and its property solicitors.

10. The expected return on investments

Each LPP I asset class pool is expected to achieve an excess return on the assets under their management greater than the relevant benchmark. In assessing performance of each LPP I pool the Investment Panel takes in to account the long-term nature of the investment process and returns are judged primarily on an annualised basis over a full market cycle of seven years. The targets and benchmarks in place are as follows:

Asset Class	Benchmark	Target Return
Global Equities	MSCI All Country World, net dividends reinvested, in GBP Index	Benchmark + 2% p.a. net
Fixed Income	Barclays Global Aggregate Bond Index GBP Hedged	Benchmark + 50bps p.a. net
Private Equity	MSCI All Country World, net dividends reinvested, in GBP Index	Benchmark + 2-4% p.a. net
Infrastructure	UK CPI + 4% - 6% p.a. net	UK CPI + 4-6% p.a. net
Alternative Credit	1 Month GBP LIBOR	1 Month GBP LIBOR + 3-5% p.a. net
Property	UK CPI + 4% - 6% p.a. net	UK CPI + 4-6% p.a. net
Total Return	1 Month GBP LIBOR	1 Month GBP LIBOR + 4% p.a. net
Cash	1 Month GBP LIBOR	1 Month GBP LIBOR

11. Monitoring and Review

The investment activities of LPP I are reviewed at each Investment Panel meeting and reported on to the Pension Fund Committee. At these meetings, asset allocation and investment performance of LPP I 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 S151 Officer 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).

12. Policy on Realisation of Investments

As the Fund is cash flow positive after including investment income, there is no need to realise investments in order to pay for benefits.

LPP I will decide when to realise investments as and when they consider appropriate in accordance with their management discretion.

13. Corporate Governance and Responsible Investment

Corporate Governance

As a long term investor, the Fund recognises the importance of good corporate governance practices in the companies in which it invests. The Fund believes that good corporate governance contributes to business prosperity by encouraging well run companies and an alignment of interests between boards, shareholders, customers, employees and wider society.

The Fund's approach to Corporate Governance

The Fund has a longstanding policy of supporting good corporate governance in the companies in which it invests and seeks to actively exercise ownership rights as a route for protecting the long-term investment interests of Fund's beneficiaries. Ownership activities will vary by asset class but include representation on company boards and advisory panels, shareholder voting, engagement with companies and regulatory or representative bodies and membership of investor organisations such as the Local Authority Pensions Fund Forum and the Pensions and Lifetime Savings Association. The implementation of the Fund's ownership activities is delegated to LPP I and is focussed on protecting ownership rights, minimising risk to companies from corporate governance failure, enhancing long-term value and encouraging corporate social responsibility.

Responsible Investment

Responsible Investment is an investment approach in which investors recognise the importance of the long-term health and stability of the market as a whole; seeking to incorporate material extra-financial factors alongside other financial performance and strategic assessments within investment decisions; and utilise ownership rights and responsibilities attached to assets to protect and enhance shareholder value over the long term – primarily through voting and engagement. The objective of responsible investment is decreasing investor risk and improving risk-adjusted returns.

Examples of potentially material risks to be considered as part of the Fund's voting and engagement activity are set out below:

Governance risks:

- Board independence – Non-Executive Directors play a vital role in overseeing the executive management and safeguarding the interests of shareholders;
- Succession planning – An ineffective policy can have implications for a company's performance, including uncertainty over its sustainability;
- Board diversity – Research suggests that shareholders, companies and boards are not best served by an overly homogenous board prone to group think;
- Auditors – The independence of auditors plays a crucial role in protecting shareholders.

Environmental risks:

- High intensity industries will incur additional financial costs from carbon regulations in different jurisdictions. Changes in climate will affect company supply chains and fixed assets;
- Energy use – Through effective management of energy use, companies are able to reduce energy costs as well as build security of supply;
- Natural resources – Demand for raw materials is ever increasing, this has implications including increasing regulation around sourcing and use of resources;
- Water – A growing global population is leading to rising consumption – this in turn increases costs and creates tensions or conflicts.

Social risks:

- Human rights – Companies operating in companies with poor human rights records may face significant challenges, such as legal challenges or reputational damage;
- Employment – Research indicates that well managed employee relations improve worker productivity and effectiveness in turn benefitting shareholders;
- Health and safety – Companies with poor health and safety records may face prosecutions, fines and in extreme cases, the withdrawal of licences to operate;
- Supply chain – Companies are increasingly reliant on a large, global workforce, exposing them to increased risks of disruptions.

Implementing a responsible investment policy helps a pension fund to adhere to the UK Stewardship Code. The Fund's current position relating to the UK Stewardship Code can be found in a separate statement on its website.

Lack of good governance interferes with a company's ability to function effectively and is a threat to the Fund's financial interest in that company.

The Fund's approach to responsible investment

The Fund is a signatory to the UN-supported Principles of Responsible Investment and is committed to developing an approach aligned with fulfilling the six principles. The Fund's approach to responsible investment divides into three areas of focus.

a) Voting Globally

The first approach, voting, is certainly not a 'boxticking' exercise, as the Fund regularly votes against resolutions. The Fund, through a proactive voting policy, in partnership with proxy voting consultants, votes its share rights constructively based upon a comprehensive analysis of company voting issues.

Votes are cast in accordance with the proxy voting consultant's guidelines unless an Investment Manager requests a different vote for investment management reasons.

b) Engagement through Partnerships

The Fund's second approach involves working in partnership with like-minded bodies. The Fund recognises that to gain the attention of companies in addressing governance concerns, it needs to join other investors with similar concerns. It does this through:

- Local Authority Pension Fund Forum (LAPFF);
- Voting on shareholder resolutions;
- Joining appropriate lobbying activities.

In terms of its engagement approach with other investors, it is most significant through LAPFF. This Forum exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance among the companies in which they invest. See the LAPFF website for further details: www.lapfforum.org

c) Shareholder Litigation

The third approach, adopted by the Fund in order to encourage corporate management to behave responsibly and honestly, is through shareholder litigation. The Fund, in partnership with two US law firms and other shareholders, submits class actions globally where possible and where appropriate.

14. Principles of Investment Practice

The Fund's compliance with the six principles of investment practice laid out in Local Government **Pension** Scheme (Management and Investment of funds) regulations 2009 is described 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.

Principle 2: Clear Objectives

Fully compliant: The overall objective for the Fund is outlined in the Statement of Investment Principles. The Investment Panel sets benchmarks for measuring the performance of each investment and an overall benchmark for the Fund as a whole in order to monitor the attainment of the objectives.

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 and decided upon an investment strategy involving a diversification of investments amongst equities, property and investments offering the prospect of acceptable returns with lower volatility.

Principle 4: Performance assessment

Fully compliant: Investment performance reports are produced by the Custodian monthly for consideration by the Investment Panel and the Pension Fund Committee..

Principle 5: Responsible ownership

Fully compliant: PIRC has been appointed the Fund's proxy to vote the Fund's shares at shareholder meetings. PIRC votes in accordance with its voting guidelines unless an Investment Manager requests differently, in which case the Treasurer to the Fund would decide how the vote should be cast in the best interests of the Fund. The Fund 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.

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.

The Fund provides all of its Members with regular information bulletins. The Annual Report and the Fund's statutory statements are made available to all the Fund's employers and members through the web site www.yourpensionservice.org.uk.