

# Croydon Council

<b>REPORT TO:</b>	<b>PENSION COMMITTEE</b> <b>08 December 2015</b>
<b>AGENDA ITEM:</b>	<b>8</b>
<b>SUBJECT:</b>	<b>Statement of Investment Principles</b>
<b>LEAD OFFICER:</b>	<b>Richard Simpson, Assistant Chief Executive (Corporate Resources and s.151 Officer)</b>
<b>CABINET MEMBER</b>	<b>Councillor Simon Hall</b> <b>Cabinet Member for Finance and Treasury</b>
<b>WARDS:</b>	<b>All</b>
<b>CORPORATE PRIORITY/POLICY CONTEXT:</b>	
Sound Financial Management: The Statement of Investment Principles (SIP) functions as a key component of the governance arrangements for the Croydon Pension Fund. All Local Government Pension Scheme (LGPS) funds have to produce, consult on and publish a Statement of Investment Principles.	
<b>FINANCIAL SUMMARY:</b>	
The SIP sets out how the Croydon Pension Fund will be invested in order to best meet the liabilities of the Croydon Local Government Pension Scheme. Croydon Council effectively underwrites these liabilities and the returns made on investments impacts in the medium and longer term on the finances of the Council.	
<b>FORWARD PLAN KEY DECISION REFERENCE NO.: N/A</b>	

## 1 RECOMMENDATIONS

That the Committee:

- 1.1 Consider and comment on the draft revisions to the SIP at Appendix A as they feel appropriate.
- 1.2 Adopt the revised investment limits as allowed for by the LGPS Investment Regulations, set out in the Statement of Investment Principles.
- 1.3 Note that the draft revisions to the SIP, with any comments from this Committee, will then be passed to the Pensions Board for its consideration and comment before coming back to this Committee for final approval.

## 2 EXECUTIVE SUMMARY

- 2.1 The SIP is a key document in ensuring that costs relating to the Croydon Local Government Pension Scheme (the Scheme) are managed and the Scheme remains viable. This report provides context for the SIP and outlines the main changes reflecting the asset allocation review.

## 3 DETAIL

- 3.1 The basic objective of Local Government Pension Scheme (LGPS) pension fund investment is to minimise the level of contributions paid into the Fund by employer bodies to ensure its solvency. Therefore, investment strategy is necessarily intrinsically linked with funding policy. All LGPS Funds are required to publish a document called a “Funding Strategy Statement” (FSS). The former Office of the Deputy Prime Minister (ODPM) defined the purpose of the FSS as being:

- “To establish a clear and transparent fund-specific strategy which will identify how employers’ pension liabilities are best met going forward;
- to support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.”

- 3.2 The current Croydon FSS dates from April 2014. Employees’ benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns contribute to the cost of some of the benefits and employees’ contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits. Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependents. The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. The FSS sets out how the Scheme’s Administering Authority attempts to balance the conflicting aims of:

- affordability of employer contributions;
- transparency of processes;
- stability of employers’ contributions; and
- prudence in the funding basis.

The FSS is a summary of the Fund’s approach to funding its liabilities, and this includes reference to the Fund’s other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework of which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years)
- the Fund’s policies on admissions, cessations and bulk transfers;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund’s Statement of Investment Principles.

- 3.3 Following the review of the asset allocation strategy, the Committee has previously put in place a strategy for asset allocation which sets out the precise mix and target

returns for each asset class. There are three component parts to this strategy asset allocation strategy. The majority of the fund (54%) is invested in global listed equity reflecting the belief that, over the long-term, this asset class will generate returns in line with the aggregate performance target for the Fund. Another significant share of the assets (21.7%) are invested in fixed interest debt, be that government or corporate debt and incorporates a large hedging component against an increase in interest rates. These investments are intended to match the growth in the Fund's liabilities. The third tranche (24%) is invested in a range of alternate asset classes, including: commercial property; private rental sector property; private equity and infrastructure. These assets share characteristics of both equities and bonds but are included in the portfolio to act as a diversifier and to generate higher returns in order address the funding gap or deficit. More diversified and less correlated asset classes such as bonds, property, infrastructure and absolute return products should achieve stabilisation which is important both to the administrating authority to avoid unforeseen increases in contribution rates and to other Scheme employers to tackle issues of affordability.

- 3.4 The Committee believes that, in the long-run, equities will revert to the mean for returns but that, at the moment, there is no compelling argument for active management. The Committee expects there to be interest rates announced in the US and thereafter in the UK that will impact on the fixed interest part of the portfolio and that this should be balanced out by the absolute return strategy adopted and by trimming back on the size of these investments. The Committee believes that private equity will continue to play an important role in the portfolio and that there are still opportunities to be exploited by the property portfolio. The Committee considers that this is now true for the private rental sector as well as for commercial property. The Committee believes that infrastructure offers an attractive investment opportunity in so far as it remains underwritten by sovereign guarantees, whether that be UK, European or globally.
- 3.5 The SIP undergoes formal evaluation every three years but is reviewed frequently to ensure it remains fit for purpose. The major changes proposed to be incorporated in this revision are as follows:
- Performance benchmarks for the portfolio and individual component elements have been revisited and reviewed;
  - References to the Hutton report have been taken out as much of those recommendations have now been incorporated into the design of the Scheme; and
  - The regulatory investment limits have been reviewed and revised.
- 3.6 The LGPS investment regulations set limits on the portfolio's exposure to any one investment or fund. The regulations set a default position and the Committee is asked to endorse those revisions recommended in the SIP where Croydon has moved away from those defaults.
- 3.7 The Committee is invited to comment on the contents of the draft revised SIP which is appended to this report. Officers will incorporate any comments Members would wish to see reflected in a final version which will then be sent out to Pensions Board for comment. The final version of the SIP will be brought back to this Committee, with any comments from the Pension Board, to consider for formal adoption at which point it will be published.

#### **4 FINANCIAL CONSIDERATIONS**

4.1 The SIP is an important document as it sets out a road map for ensuring the viability of the LGPS. Croydon Council underwrites the Fund and so any underachievement against the performance targets will impact on the financial pressures faced by the Council.

#### **5. OTHER CONSIDERATIONS**

5.1 Other than the considerations referred to above, there are no customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report.

#### **6. COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER**

6.1 The Council Solicitor comments that there are no direct legal implications arising from this report.

(Approved by: Gabriel MacGregor Head of Corporate Law on behalf of the Council Solicitor and Monitoring Officer)

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#### **CONTACT OFFICER:**

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Corporate Resources Department, ext. 62552.

#### **BACKGROUND DOCUMENTS:**

Appendix A

The revised Statement of Investment Principles.