

WEST MIDLANDS



PENSION FUND



# Statement of Investment Principles 2010

June 2010

# Statement of Investment Principles Update - June 2010

## 1. Introduction

The following information updates the 2007 and 2009 Statement of Investment Principals in accordance with The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

## 2. Myners' Principles

The Fund complies with the Myners' Six Principles for Investment as detailed in its policy statement "Compliance with Myners' Principles April 2010".

## 3. Updated Manager Structure

An updated manager structure summary is as follows:

Asset Class	Manager
<b>Equities</b>	
UK	PFID
North America	PFID Intech
Europe	PFID Blackrock
Far East	PFID
Global	MFS Investment Management Blackrock Alliance Bernstein Axa Rosenberg Investment Management
Emerging markets	PFID through specialist funds
Private equity	PFID through specialist funds
<b>Complementary investments</b>	
PFID through specialist funds	
<b>Fixed interest</b>	
UK gilts	PFID through specialist funds
UK index-linked	PFID through specialist funds
UK corporate bonds	PFID through specialist funds Royal London Asset Management
Cash	PFID
Direct property	ING Real Estate
Overseas property	PFID through specialist funds

PFID = Pension Fund Investment Division

## 4. Operational Risk Management

The Fund manages operational risks through the following measures:

- Robust financial plan and clear operating procedures for significant activities.
- The use of a global custodian, HSBC, for custody of assets.
- Having formal contractual arrangements with investment managers.
- Maintaining independent investment accounting records.
- Maintaining a comprehensive risk register with regular reviews.
- Having access to internal and external audit services.

## 5. Stocklending

The Fund undertakes stocklending for its quoted equity holdings, as permitted by the LGPS (Management and Investment of Funds) Regulations 2009 and operates within the limits set by the regulations.

The lending is through the Fund's custodian with a formal agreement in place and approved collateral to protect the Fund's interests. Regular reviews of the lending programme take place with the custodian.

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PENSION FUND



# Statement of Investment Principles 2009

April 2009

# Statement of Investment Principles Update 2009

## 1. Introduction

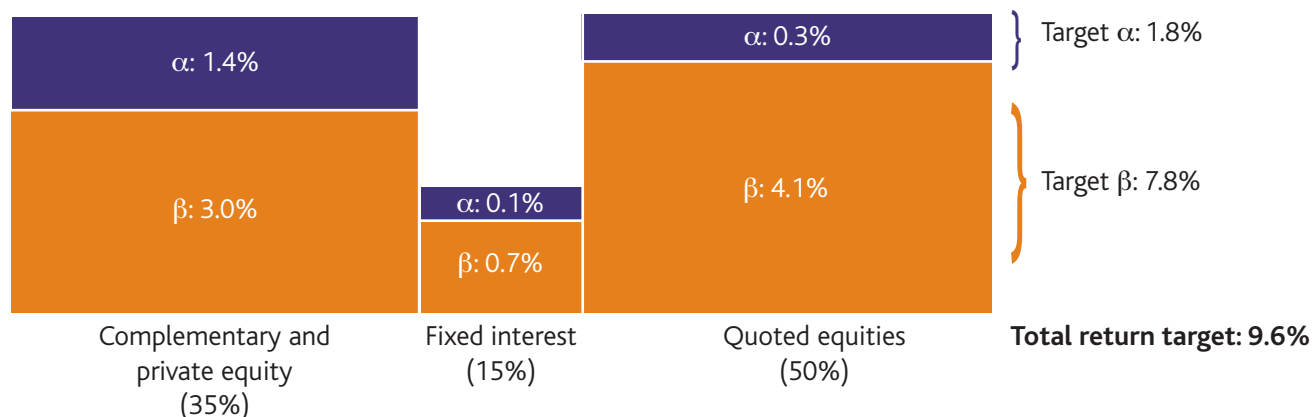
1.1. The Fund has, following the events of 2008 in the financial and economic markets, reviewed its investment strategy to ensure the Fund positions its investment strategy to take advantage of any new investment opportunities, and its investment risks are understood and balanced following the turmoil in the markets. An updated Investment Strategy Statement 2009 details the changes to the investment strategy that have resulted.

## 2. Updates to the SIP 2007

- 2.1. (i) The updated strategy seeks to carry on the trend of further diversifying the Fund's overall risk away from an overdependence on the equity risk premium. In addition to the alternative assets already sitting in 'complementary investments', the Fund will going forward, be investing in an asset class referred to as 'absolute return strategies'.
- (ii) It also seeks to rebalance the Fund's global equity exposure to take account of wealth indices and GDP, in addition to market capitalisation. Hence, the allocation to emerging market equities will increase.
- (iii) It is recognised that the turmoil of the markets experienced during 2008 has created some short- to medium-term investment opportunities that the Fund is well-positioned to embrace.
- (iv) An updated summary diagram showing the split between alpha and beta return targets is shown below:

2.2. An updated manager structure summary overrides the previous table in 3.1 and is as follows:

Asset Class	Manager
<b>Equities</b>	
UK	PFID
North America	PFID Intech
Europe	PFID Barclays Global Investors
Far East	PFID
Global	MFS Investment Management Barclays Global Investors Alliance Bernstein Axa Rosenberg Investment Managers
Emerging markets	PFID through specialist funds
<b>Complementary investments</b>	
	PFID through specialist funds
<b>Fixed interest</b>	
UK gilts	PFID through specialist funds
UK index-linked	PFID through specialist funds
UK corporate bonds	PFID through specialist funds Royal London Asset Management
Overseas bonds	PFID through specialist funds
Cash	PFID
Direct property	ING Real Estate
Overseas property	PFID through specialist funds



2.3. The revised benchmark as agreed at the January 2009 committee overrides the previous table in 3.1 and is set out below:

	Medium-Term Asset Allocation January 2009	
	%	%
<b>Quoted equities</b>		<b>50</b>
UK	14.0	
Europe	11.0	
North America	8.0	
Japan & Far East	5.5	
Frontier & emerging markets	5.5	
Global equities	6.0	
<b>*Private equity</b>	<b>10.0</b>	
<b>Total equities</b>		<b>60</b>
<b>Fixed interest</b>		<b>15</b>
UK index-linked	4.7	
UK gilts	4.7	
UK corporate bonds	4.6	
Cash	1.0	
<b>Complementary</b>		<b>25</b>
Property	9.0	
Emerging market debt	2.0	
Commodities	3.0	
Infrastructure	3.0	
Absolute return strategies	8.0	
<b>Total non-equities</b>		<b>40</b>
<b>Total Fund</b>		<b>100</b>

\* Previously in Complementary

2.4. The 2007 SIP follows:

WEST MIDLANDS



PENSION FUND



# Statement of Investment Principles 2007

December 2007

# Statement of Investment Principles 2007

## 1. Introduction

1.1. The West Midlands Pension Fund has drawn up this Statement of Investment Principles ('the SIP') to comply with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998.

This statement is available to anyone with an interest in the Fund and the public generally.

1.2. Overall investment policy falls into two parts. The strategic management of the assets is fundamentally the responsibility of the Superannuation Committee established by Wolverhampton City Council (the administering authority) which has representation from the seven West Midlands metropolitan district councils and local trade unions. The Committee determines the strategic management of the assets based upon the professional advice it receives and the investment objectives as set out in section 2 on page 3. The Investment Advisory Sub-Committee has oversight of the implementation of the management arrangements and comprises representatives from the seven district councils and two local trade unions. The Committees meet at least four times a year. A Joint Consultative Panel made up of local trade union members meets three times a year.

1.3. The roles of the members and Committee are:  
**Role Of Superannuation Committee Member**  
**Principal Accountabilities**

1. To discharge the functions of the administering authority for the application of the Local Government Pension Scheme Regulations in the West Midlands.
2. To put in place and monitor the administration of contributions and payments of benefits as required by the Regulations and the proper management and investment of monies held for the purpose of paying benefits.

3. To determine and review the provision of resources made available for the discharge of the function of administering authority.

### Key Duties

#### (a) Superannuation Committee Members

1. Monitor compliance with legislation and best practice.
2. Determine admission policy and agreements.
3. Monitor pension administration arrangements.
4. Determine investment policy:
  - (a) benchmark (medium-term)
  - (b) tactical
5. Monitor policy.
6. Appoint committee advisers.
7. Determine detailed management budgets.

#### (b) Investment Advisory Sub-Committee

1. Monitor investment management arrangements.
2. Review strategic investment opportunities.
3. Appoint and dismiss segregated managers.
4. Monitor implementation of investment policy.

The Council delegation to Superannuation Committee is as follows:

- (a) To exercise the functions of the Council in relation to the administration of the West Midlands Metropolitan Authorities Pension Fund arising by virtue of the Local Government Pension Scheme Regulations 1997, and any subsequent related legislation.
- (b) To exercise all the general powers and duties of the Council granted to cabinet teams and standing bodies provided that those parts of the Council's Financial Procedure Rules and Contracts Procedure Rules which relate to the acquisition and disposal of land and the approval of expenditure, shall not apply in relation to such acquisitions and disposals and expenditure in connection with the Pension Fund.
- (c) To ensure that equality issues are addressed in the development of policies and the provision of services and are appropriately monitored.

- (d) To ensure that consideration is given to the impact which the committee's policies and provision of services have with regard to environmental matters.

The delegation to the Investment Advisory Sub-Committee is as follows:

- (e) To advise on the establishing of policies in relation to investment management include the appointment and approval of terms of reference of independent advisers to the Fund.
- (f) To monitor investment activity and the performance of the Fund.
- (g) To oversee the investment management functions of the Fund.

The Director for Finance and Physical Resources implements the committee policy and manages the day-to-day functions as described in Section 3.

- 1.4. This SIP has been prepared taking into account the 2007 Actuarial Valuation and the Funding Strategy Statement. The statement is updated as part of any significant changes on an ongoing basis, for example, appointment of new managers.

## 2. Investment Objectives and Risk

### 2.1. Investment Objectives

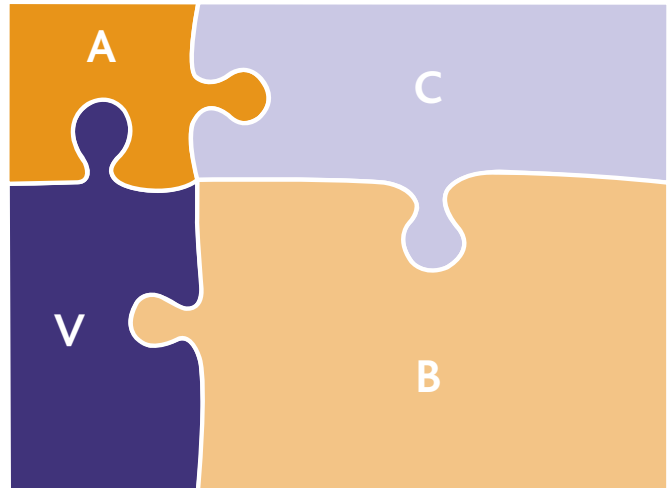
The Authority has set the following objectives:

- (i) Seek returns that are consistent and match those available in the major investment markets and are comparable with other institutional investors.
- (ii) Emphasise markets that over time are likely to give better returns.
- (iii) Acknowledge the risk of investing and have regard to best practice in managing that risk.
- (iv) Have resources available to meet the Fund's liabilities for pensions and other benefits provided.

### 2.2. Risk

There are various risks to which any pension scheme is exposed and these are described in the FSS. It is believed that the investment risks are managed at an acceptable level and are tightly controlled within the risk budget. This budget has four elements:

#### Risk Budget



- A Alpha or manager skill
- C Correlation of asset classes
- B Beta or market returns
- V Volatility of Fund

There are a number of risks that have to be monitored:

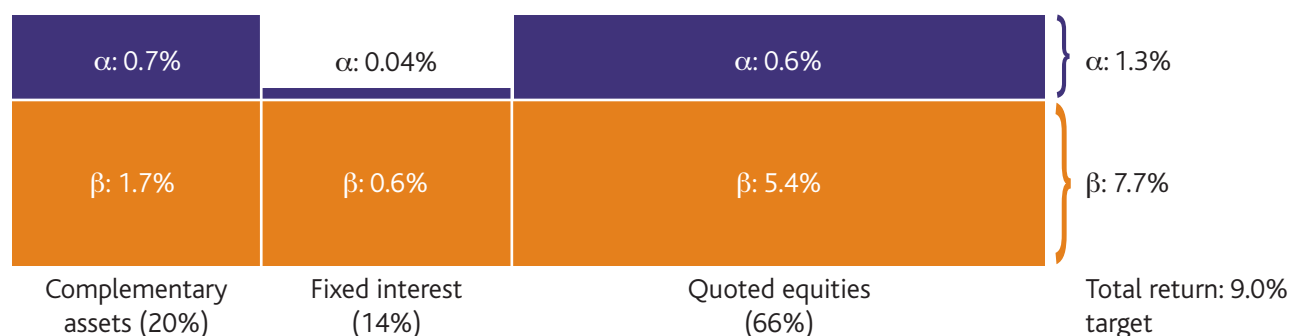
- (i) The risk of a deterioration in the funding level of the Fund due to investment markets not delivering the expected returns or unexpected events, such as a credit crunch. Managed by an optimum benchmark reflecting low correlation between asset classes and diversification.
- (ii) The risk that the active managers will not achieve their set targets. Managed by the optimum split between active management (alpha) and market returns (beta). Within the allocation to alpha there is a range of specialists returning alpha at varying levels of risk and return, whilst also ensuring manager diversification.
- (iii) The risk of not achieving the long-term return as identified by the actuarial review.

Managed by an investment structure designed to deliver the core return from beta, any returns generated by active management is in excess of the long-term return identified by the actuarial review.



### 2.3. Investment Strategy

The authority sets a long-term investment strategy (the mix of asset types) to have regard to the Fund's liability structure and the investment objectives set out above and in its FSS. This is reviewed at least every three years, after each actuarial valuation and monitored on an ongoing basis to facilitate any necessary changes. The present split between the three main asset classes and the expected returns is illustrated in the following diagram:



The table shows that:

- i) the bulk of the Fund's overall return (5.4%) comes from its core/passive equity investments.
- ii) although the Fund only has a 20% allocation to 'complementary' asset classes, almost 50% of the alpha is derived from these.

The introduction of these complementary asset classes increases the overall returns whilst slightly reducing the overall level of risk due to diversification. Volatility also forms part of the overall equation, acknowledging there is market risk plus active risk (associated with any active management). The key is to find investments where the extra alpha more than offsets any increase in volatility.

Tactical asset allocation decisions are taken on a quarterly basis by the Superannuation Committee, based on advice from Gartmore Investment Management and its other professional advisers.

In order to better manage and to improve the risk return on investments, a medium-term target of 25% complementary, 15% fixed-interest and 60% equities is planned. Further details can be found in the Fund's Investment Strategy Report.

## 3. Day-to-Day Management of the Assets

### 3.1. Main Assets

The Authority invests the assets of the Fund in portfolios, 'vehicles' and structured products operated by both internal and external investment managers. The Authority is satisfied that the level of diversification (and correlation) and degree of active management combined with beta provides the appropriate risk/return structure for the Fund.

A significant amount of investment is carried out by the Fund's own Pension Fund Investment Division (PFID) and is designed to manage approximately 65% of the Fund's investments. The majority of quoted equities are still managed in-house, either on a passive or active core basis, the latter having relatively low alpha and volatility targets. PFID sometimes uses pooled specialist funds to achieve the core objectives.

The remainder of the assets are with external managers who have the specific skills set necessary to provide the target returns required. These vary from enhanced indexing to high alpha mandates. The managers used are listed as follows:

<b>Asset Class</b>	<b>Manager</b>
<b>Equities</b>	
UK	PFID State Street Global Advisers Henderson Global Investors Goldman Sachs Asset Management
North America	PFID Intech Blackrock Financial Management
Europe	PFID Barclays Global Investors DIAM International
Japan	PFID Nomura Asset Management Legal & General Asset Management
Pacific (excluding Japan)	PFID Schroder Investment Management
Global	MFS Investment Management Barclays Global Investors Alliance Bernstein Axa Rosenberg Investment Managers
Emerging markets	PFID through specialist funds
<b>Complementary investments</b>	
Private equity	PFID through specialist funds
Infrastructure	PFID through specialist funds
Emerging market debt	Ashmore Investment Management
Currency alpha	Record Currency Management Overlay Asset Management Mellon Capital Management
Commodities	Goldman Sachs Asset Management Bache Wellington
<b>Fixed interest</b>	
UK gilts	Legal & General European Credit Management
UK index-linked	Legal & General
UK non-government bonds	PFID Royal London Asset Management
Cash	PFID
Property	ING Real Estate
Overseas property	PFID through specialist funds

Special arrangements exist for the management of private equity and some of the other complementary assets, which involves selecting specific funds. UK direct property is also managed through specialist managers, subject to close in-house involvement and final decision taking on all, except minor, property matters. Index-linked bonds are managed externally on a passive basis whilst part of the UK corporate bonds is also managed externally. UK gilts are managed externally split between a high alpha and a passive mandate. The Fund currently uses passive currency hedging overlay to a much wider part of the overseas asset allocation when timing is considered appropriate.

The Fund has also used futures for protecting its quoted equity allocation whilst in the process of implementing its benchmark. Going forward, the Fund will give serious consideration to any structured product or derivative that is considered to be a 'permitted' investment under LGPS regulations and that is considered to be the most efficient use of the Fund's assets within the risk budget.

## Investment Performance Benchmark

The asset allocation benchmark is as set out below:

	2004 Benchmark %	June 2007 Benchmark %
<b>UK equities</b>	37.0	34.0
<b>Global equities</b>	6.0	6.0
<b>Overseas equities</b>	27.0	26.0
North America	8.0	6.0
Europe	10.0	11.0
Japan	3.5	3.0
Pacific Basin	3.0	3.0
Emerging markets	2.5	3.0
<b>Total</b>	<b>70%</b>	<b>66%</b>
<b>Bonds</b>	15.0	14.0
UK fixed interest gilts	5.0	4.4
UK index-linked gilts	5.0	4.3
Corporate bonds	5.0	4.3
Cash	0.0	1.0
<b>Complementary investments</b>	15.0	20.0
Private equity	5.0	5.5
Property	8.0	9.0
Currency alpha	}	1.5
Emerging market debt		1.5
Commodities		1.5
Infrastructure		1.0
<b>Total non-equities</b>	<b>30%</b>	<b>34%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>

## 3.1.2. Expected Return on the Investments

Over the long-term, it is expected that the investment returns will be at least in line with the assumptions underlying the actuarial valuation. The individual portfolios should match or exceed the specific targets set for each portfolio over time. The Investment Strategy Review 2004 indicated that with a target long-term return of 7.7% the risks associated with that target are manageable. The total return target for the Fund is 9.0% but this is split between the returns expected from beta (the core return of 7.7%) and those from alpha (1.3%).

## 3.1.3. Investment Restrictions

The investment managers are prohibited from holding investments not defined as "investments" in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998. The Fund operates at the limits set by the lower level of control under Regulation 11(2), except for contributions to partnerships where it has resolved to work to the upper limit of 15% under Regulation 11(2A). This reflects the level of investments planned for private equity and nature of some property holdings.

## 3.2. Additional Assets

Assets in respect of members' additional voluntary contributions are held separately from the main Fund assets. These assets are held with Equitable Life and the Prudential Assurance Company Limited. Members have the option to invest in With profits funds, unit-linked funds and deposit funds. The Authority monitors from time to time the suitability and performance of these vehicles. No new business is being placed with Equitable Life.

### 3.3. Realisation of Investments

In general, the Fund's investment managers have discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments. There is no current policy on realising investments to meet benefit outgoings etc as the Fund's cashflow is positive.

### 3.4. Monitoring the Investment Manager

The performance of the internally managed assets and of the external investment managers is independently measured. In addition, officers of the Fund meet the investment managers regularly to review their management of the portfolio together with the reasons for the background behind the investment performance. The Investment Advisory Sub-Committee meets at least quarterly to review markets and managers.

#### Advisers

The Fund uses a range of advisers in addition to its own specialist officers as follows:

- **Gartmore Investment Management**

Investment policy, quarterly asset allocation, general investment matters.

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- **Mercer Human Resource Consulting**

Actuarial matters.

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- **Mercer Investment Consulting**

Selection of investment managers, policy and investment matters relative to liabilities.

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- **ING Real Estate**

Commercial and industrial property matters, day-to-day management of properties and transactions, involving the sale and purchase of property (excluding agricultural).

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- **John Fender Consultancy**

Independent property advice

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- **Knight Frank**

Agricultural property management matters

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- **Knight Frank**

Independent property valuations

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- **Savills**

Independent agricultural property valuations.

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- **Entec**

Planning matters (agricultural holdings).

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- **Lawrence Gould**

Independent agricultural property advice.

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- **Deloitte & Touche**

Investment management practices and regulations.

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- **PIRC**

Company governance issues.

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Fees paid to advisors are agreed on an individual basis and, except for ING, are a fixed sum or scale reviewed annually or as work is commissioned.

## 4. Corporate Governance and Socially Responsible Investment (SRI)

- (i) The Authority recognises its responsibility as an institutional investor to support and encourage good corporate governance practices in the companies in which it invests. The Authority considers that good corporate governance can contribute to business prosperity by encouraging accountability between boards, shareholders and other stakeholders. Good corporate governance also plays a major role in encouraging corporate responsibility to shareholders, employees and wider society.
- (ii) The Fund has a longstanding policy of supporting good corporate governance in the companies in which it invests, and challenging companies who do not meet the standards or reasonable expectations set by their peers.

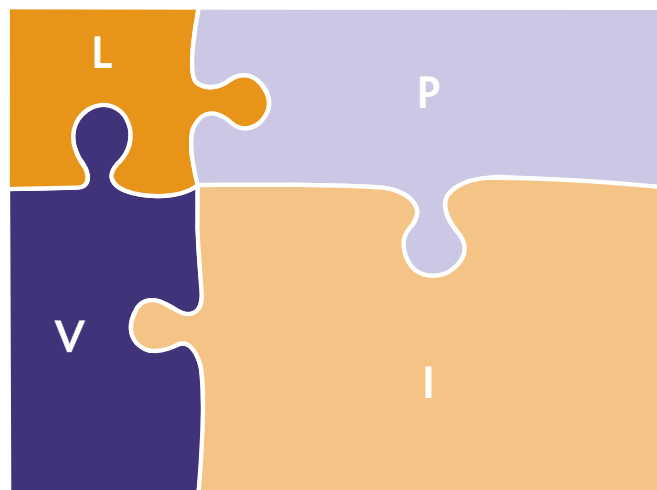
The Fund's approach is part of its overall investment management arrangements and its active governance policy.

In order to fulfil this responsibility, the Authority communicates with companies and exercises the rights (including the voting rights) attaching to investments in support of its corporate governance policies. The Authority's voting rights are an asset and will be used to further the long-term interests of the Fund beneficiaries. As a general principle, votes will be used to protect shareholder rights, to minimise risk to companies from corporate governance failure, to enhance long-term value and to encourage corporate social responsibility. It is the Authority's policy to vote against a company's report and accounts where there is insufficient disclosure on environmental, employee and community policy. A copy of the Authority's corporate governance policy and a summary of its voting actions can be found on our website at: [www.westmids-pensions.org.uk](http://www.westmids-pensions.org.uk)

- (iii) Socially responsible investment is taken as giving consideration to issues that give risk to social concerns – for example, employment practices, human rights, use of natural resources, environmental issues and external business standards. This links to, and covers, the issues around sustainability, that have a rapidly growing significance for companies from a legislative, reputational and practical operational standpoint.
- (iv) 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 corporate governance and SRI divides into four areas.

### ESG Best Practice



- L** Litigation (shareholder)
- P** Partnerships (through engagement)
- I** Investing (active)
- V** Voting (shareholdings)

#### (a) Voting Globally

The first approach, voting, is certainly not a 'box-ticking' exercise, as the Fund regularly votes against resolutions.

The Fund, through a proactive voting policy, votes its shares constructively based upon a comprehensive analysis of company voting issues.

During the twelve months ending May 2007, the Fund voted at 684 UK meetings and opposed in excess of 27% of all resolutions – with the remuneration report receiving the most opposition, as the Fund feels that mediocre management performance should not be rewarded.

Where possible, the Fund votes on its overseas holdings, and during the twelve months ending May 2007, it voted at 228 European and 500 US meetings. The Fund's trustees have continued to ensure that Scheme members are kept informed about the Fund's voting policy and activity, which is detailed in its annual report and accounts and on the Fund's website, where it is reported on a quarterly basis.

## **(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:

1. LAPFF.
2. Voting on shareholder resolutions.
3. Joining appropriate lobbying activities.
4. Funding research into governance issues.

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 amongst the companies in which they invest. See the LAPFF website for further details: [www.lapfforum.org](http://www.lapfforum.org)

The Authority is actively developing corporate governance partnerships as it believes this will maximise the influence of shareholders, will lead to best practice and will promote high standards on a global basis. Current partners include the Institutional Investors Group on Climate Change and the Council of Institutional Investors.

## **(b) 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 a US law firm and other shareholders, submits class actions globally where possible and where appropriate.

## **(b) Active Investing**

The fourth and most challenging activity for the Fund in this particular field is actively seeking SRI investments, provided these meet the Fund's requirements on fundamental investment grounds.

To date, the Fund has committed around 1.5% of its total assets in investments where strong returns are combined with best practice in SRI and/or corporate governance.

Such investments include alternative energy, clean energy, urban regeneration and activists' funds.

The corporate performance of companies and their value as investments are increasingly affected by environmental factors. In pursuance of a prudent and environmentally responsible response by companies, the Authority will encourage and support companies that demonstrate a positive response to SRI and environmental concerns.

The Authority expects companies to:

- 
- Make a commitment to achieving environmental excellence.
- 
- Institute regular monitoring of their environmental impacts.
- 
- Establish procedures which will lead to incremental improvements in environmental performance.
- 
- Comply with all current environmental and other relevant legislation and to seek to anticipate future legislative changes.
- 
- Make available to shareholders regular and detailed reports of progress made towards attaining improved environmental standards.
- 
- Seek to take all reasonable and practical steps to minimise or eliminate environmental damage.
- 
- Actively and openly engage in discussion on the environmental ethical effects of their business.
- 
- Take environmental matters seriously and produce an environmental policy which is effectively monitored.
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## 5. Compliance with this Statement

The Authority will monitor compliance with this statement. In particular, it will ensure its investment decisions are exercised with a view to giving effect to the principles contained in the statement, so far as is reasonably practicable.

## 6. Compliance with Myners

- 6.1. Following from the Myners' Report into Institutional investment in the UK, the Government, after consultation, indicated it would take forward all of the report recommendations and identified ten investment principles to apply to pension schemes. These principles cover the arrangements for effective investment management decision-making, setting and monitoring clear investment objectives, focus on asset allocation, arrangements to receive appropriate expert advice, explicit manager mandates, shareholder activism, use of appropriate investment benchmarks, measurement of performance, transparency in investment management arrangements and regular reporting.

The Fund supports the principles and complies with the principles. Full details of compliance are on the Fund's website.

## 7. Review of this Statement

The Authority will review this statement in response to any material changes to any aspects of the Fund, its liabilities, finances and its attitude to risk which they judge to have a bearing on the stated investment policy. This review will occur no less frequently than every three years to coincide with the actuarial valuation.







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