The Highland Council	Agenda Item	**5**
Pensions Committee and Board – 18 February 2016	Report No	**PC/03/16**

Statement of Investment Principles

Report by Director of Finance

Summary

The purpose of this report is to seek approval from Members on the proposed Statement of Investment Principles for the Highland Council Pension Fund (HCPF).

The Statement of Investment Principles is prepared as required by the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (No. 233).

1. Introduction

1.1 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (No. 233)[1] require administering authorities to prepare, maintain and publish a written statement of principles (SIP) that govern their decisions about investments. The SIP must be reviewed regularly and should be updated when there are material changes in policy.

2. Governance

2.1 The Highland Council is the Administering Authority for the Highland Council Pension Fund.

2.2 The Highland Pensions Committee and Board has delegated responsibility for the supervision of the Funds.

2.3 The appointment of Investment Consultants, Actuaries and Performance Measurement Consultants to give advice and assist in the discharge of the Authority's responsibilities is conducted by Officials of the Authority under competitive tendering procedures. Details of the current Investment Consultants, Actuaries and Performance Measurement Consultants are at Appendix 4.

2.4 The SIP forms part of a framework that includes:
- The Statutory Regulations
- The Pensions Board

[1] http://www.legislation.gov.uk/ssi/2010/233/crossheading/investment-and-use-of-pension-fund-money/made

- The Pensions Committee
- The Investment Sub Committee
- The Funding Strategy Statement
- Administration Strategy
- Governance Policy

2.5 As set out in the 2010 Regulations, the SIP should set out policy on the following:

- the types of investment to be held (Appendix 2)
- the balance between different types of investment (Appendix 2)
- risk, including the ways in which risks are to be measured and managed (section 9)
- the expected return on investments (section 10)
- the realisation of investments (section 12)
- the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments (section 14)
- the exercise of the rights (including voting rights) attached to investments (section 16)
- stock lending (section 17)

2.6 In addition, the statement must also cover the extent to which the authority complies with guidance provided by the Scottish Ministers and, to the extent it does not comply, the reasons for not complying.

3. Pension Fund Ownership and Responsibilities

3.1 The administration of the HCPF is a statutory duty on the Council required by Regulations made under the Superannuation Act 1972. It is neither a joint function with other Councils nor a lead authority arrangement. The Fund's status is that of a Fund of the Council, which is regulated by statutory instruments. The Fund has no separate legal identity from the Council.

3.2 Elected Members of the Council, therefore, who serve on the Pensions Committee and Board, and Investment Sub-Committee, serve not as Trustees but in the same capacity that they serve on other Committees of the Council. It is, however, widely held that in administering LGPS Funds, Councillors are in the same position as a body of Trustees and, in recent years, the term "Quasi Trustee", has come into use to describe Councillors acting in this capacity.

3.3 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 includes instructions on the appointment of Investment Managers. The Regulations also require Quasi Trustees to consider the suitability of particular investments, ensure diversification of the investments and requires them to obtain and consider proper advice, at reasonable intervals, about their investments.

4. Description of Fund's liabilities

4.1 The LGPS is a defined benefit pension scheme which provides benefits related to 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 Fund's assets.

4.2 The employing bodies are responsible for meeting the balance of costs necessary to finance the benefits under the Scheme and their contribution rates are determined from time to time based on the advice of the Fund's Actuary.

4.3 The Regulations require the level of employers' contributions to be as stable as possible.

4.4 Beneficiaries have an interest in the extent to which the Fund's assets are sufficient to meet accrued benefits albeit their benefits are guaranteed by the Regulations. The employers however, have a direct financial interest in the investment return achieved on the Fund's assets since they have a direct bearing on their own costs.

5. Liability Profile

5.1 The funding level shown by the last full Actuarial Valuation at 31/03/14 compared to the valuation at 31/03/11 is shown below.

31/03/11 %	Past Services Liabilities	31/03/14 %
48	Active Members	47
12	Deferred Pensions	14
40	Pensioners	39
£m		£m
1,024	Total Liabilities	1,331
991	Assets	1,279
(33)	Surplus (Deficit)	(52)
96.8%	Funding Level	96.2%

5.2 Active membership liabilities, therefore, are slowly decreasing as a proportion of total membership while the deferred numbers show a slight increase. The Fund's overall liability profile is not untypical of the general position of Funds in the LGPS and many LGPS Funds are much more mature (number of pensioners is equal or greater than number of active members).

5.3 The main actuarial assumptions contained in the last Valuation, together with details of the mix of assets and liabilities are set out in Appendix 1.

6. Funding Strategy

6.1 A Funding Strategy Statement for the Pension Fund has been prepared in accordance with Regulation 75A (1) of the Local Government Pension Scheme (Scotland) Regulations 1998 as amended by the Local Government Pension Scheme (Scotland) Amendment Regulations 2005. The Statement describes the strategy of the Highland Council in acting in its capacity as Administering Authority for the funding of the Highland Council Pension Fund. The Statement can be viewed at **http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Funding%20Strategy%20Statement.pdf**

7. Investment Policy

7.1 The Fund's Investment Policy will be directed to ensuring that in normal market conditions, all accrued benefits are fully covered by the actuarial value of the Fund's assets and that an appropriate level of contributions is agreed by the administering authority to meet the cost of future employers' benefits accruing.

7.2 The existence of surpluses or deficits from previous valuation periods can reduce or increase the contributions made by employers. Volatility in the employers' contribution rate is undesirable and policy will be directed towards ensuring as stable a contribution rate as possible.

7.3 While stability of cost has the higher priority, absolute cost to the employer is also important. This implies:

- that the cost of administering the Fund will be constrained by the adoption of best management practice and benchmarked against leading public and private sector funds;
- that employers will adopt appropriate and economic policies in those areas where they have discretion and where the costs of their actions fall on the Fund;
- that the Fund will recover "strain on the Fund" costs to minimise cross subsidisation between employers;
- that the Fund's overall investment policy will be geared to the production of superior investment returns relative to the growth of liabilities. This implies that the Fund will continue to take an active risk relative to its liability profile.

7.4 The investment policy of the Fund is intended to strike an appropriate balance between the policy most suitable for the long term consistent with the objectives outlined above.

7.5 The long term investment objective of the Fund is to achieve a real rate return of 3-4% per annum on average. The Fund has agreed a strategic benchmark for each Manager (see Appendix 3). In broadly defining the assets to be held and setting the asset allocation this benchmark provides an efficient balance between risk and return in light of the liability profile, and funding level of the Fund. A comparison of the asset allocation implied by the strategic benchmark with the current assets as at 31 December 2015 is given at Appendix 2.

7.6 The strategic benchmark is expected to produce a return over the long term in excess of the investment return assumed in the Actuarial Valuation. The Fund's assets are managed 79% on an active basis and these are expected to outperform their respective benchmarks over the long term. The remainder is managed on an index tracking (Passive) basis.

7.7 The Fund's strategic asset allocation is intended to achieve a satisfactory long term return commensurate with an acceptable level of risk (defined as volatility of returns).

7.8 The Council understand that active management may add to or subtract from the returns which could be achieved by managing the asset mix in a wholly passive manner but they believe that over the long term, active management should add value. This additional return is felt to be worth the increase in investment risk which results from the appointment of active managers.

8. Investment Responsibilities

8.1 The Fund pursues a policy of lowering risk through diversification of both investments and Investment Managers. It has delegated day to day investment decisions to Investment Managers.

8.2 The complete list of investment managers, their mandates and the target split of the Fund is attached as Appendix 3. Management agreements are in place for each Investment Manager, which set out the relevant benchmark performance target, asset allocation ranges, and any investment restrictions.

8.3 The adoption of a strategic benchmark and the explicit monitoring of performance relative to performance targets constrain the Investment Managers from deviating significantly from the intended approach, while permitting flexibility to manage the Fund in such a way as to enhance returns. The division of investment responsibilities is set out below.

8.4 The Council is responsible for:-

- Preparing the Statement of Investment Principles;
- Monitoring compliance with the Statement and reviewing its contents, at least annually;
- The establishment and review of strategic asset allocation benchmarks and targets;
- Appointing the Investment Manager(s) and any external Consultant(s) felt to be necessary;
- Appointing the Custodian(s); and
- Reviewing on a regular basis, the Investment Managers' performance

against established benchmarks, and satisfying themselves as to the Managers' expertise and the quality of their internal systems and controls.

8.5 The Investment Managers are responsible for:-

- The investment of the Fund's assets in compliance with prevailing legislation and the constraints imposed by each Managers' detailed Investment Management Agreement with a view to giving effect to the principles contained in this document so far as reasonably practicable;
- Tactical asset allocation around the benchmarks set out in the Investment Management Agreements;
- Selection of individual securities within asset classes;
- Preparation of a quarterly review of investment performance;
- Attending review meetings at the Council's request;
- Preparation of an annual certificate of compliance with this document;
- Notifying the Council promptly of any breach of their investment management responsibilities as set out in the Investment Management Agreements, this Guide and in the Statement of Investment Principles;
- Providing details in a timely manner to the organisation responsible for the Fund's Performance Measurement (currently the Northern Trust Company), to enable them to calculate the rate of return achieved on the Fund's investments.

8.6 The Custodians are responsible for:-

- The safekeeping of assets and the execution of transactions in accordance with the Custody Agreement;
- Their own compliance with prevailing legislation;
- Providing the Council with quarterly holding lists of the Fund's assets and details of all transactions during the quarter.

8.7 The Actuary is responsible for:-

- Providing the Council with advice as to the maturity of the Fund and its funding level to aid the 'Trustees' in balancing the investment objectives of the Fund through the Actuarial Valuation.

8.8 The Investment Consultants are responsible for:-

- Assisting the Council in the preparation and review of this document if required.
- Providing the Council with advice relating to the establishment of strategic asset allocation benchmarks and any associated ad-hoc investment considerations.

9. Control of Risk

9.1 The Fund pursues a policy of lowering risk through diversification of both investments and investment managers (Appendices 2 and 3). A management agreement is in place for each investment manager, which sets out the relevant benchmark performance target, asset allocation ranges, and any restrictions, as determined for the Fund.

10. Expected Return on Investments

10.1 The long term investment objective of the Fund is to achieve a real rate of return of 3-4% per annum on average.

10.2 The investment strategy for the Fund was determined following a Strategic Review in 2014.

10.3 The expected returns for the various asset classes are shown in Appendix 6. Applying these returns to the strategic benchmark leads to an expected annual return for the Fund of 6.8%, net of fees, before Manager's out performance targets are taken into account.

11. Diversification of Investment

11.1 The Council appointed The Northern Trust Company as the Fund's Global Custodian. As at 31 December 2015, the Fund has seven appointed investment managers.

11.2 The Investment Managers were appointed to outperform prescribed benchmarks while remaining within asset mix constraints. Each Manager, with the exception of the index tracking Manager, has full discretion in asset mix and stock selection, subject to the investment principles contained in this document and, more importantly, to the detailed Investment Management Agreement relative to each appointment, to add value to the benchmark set. In choosing investments, the Managers must have regard to:-

- Their benchmark;
- Their performance objective;
- Diversification; and
- The suitability of those assets.

11.3 If the Manager wishes to invest in investment vehicles which do not form part of the benchmark or in individual securities which are not authorised by the Investment Management Agreement, they must obtain the written authorisation of the Council in advance of any such investment.

11.4 The Council will consider the performance of the Investment Manager at least annually in comparison to agreed strategic benchmarks.

11.5 The Council will review the overall investment strategy of the Fund at least annually and carry out a full strategy review every three years, taking account of changes in the funding position of the Fund. Other non-investment factors, such as salary inflation, price inflation, mortality, early retirement, new entrants etc. may also impact materially on the funding position and strategy.

11.6 The Council agreed a 5% target allocation for Private Equity. A private equity manager was given approval for 50m euro commitment in 2012 and a further commitment was made of 80m euro which was approved by

Committee on 14 August 2014.

11.7 To enable the investment in private equity to be concluded in compliance with The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, the Council agreed to an increase in the maximum limit of total Fund resources which may be invested in any single partnership contract from 2% to 5%, and the limit for contributions to all partnerships from 5% to 15% (under Regulation 14(3)). This was approved by the Resources Committee on 1 December 2011.

11.8 During 2014/15, a procurement exercise was completed for a property debt manager and appointment was made in December 2015. The decision to invest in property debt was approved by Committee on 14 August 2014 and will be funded from passive global equity (1.5%) and passive bonds (2.5%).

11.9 The Committee has taken proper advice in respect of these decisions from the Fund's Investment Advisor, Aon Hewitt.

12. Realisation of Investments

12.1 The majority of the investments held by the Fund are quoted on major stock markets and may be realised quickly if required. Property investment is via pooled funds which are relatively illiquid. These currently make up approximately 10% of the total Fund. There are also private equity (target asset allocation 5%) and property debt investments (target asset allocation 4%) which are relatively illiquid.

12.2 If the active membership of the Highland Fund was to remain stable at 2014 levels then the Fund is projected to be a net investor for around 10 years and assuming the current investment income yield of around 2% is maintained, then this would generate sufficient income to meet benefit payments for the foreseeable future.

12.3 However a combination of public sector cuts (voluntary redundancy exercise 2016), member opt-outs or outsourcing which reduces the pensionable payroll could bring forward the date when the Fund has to use investment income to meet benefit payments.

12.4 However provided the investment income yield remains at current levels then the time when assets need to be sold to meet benefit payments still looks a long way off (total benefit outflow to be higher than the contribution income to the Fund from around 2026 onwards).

13. Underwriting

13.1 Investment Managers are permitted to underwrite and sub underwrite stock issues only on the basis that the subject stock is already held in the portfolio or that the Manager wishes to acquire a long term holding.

14. Social, Environmental and Ethical Considerations

14.1 The following approach was approved at the Resources Committee on 1 October 2008. The Fund recognises that social, environmental and ethical considerations are among the factors which Investment Managers will take into account, where relevant, when selecting investments for purchase, retention or sale. Public opinion and consumerism are beginning to add a further dimension to corporate life such that companies which act irresponsibly or without consideration for the public view may run serious reputational risk which could have a significant impact on their earnings and ultimately on the value of their shares.

14.2 In general terms, this means that there is a group of socially responsible investment type concerns which investors need to be aware of and which should be taken into consideration when the decision to invest is being made. This does not mean that the decision whether or not to invest depends entirely on the assessment of these factors but that they should be weighed in the balance along with all over relevant factors when decisions to buy, hold or sell investments are being made.

14.3 The Council has elected to delegate management of the Fund to external Investment Managers with a view to securing the best financial interests of Fund beneficiaries, contributing employers and Council taxpayers.

14.4 The Council has instructed the Investment Managers to take into account the key principles of socially responsible investment primarily through a policy of engagement with Companies that demonstrate appropriate observance of these principles.

14.5 Engagement in this context is to involve the Investment Managers in:

- Meeting and corresponding with Companies on relevant issues;
- Working with the representatives of other shareholders, where appropriate;
- Voting against adverse proposals at Company AGM/EGMs;
- Reporting regularly on actions taken in this regard.

15. Corporate Governance

15.1 The Fund ensures that the votes attaching to its holdings in all UK quoted companies are exercised whenever practical. The Fund's votes are exercised by its Investment Managers in accordance with their own policies and practices and taking account of the Combined Code on Corporate Governance.

16. Exercise of Voting Rights

16.1 Voting rights are exercised at the discretion of each investment manager, in line with the manager's own voting policies and procedures, and subject to any specific instructions from the Pension Fund. The Council's Custodian provides regular reports on voting undertaken.

17. Stock Lending

17.1 It was agreed by Resources Committee on 1 October 2008[2] that the Council could enter into stock lending with The Northern Trust on the basis of an income split in the Council's favour, that the amount of lendable securities be limited to a maximum of 25% of the value of the Fund; and this arrangement was to be regularly reviewed to take account of changing market circumstances.

17.2 After approval was given to enter stock lending there was the banking crisis which resulted in a Government rescue package for RBS and Bank of Scotland in October 2008. Following the banking crisis, it was decided not to enter any stock lending agreements.

17.3 During 2015, after evaluation of the risks and assurance that there will be adequate collateral to support stock lending arrangements it was decided that The Fund will undertake stock lending. The Fund is in the process of negotiating a stock-lending agreement with Northern Trust.

18. Compliance

18.1 Investment Managers will provide an annual statement to the Council confirming that they have given effect to the investment principles contained in this document so far as reasonably practicable (highlighting exceptions).

18.2 The Custodian will certify on an annual basis that they have complied with this document.

18.3 The Council will be responsible for assessing the risks assumed by the Fund at global level, i.e. assuming that the portfolios of the individual Investment Managers were amalgamated.

18.4 The Council is responsible for monitoring the Fund's performance both at the global level and at Investment Manager level.

18.5 The Council is responsible for monitoring the qualitative performance of the Investment Managers and Custodians employed to ensure that they remain suitable for the Fund. These qualitative aspects include, inter alia, changes in ownership, changes in personnel, poor administration, compliance with regulatory bodies/codes/guidelines etc.

18.6 Adhering to guidance given by Scottish Ministers, The Fund is compliant with the six revised principles on investment decision making for occupational pension schemes, as set out in guidance published by the Chartered Institute of Public Finance and Accountancy in December 2009 called 'Investment Decision Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners

Principles' (see Appendix 5).

18.7 The Fund is compliant with the statutory restrictions set out in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.

18.8 The Council will regularly consider the Fund's compliance with this Statement of Investment Principles. The Statement will be reviewed annually and a revised Statement prepared and published where there has been any material change in the Fund's policies.

Recommendation

The Committee is invited to approve the Statement of Investment Principles.

Designation:	Director of Finance
Date:	8 February 2016
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Appendix 1 – Actuarial Valuation

Main Actuarial Assumptions as at 31 March 2014

	Nominal	**Real**
Discount rate	5.3%	2.6%
Increases in pay (exc. Promotional increases)	4.5%	1.8%
Price inflation (pension increases)	3.0%	-

This funding method used is known as the Projected Unit Method. As well as the whole fund, it is appropriate for individual employers that continue to admit new entrants to the Fund.

However, some participating employers may have a policy of not admitting new entrants. In this case, the membership profile will inevitably begin to age. Under these circumstances, the Projected Unit Method is arguably no longer appropriate and will not promote sufficient stability in the future service rate. For these employers, a funding method known as the Attained Age Method is adopted, which effectively looks at the cost of benefits that members will earn over the entirety of their remaining working lifetime (rather than just the year following the valuation).

Based on the actuarial valuation as at 31 March 2014.

Appendix 2 – Asset mix as at 31 December 2015

	Fund		Target
Asset Class	**%**	**%**	**%**
UK Equities	33.2		30.7*
Global Equities	30.9		30.3
Total Equities		**64.1**	**61.0**
Total Fixed Income	18.1	**18.1**	**20.0***
Property Debt	2.5	**2.5**	**4.0***
Property	11.3	**11.3**	**10.0**
Private Equity	4.0	**4.0**	**5.0***
Total Assets		**100.00**	**100.0**

*The targets shown reflect expected targets following full draw-down of the private equity and property debt mandates. Full draw down is expected to take several years. Full draw down will see a decrease in fund assets in UK equities and gilts, and an increase in Private Equity assets, compared to the 31 December 2015 position shown above.

Appendix 3 - Fund manager structure effective from December 2015

Manager	TOTAL	Mandate	Target	Benchmark	Performance objectives
Baillie Gifford	**33%**	UK Equity (active)	18.2%	FTSE All Share Index	Outperform by 1.5% p.a. (gross of fees) over rolling 3 yr period.
		Global Equity (active)	14.8%	MSCI All Countries World Index	Outperform by 2.5% p.a. (gross of fees) over rolling 5 yr periods.
Pyrford	**12%**	Global Equity (active)	12%	MSCI All Countries World Index	Outperform benchmark by 2-4% p.a. (net of fees) over rolling 5 yr periods.
Legal and General	**21%**	UK Equity (passive)	12.5%	FTSE All Share Index	Perform in line with index within stated tolerance ranges.
		Global Equity (passive)	3.5%	FTSE World (ex-UK)	
		Bonds (passive)	5.0%	All Stocks Gilts Over 5 Index Linked Gilts	
Fidelity	**15%**	UK gilts and non-gilt fixed interest securities (active)	7.5%	50% iBoxx Gilts 50% iBoxx Non Gilts	Outperform by 1.25% p.a. (gross of fees) over 3 year periods.
		UK and International Government and Corporate Bonds (active)	2.25%	50% BoA Merrill Lynch 15+yr UK gilt index 50% BoA Merrill Lynch 15+yr Sterling Non-Gilt index	
		UK and International Government and Corporate Bonds	5.25%	Custom aggregate (targeting 5 yrs duration index; consisting of: 50% BoA Merrill Lynch 15+yr UK gilt index 50% BoA Merrill Lynch 15+yr Sterling Non-Gilt index BoA Merrill Lynch Sterling Synthetic Par Coupon Swap indices	
Standard Life	**4%**	Commercial Real Estate Debt (active)	4%	LIBOR + 2%	Expected target return of 5% to 6% based on the current expected course of future interest rates over the life of the fund.
Schroders	**10%**	Property (active)	10%	IPD Balanced Property Unit Trust Median	Outperform by 0.75% on a 3 yr rolling basis.
Partners Group	**5%**	Private equity (active)	5%	MSCI World GD Index	Outperform quoted equities (by 3-5% p.a.) over program life.
	100%		100%		

Appendix 4 – Custodian, External Advisers, & Auditor Details

	Name	Address
Custodian and Investment Analyst	The Northern Trust Company	50 Bank Street Canary Wharf LONDON , EC2Y 5EA
Actuary	Hymans Robertson Consultants and Actuaries	Central Exchange 20 Waterloo Street GLASGOW, G2 6DB
Investment Consultant	Aon Hewitt	Aon Hewitt Consulting Atria One 144 Morrison Street Edinburgh EH3 8EX
External Auditor	Audit Scotland	Ballantyne House 84 Academy Street INVERNESS, IV1 1LU

Appendix 5 Statement of Compliance with CIPFA Principles for Investment Decision Making

PRINCIPLE	COMPLIANCE	EVIDENCE
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*.	Fully compliant	Members are formally briefed on their fiduciary responsibility in the stewardship of the Pension Fund. Members take advice from the Council's officers, investment adviser, investment managers and global custodian. Members participate in a rolling training programme involving attendance at specific presentations, courses and seminars. Successive Councils have agreed to the formulation of an Investment Sub-Committee to consider pension fund issues and make recommendations to the Council's Pensions Committee and Board.
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 tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisors and investment managers.*	Fully compliant	Overall Fund objectives and attitude to risk are set out in the "Statement of Investment Principles" (SIP) which is regularly reviewed. The Fund's SIP, Funding Strategy Statements (FSS) and final accounts are available on the Council's website for all interested parties. Fund assets and liabilities are accounted for in triennial valuations prepared by the Fund's actuary. Periodic asset/liability exercises have been carried out by consultants and officers since 2003 leading to the development and ongoing review of bespoke benchmarks.
3. Risk and Liabilities *In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.*	Fully compliant	The Fund takes advice from the actuary regarding the nature of its liabilities. Asset-liability modelling is undertaken periodically to aid the setting of investment strategy, and exercises specifically take account of covenant strength

These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.		when assessing risk tolerance. Asset-liability modelling is undertaken by the investment advisor who obtains information from the actuary regarding liabilities to use in the model. All risk measurement in this context is performed with reference to the liabilities. The funding strategy for the Fund is expressed in relation to solvency of the Fund. Consideration is given to affordability of employer contributions at the actuarial valuation. The Pension Fund operates within the internal control arrangements administered by the Council which are subject to internal and external audit. All audit reports are scrutinised by the Council's Audit and Scrutiny Committee. The external auditors report annually to the Council's Audit and Scrutiny Committee. The Council maintains a risk register. The Council's risk management process would highlight any risks relating to the Pension Fund and these would be included in the risk register if appropriate. The risk register is reported to the Council's Audit and Scrutiny Committee. http://www.highland.gov.uk/meetings/meeting/3571/pensions_committee
4. Performance Assessment *Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors.* *Administering authorities should also periodically*	Fully compliant	The Fund's performance and performance of the Fund Investment Managers is monitored quarterly by officers, the Global Custodian, the Investment Advisor and the Investment Sub-Committee. Investment Managers are given specific performance targets and these are assessed as part of the mandate monitoring process.

*make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members***.**		The Investment Sub-Committee monitors performance against planned activities detailed in the Highland Council Pension Fund portfolio mandates, and reviews the appointment of advisers when appropriate. Investment managers attend the Investment Sub-Committee when requested, to explain performance. Training and attendance of members of the Investment Sub-Committee is monitored and recorded..
5. Responsible Ownership *Administering authorities should:* *Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee 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.*	Fully compliant	The Fund's Investment Managers have adopted the UK Stewardship Code 2010. The seven principles in the Code cover, and expand upon, the main issues highlighted in the Institutional Shareholders' Committee Statement of Principles (1991).The Highland Council Pension Fund delegates its voting responsibilities to relevant Investment Managers The Fund's policy on Social, Environmental and Ethical Considerations is included in the Statement of Investment Principles. The Fund's Annual Report and Accounts reproduces a summary of the Statement of Investment Principles. The Annual Report and Accounts and the Statement of Investment Principles is available on the Council's website.
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*	Fully compliant	Members are given information through the Council's web site, periodic seminars and newsletters. The Statement of Investment Principles (SIP), Funding Strategy Statement and Pension Fund Compliance Statement along with the Pension Fund Annual Report are

objectives. *Provide regular communication to scheme members in the form they consider most appropriate.*		published on the Council's web site. http://www.highlandpensionfund.org/about-us/forms-and-publications.aspx The Fund's policy statements, including its Governance Policy Statement, SIP and FSS are maintained regularly. Documents are available on the Council's website for stakeholders and any other interested parties. The Fund produces an Annual Report and Accounts, referring to the availability of the key documents (listed above) on the Council's website. http://www.highlandpensionfund.org/about-us/forms-and-publications.aspx The Fund produces periodic newsletters for pensioner members and for active members and briefings for employers. The website is updated regularly. The Investment Sub-Committee Minutes are submitted for approval to the Council's Pensions Committee and are published on the Council's website.

Appendix 6 – Expected Return on Investments

As at 31 March 2014 the expected returns on investments, as calculated by Hymans Robertson using the Hymans Robertson Asset Model (HRAM) and provided to the Council in July 2015 are shown below.

The expected returns shown in the table below are the 20 year (absolute) geometric averages and the volatilities quoted are the first year's standard deviations. All returns are shown net of fees. No allowance for active management has been made with the calculation of these returns.

Asset Class	Expected Return (% pa)	Expected Volatility (% pa)
UK Equities	6.8	17.0
Global Equities	6.5	19.0
Private Equity	8.1	28.0
Fixed interest gilts	3.6	10.0
Corporate Bonds	4.4	12.0
Property (commercial)	4.8	15.0
Property debt	5.4	9.0
Portfolio	6.8	12.0