

Agenda Item	3
Report No	PC/9/24

HIGHLAND COUNCIL

Committee: Pensions Committee

Date: 24 June 2024

Report Title: **Statement of Investment Principles**

Report By: Head of Corporate Finance

1 Purpose/Executive Summary

- 1.1 The purpose of this report is to seek approval from Members on the proposed Statement of Investment Principles (SIP) for the Highland Council Pension Fund (“the Fund”).
- 1.2 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).

2 Recommendations

- 2.1 Members are invited to:
 - i. Approve the Statement of Investment Principles.
 - ii. Approve the revised strategic asset allocation in Appendix 1.

3 Implications

- 3.1 Resource – officer resource will be required to implement the proposed changes which will also need support from the Fund’s Investment Advisor. The costs of specialist professional advice provided by the Fund’s Investment Advisor are reported and monitored at Investment Sub Committee. These costs are also monitored against budget and reported to the Pensions Committee.
- 3.2 Legal –The Highland Council (the “Council”), in its capacity as Administering Authority for the Highland Council Pension Fund (“the Fund”) is required by legislation to prepare, maintain and publish a written statement of the principles governing its decisions about the investment of fund money. The legislation sets out policy that must be covered in the statement of investment principles (Regulation 12(1) and 12(2) of the Local Government Pension Scheme (of the Management and Investment of Funds) (Scotland) Regulations 2010 (No. 233) as amended by the 2016 regulations (No. 74)).

It is a legislative requirement that Fund should obtain proper advice at reasonable intervals and consider such advice in taking any steps in relation to its investments (Regulation 11(5) and (6), Local Government Pension Scheme (of the Management and Investment of Funds) (Scotland) Regulations 2010.

- 3.3 Community (Equality, Poverty, Rural and Island) – there are no specific community implications for this report.
- 3.4 Climate Change / Carbon Clever – alongside the SIP, a key document is the Responsible Investment policy which documents the Fund’s approach to the oversight and monitoring of investment activities from a Responsible Investment (RI) perspective. Information on the RI policy is provided in the SIP (section 14). The Pensions Committee aims to integrate consideration of ESG issues in all aspects of the investment decision-making including modelling and setting investment strategy and monitoring the Fund's investment managers.
- 3.5 Health and Safety (risks arising from changes to plant, equipment, or people) – there are no Health and Safety (risks arising from changes to plant, equipment, or people) considerations to be included in the report.
- 3.6 Risk – the key investment strategy risks for the Fund are set out below, with equity risk and inflation risk identified as the most significant risks to the Fund’s funding position:
- Equity risk – due to their high volatility, equities and the higher strategic allocation to this asset class, equities are the largest growth asset but highest risk.
 - Inflation risk – higher inflation increases the value of the Fund liabilities.

- Other growth asset risk – loss of value in other growth assets such as UK property, global infrastructure equity and private credit is a risk. The Fund’s diversification of these asset classes helps to improve efficiency and reduce this risk.
- Longevity risk – increases in assumed longevity increases the value of the Fund liabilities.

The Fund’s Investment Advisor recommended changes to the investment asset allocation to manage these risks, which were agreed by Investment Sub Committee on 29 May 2024 and are reflected in the SIP (Appendix 1).

4 Background

- 4.1 On 29 May, the Investment Sub Committee (ISC) reviewed the Investment Strategy Review report prepared by the Fund’s Investment Advisor. This report included recommendations to change the strategic asset allocation in the context of the strong funding position of the Fund at the recent 2023 Actuarial Valuation (136% funding level) and to manage investment risk.
- 4.2 The recommended changes to the strategic asset allocation which were agreed by the ISC are as follows (28 May ISC minutes are to go to Council for approval 27 June 2024):
- For the assets supporting the accrued and future liabilities c 75% of total Fund assets, reduce the target strategic allocation to UK property by 2% (to be 6% of total portfolio) and increase infrastructure by 2% (to be 5.3% of total portfolio) in order to increase direct inflation protection and reflect the Fund’s Investment Advisor’s (Aon) current relative views on those asset classes.
 - For the surplus assets of 25% of total Fund assets invest
 - 50% in index linked gilts (to take the allocation to 12.5% of total portfolio)
 - 25% in global corporate bonds (to take the allocation to 8.4% of total portfolio) and
 - 25% in asset backed securities (to take the direct allocation to 6.3% of total portfolio).
- 4.3 The reason for these changes to the strategic asset allocation is to secure the Pension Fund surplus from the recent 2023 Actuarial Valuation (Pensions Committee, February 2024) and manage equity and inflation risks by investing in index linked gilts, corporate bonds and asset backed securities.

The investment objectives for these surplus assets will be to:

- Preserve value to support reduced future Employer contributions.
- Provide a buffer for the funding position against falls in the assets supporting the liabilities.
- Be largely liquid to enable the investment of these assets to be revised if required in 3 years’ time after the 2026 actuarial valuation and meet any unexpected cashflow requirements.

- 4.4 The Highland Council Pensions Committee and Board has delegated responsibility for the supervision of the Fund. This includes the specific delegated duty to set the Investments Strategy (including strategic asset allocation) and associated policies for the Pension Fund and oversee the ISC in the implementation of Investment Strategy and policies.
- 4.5 Therefore, the Pensions Committee and Board must approve the Statement of Investment Principles which sets out investment strategy and policy and includes the investment asset allocation. If Pensions Committee approves the revised strategic asset allocation, the next steps are that officers with the support of the Fund's Investment Advisor will develop a transition plan and regular updates will be provided to ISC, who will oversee implementation and monitor progress.
- 4.6 The next scheduled Pensions Committee is 9 October which would mean a delay of over 4 months between ISC approving the revised strategic asset allocation and the Pensions Committee approving the SIP, before these changes can be implemented. The Fund's Investment Advisor has recommended a phased approach to implementing this change. The purpose of this report and additional meeting of the Committee, is to support early consideration of this updated SIP and allow progress to be made with the transition of investments.
- 4.7 With current volatility in gilt markets which could be impacted by potential interest rate cuts and geopolitical events it was considered prudent to schedule a special meeting to invite Pensions Committee members to approve the SIP containing recommended changes to the strategic asset allocation.

5 Highland Council Pension Fund Statement of Investment Principles (SIP)

- 5.1 The Fund is required by legislation to prepare, maintain and publish a written statement of the principles governing its decisions about the investment of fund money.
- 5.2 In accordance with the 2010 Regulations, the SIP sets out policy on the following:
- the types of investment to be held (Appendix 1)
 - the balance between different types of investment (Appendix 1)
 - 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)

- 5.3 The key changes to the SIP are the revised strategic asset allocation at Appendix 1, with the reasons for this are covered in this report. The SIP has also been updated to reference the Responsible Investment policy.

Designation: Head of Corporate Finance

Date: 17 June 2024

Author: Catriona Stachan, Pension Fund Manager

Background Papers: LGPS regulations, Aon Investment Strategy review report presented to ISC 29 May 2024.



Highland Council Pension Fund Statement of Investment Principles

**Pensions Committee
24 June 2024**

Amendments

- 22/09/2021 Appendix 1 – Change to Strategic Asset Allocation (reduce allocation to UK equities)
- 14/02/2022 Appendix 1 – Change to Strategic Asset Allocation (increase percentage from passive to active manager)
- 24/06/2024 Full document review and revised Strategic Asset Allocation

1. Background

- 1.1 This Statement of Investment Principles (SIP) describes the principles governing the decisions made by the Highland Council Pension's Committee regarding the management of the Highland Council Pension Fund investments.
- 1.2 The Highland Council (the "Council"), in its capacity as Administering Authority for the Highland Council Pension Fund ("the Fund") is required by legislation to prepare, maintain and publish a written statement of the principles governing its decisions about the investment of fund money.¹
- 1.3 Alongside the SIP is the Fund's Responsible Investment (RI) Policy which documents Fund's approach to the oversight and monitoring of investment activities from a Responsible Investment (RI) perspective and more information is provided on this in section 14.
<https://www.highlandpensionfund.org/resources/responsible-investment-policy/>
- 1.4 The SIP must be reviewed regularly and should be updated when there are material changes in investment policy.

2. Governance

- 2.1 The Highland Council is the Administering Authority for the Highland Council Pension Fund ("the Fund").
- 2.2 The Highland Council Pensions Committee and Board has delegated responsibility for the supervision of the Fund. This includes the specific delegated duty to set the Investments Strategy (including strategic asset allocation) and associated policies for the Pension Fund and oversee the Investment Sub-Committee in the implementation of Investment Strategy and policies.
- 2.3 The appointment of Investment Advisors, Actuaries and Performance Measurement Consultants to give advice and assist in the discharge of the Authority's responsibilities is conducted by Officers of Highland Council in compliance with competitive tendering procedures. Details of the current Investment Advisor, Actuaries and Performance Measurement Consultants are at Appendix 4.
- 2.4 The SIP forms part of a governance framework that includes the following structures policies and strategies:
- The Statutory Regulations
 - The Pensions Board

¹ Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (No. 233) as amended by the 2016 regulations (No. 74)

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

- 2.5 The primary objective of the Fund is to ensure that there are sufficient funds available to meet all liabilities as they fall due.
- 2.6 The funding objectives are documented in the Funding Strategy Statement, which is reviewed at least triennially alongside the Actuarial Valuation. Key considerations in setting the investment strategy are the funding objectives, alongside targeted rates of return and levels of risk tolerance. These considerations determine the allocation across different types of investment (asset classes). Definitions of the asset classes are at Appendix 2.
- 2.7 The investment objectives of the pension fund are to achieve a return on assets which is sufficient over the long term to meet the funding objectives outlined in the Funding Strategy Statement, i.e. to pay liabilities and to make the scheme affordable to employers now and in the future, while minimising any increase in contribution rates.
- 2.8 In accordance with the 2010 Regulations, the SIP sets out policy on the following:
- the types of investment to be held (Appendix 1)
 - the balance between different types of investment (Appendix 1)
 - 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)
- 2.9 The SIP 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. The Fund fully complies with the guidance provided by Scottish Ministers.

3. Pension Fund Ownership and Responsibilities

- 3.1 The administration of the Fund 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 the term "Quasi Trustee", is used to describe Councillors acting in this capacity. The "quasi trustee role" can be defined as; the fiduciary duty to scheme beneficiaries, which must always be put before the interests of individuals, individual groups or sectors represented on the Committee.
- 3.3 The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 set out the rules on the appointment of Investment Managers. The Regulations also require Committee to consider the suitability of particular investments, ensure diversification of the investments and obtain and consider proper advice, at reasonable intervals, about their investment managers and their term of appointment.

4. Description of Fund's liabilities

- 4.1 The LGPS is a defined benefit pension scheme which provides benefits related to 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 as member benefits are guaranteed by the Regulations.
- 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 during the triennial actuarial valuation process. Therefore, employers, have a direct financial interest in the investment return achieved on the Fund's assets as these could potentially impact employer contributions rates.
- 4.3 The Regulations require the level of employers' contributions to be as stable as possible.

5. Liability Profile

- 5.1 The funding level shown by the last full Actuarial Valuation at 31/03/23 compared to the valuation at 31/03/20 is shown below with the Valuation published on the Fund's website. <https://www.highlandpensionfund.org/resources/actuarial-valuation-report-2023/>

The past service funding position has improved due to better than expected investment returns and higher assumed future investment returns, which have more than offset the increase in short to medium-term inflation expectations.

31/03/20 £m	31/03/20 No	Past Services Liabilities	31/03/23 £m	31/03/23 No
782 (41%)	12,617	Active Members	674 (38%)	13,182
301 (16%)	11,918	Deferred Pensions	276 (16%)	14,045
803 (43%)	10,497	Pensioners	823 (46%)	12,026
1,886		Total Liabilities	1,773	
1,892		Assets	2,406	
6		Surplus (Deficit)	633	
100%		Funding Level	136%	

- 5.2 Overall pensioner liabilities have increased with active membership liabilities, slowly decreasing as a proportion of total membership while the pensioner numbers have increased. 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 most recent and previous valuations are below.

Assumptions	31/03/20	31/03/23
Discount rate – to place a 'today's money' value on all the benefits promised to scheme members at the valuation date. The Fund's assets are estimated to have a 80% likelihood of achieving a return that is at least equal the discount rate).	3.2% pa	5.2% pa
Benefit increases/CARE revaluation – to determine the size of future benefit payments.	1.7% pa	2.3% pa
Salary increases – to determine the size of future final-salary linked benefit payments.	2.5% pa	3.1% pa

6. Funding Strategy

- 6.1 The Funding Strategy 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. This was 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. And is published on the Fund's website.
<https://www.highlandpensionfund.org/resources/funding-strategy-statement-2023/>

7. Investment Policy

- 7.1 The objective of the Fund's Investment Policy is 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 employees' 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 is maintained.
- 7.3 While stability of cost has the higher priority, absolute cost to the employer is also important which is why the following are key considerations:
- 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 focussed on generating a growth in investment returns relative to the growth of liabilities alongside managing investment risks.
- 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 5-6% per annum on average. The Fund has a strategic benchmark for each Manager. In broadly defining the assets to be held and setting the strategic asset allocation this benchmark provides an efficient balance between risk and return considering the liability profile, and funding level of the Fund. There are changes proposed to the

current strategic asset allocation in order to reduce the overall risk in the Fund and protect the real or nominal value of the surplus from the 2023 actuarial valuation. The current assets as at 31 May 2024 and proposed strategic asset allocation, is at Appendix 1.

- 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 currently managed approximately 80% 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. The plan is for the Fund's assets being managed approximately 70% on an active basis and 30% on a passive basis.
- 7.7 The aim of the Fund's strategic asset allocation should be to achieve a satisfactory long term return commensurate with an acceptable level of risk (defined as volatility of returns).
- 7.8 The Committee understands 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 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 roles and responsibilities of the main parties involved in management of the Fund are set out in Appendix 4.

9. Control of Risk

- 9.1 The Fund pursues a policy of lowering risk through diversification of both investments and investment managers (Appendix 1). 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. Investment risks are reviewed and assessed on an ongoing basis and reported to Pensions Committee. The identification, assessment and consideration of investment risks is a key part of reviewing the Investment Strategy and deciding the investment asset allocation.

10. Expected Return on Investments

- 10.1 The long-term investment objective of the Fund is to achieve a real rate of return of at least 2.9% per annum (in line with the Fund Actuary's valuation assumptions), but the best estimate long term expectation of the Fund was modelled to be a real return of 5-6% per annum on average.

- 10.2 The Fund's Investment Advisors formally reviewed the strategic asset allocation in May 2024 as part of an Investment Strategy Review that was reported to Investment Sub Committee on 29 May 2024. The outcome of this review was to recommend a revised strategic asset allocation in view of the very strong returns and increase in projected surplus assets reported in the triennial Actuarial Valuation. The revised strategic asset allocation is at Appendix 1.
- 10.3 Based on capital market assumptions as at 30 September 2023, the expected nominal return for the revised strategic asset allocation backing the accrued and future accruing liabilities is 8.1% each year (10 year average expected return) and an expected real return of 5.7% each year (10 year average expected return above CPI); and for the overall assets' revised strategic asset allocation the expected nominal return is 7.6% each year (10 year average expected return) and an expected real return of 5.2% each year (10 year average expected return above CPI) (Appendix 1). The strategic asset allocation is kept under regular review by Officers and the Investment Sub-Committee.

11. Diversification of Investment

- 11.1 The Fund appointed The Northern Trust Company (Northern Trust) as the Fund's Global Custodian. Northern Trust are responsible for ensuring safe custody of the Fund's assets managed by the appointed investment managers and providing consolidated accounting and performance reporting services to the Fund.
- 11.2 The Fund has 12 investment managers at 31 May 2024. The Investment Managers were appointed to outperform prescribed benchmarks while remaining within asset mix constraints. Each Manager, with the exception of the index tracking passive 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:
- benchmark
 - performance objective
 - diversification; and
 - suitability of 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 Fund in advance of any such investment.

- 11.4 The Fund will consider the performance of the Investment Manager at least annually in comparison to agreed strategic benchmarks.
- 11.5 The Fund 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 Committee has taken proper advice in respect of all the above decisions and review of strategy from the Fund's Investment Advisor, Aon.

12. Realisation of Investments

- 12.1 Approximately 70% of the investments held by the Fund at 31 May 2024 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 9.4% of the total Fund with the revised allocation being 6.0%. There are also private equity (target asset allocation 3.7%), private credit (target asset allocation 5.4%) and infrastructure equity investments (target asset allocation 5.3%) which are very illiquid.
- 12.2 If the active membership of the Fund was to remain stable at 2023 levels and general cashflows remain similar, then the Fund will be in a marginally cash negative position.
- 12.3 However, assuming the current investment income yield is maintained (2022/23 investment income was £40m), then this would generate sufficient income to meet benefit payments for the immediate future. Provided the investment income yield remains at current levels then the time when assets need to be sold to meet benefit payments still looks sometime in the future.
- 12.4 It should be noted that the negative cash flow position could be increased by a combination of public sector cuts, member opt-outs or outsourcing which reduces the pensionable payroll.
- 12.5 Cash flow modelling will be completed, as required, to plan for the future maturity of the Fund.

13. Underwriting

- 13.1 The Fund's 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. Responsible investing

14.1 The Pensions Committee has a fiduciary duty to act in the best financial interest of the employers and members of the Fund and ensure that the objectives of the Fund are met. Alongside this fiduciary duty, The Highland Council Pension Fund is a long-term investor, and the Pensions Committee members recognise that they should incorporate ESG (Environmental Social Governance) risks into the investment decision making process and monitoring process. If ESG risks are not understood, evaluated and managed properly these could negatively impact the long-term value of investments.

14.2 The Fund acknowledges its responsibilities as an institutional asset owner with long term liabilities and takes the approach that there should be effective stewardship of all the Fund's assets which focuses on good corporate governance to deliver sustainable investor value.

14.3 The Pensions Committee and Board participated in a series of workshops to develop a Responsible Investment policy which was approved by Committee in February 2022.

<https://www.highlandpensionfund.org/resources/responsible-investment-policy/>

14.4 The Fund's RI policy sets out the following:

- the Fund's beliefs and principles and approach to Responsible Investing. These are that:
 - the Pensions Committee aim to integrate consideration of ESG issues in all aspects of the investment decision-making including modelling and setting investment strategy and monitoring the Fund's investment managers.
 - With the support of the Fund's advisors and officers, consideration is given to the availability, suitability and depth of conviction in an idea or strategy prior to investing and will take into account the expected cost versus potential benefit from a member perspective in line with the Committee members' fiduciary duty.
 - Committee members do not apply personal, ethical or moral judgements when making investment decisions, and will remain focused on the primary objective of acting in the best financial interests of the Fund's members.
 - Committee members undertake periodic training on RI to understand how ESG factors, including climate change, could impact the Fund's assets/liabilities and members' retirement outcomes; and
- the Framework for ESG risk monitoring and assessment.
- expectations that the Fund's investment managers will take account of financially material ESG considerations (including climate change) in the selection,

retention and realisation of investments and their investment approach aligns with the UK Stewardship Code Principles and PRI objective.

- Processes to monitor the performance of managers in meeting these expectations.
- Committee acknowledgement that the Fund's approach to RI will need to continually evolve, due to both the changing landscape with respect to ESG issues and broader industry developments. Committee commitment to making ongoing improvements to our approach and the processes that underpin the delivery of this policy and are focused on making sure that it remains relevant and appropriate for our members.

14.5 The Fund has been a member of the Institutional Investors' Group on Climate Change (IIGCC) since September 2020. This allows the Fund to be aligned with and contribute to one of the leading organisations challenging corporate entities over their climate change policies such as Climate 100+ which was an investor initiative to lobby the world's largest corporate organisations to reduce carbon emissions.

15. Corporate Governance

15.1 The Fund ensures that the votes attached 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 Fund's Custodian provides regular reports on voting undertaken and vote reports are published on the Fund's website.

17. Stock Lending

17.1 The Fund has a stock-lending agreement with Northern Trust. The amount of lendable securities is limited to a maximum of 25% of the value of the Fund; and this arrangement will be regularly reviewed to take account of changing market circumstances.

18. Compliance

18.1 Investment Managers will provide an annual statement to the Fund 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 Fund 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 Fund is responsible for monitoring the Fund's performance both at the global level and at Investment Manager level.
- 18.5 The Fund is responsible for ensuring compliance with legislation including the Markets in Financial Instruments Directive (MiFID II) and having processes in place so that the Highland Council Pension Fund maintains its status as a "professional investor".
- 18.6 The Fund 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.
- 18.7 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' (Appendix 6).
- 18.8 The Fund is compliant with the statutory restrictions set out in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.
- 18.9 The Fund will regularly consider its' 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.

Appendix 1 - Strategic Asset Allocation

Asset classes	Actual 31 May 2024	Target set Feb 2022	Proposed Target June 2024 <i>for assets supporting 'accrued & future accruing liabilities'</i>	Proposed Target June 2024 <i>for 'surplus assets'</i>	Proposed Target Overall Jun 2024 <i>Assuming split between 75% 'accrued & future accruing liabilities'; and 25% 'surplus assets'</i>
Growth					
Global equities - active	39.0%	39.0%	39.0%	-	29.2%
Global equities - protected	16.5%	17.0%	17.0%	-	12.8%
Private equity	7.1%	5.0%	5.0%	-	3.7%
Absolute return strategies	6.0%	5.0%	5.0%	-	3.7%
Total Growth	68.6%	66.0%	66.0%	-	49.4%
Income					
UK Gilts	0.8%	3.0%	3.0%		2.2%
Corporate Bonds	4.7%	3.0%	3.0%	25.0%	8.4%
Asset Backed Securities	-	-	-	25.0%	6.3%
Multi-Asset Credit	3.7%	6.0%	6.0%	-	4.5%
Private Credit - Property Debt	2.7%	3.5%	3.5%	-	2.7%
Private Credit – Corporate Debt	3.4%	3.5%	3.5%	-	2.7%
Total income	15.3%	19.0%	19.0%	50.0%	26.8%
Inflation protection					
UK Index-Linked Gilts	0.6%	-	-	50.0%	12.5%
Infrastructure equity	6.1%	5.0%	7.0%	-	5.3%
UK Property	9.4%	10.0%	8.0%	-	6.0%
Total inflation protection	16.1%	15.0%	15.0%	50.0%	23.8%
Cash	-	-	-	-	-
Total Assets	100.0%	100.0%	100.0%	100.0%	100.0%
Expected return (p.a.)*		8.1%			7.6%
Expected real return (p.a.)**		5.7%			5.2%
Volatility (p.a.)		12.3%			9.5%
Inflation protection (direct)***		-			12.5%

* 10-year median expected return

**10-year median expected return above CPI

***Approximate inflation hedge obtained from index-linked gilts

Appendix 2 – Investment asset class definitions

Investment returns are a combination of income and capital gains/losses. The major types of investments and their characteristics are:

- **Global equities** provide an equitable share in the assets and profits of public companies. Income is traditionally provided through share dividends which, although variable in amount from year to year, have historically risen above inflation. Equities produce capital gains/losses as share prices reflect investors' expectations of the prospects of a specific company, sector or market. Global equities provide exposure to the currency of the market where the shares price is listed. The investment returns will be enhanced, or reduced, by the appreciation or depreciation respectively of the market currency against sterling.
- **Global equities – protected strategies** use derivatives to enable investors to protect some or all of their global equities by retaining a proportion of equity return whilst providing material downside protection. For example, for the global equity protection currently in place as long as returns are not below -25%, equities are full protected against negative returns and also retain up to 36% of any cumulative positive market returns over the period that the equity protection strategy is in place.
- **Private equity** is an alternative investment class and consists of capital that is not listed on a public exchange. Private equity is composed of funds and investors that directly invest in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity.
- **Alternative risk premia strategies** – diversified multi asset investment which is uncorrelated to traditional asset classes and aims to achieve medium-term absolute returns in all market conditions across liquid asset classes.
- **Index linked gilts** are bonds issued by the UK Government. They provide interest and redemption value directly linked to the price of inflation as measured by the Retail Price Index (RPI).
- **Bonds** are debt instruments issued by Governments and other borrowers (in the UK Government Bonds are known as **Gilts** and bonds issued by companies are **Corporate Bonds**). Bonds provide a fixed rate of interest and are generally redeemed at par by the issuer at a known future date. The price primarily reflects the fixed level of interest, the term of the redemption and the overall return (the yield) demanded by the investors. Prices of bonds tend to fluctuate less than the price of equities.
- **Credit** refers to the market through which various parties issue debt to investors. Simply put as payments are received on a debt, the investor earns interest on their security. The credit market includes debt offerings, such as collateralised/structured obligations (including **asset backed securities** and mortgage backed securities), high yield (B/CCC areas), Emerging Market Debt (EMD) and **Multi Asset Credit (MAC)**. **Private credit** can be broadly defined as privately negotiated loans that take place outside of the traditional banking network e.g. Property Debt and Corporate Debt. Credit opportunities are typically

Appendix 2 – Investment asset class definitions

higher yielding comparative to Government issued bonds such as Gilts but do come with a slightly higher risk profile.

- **Property** is investment in land and/or buildings such as offices, retail and industrial. The income comes from the rents payable. Property prices primarily reflect the rents they are able to produce, and investors demand.
- **Infrastructure equity** definitions vary, however typically the term is for the basic physical systems of a business or nation — transportation, communication, sewage, water and electric systems are all examples of infrastructure. These systems tend to be high-cost investments and are vital to a country's economic development and prosperity. Infrastructure is also an asset class that tends to be less volatile than equities over the long term and provides a higher yield. It is also thought to be generally uncorrelated with other asset classes therefore can be a useful diversifier to building a balanced portfolio.
- **Cash** is usually deposited with institutions for very short terms and will attract interest at about money market rates.

Appendix 3 – Investment Mandates

Asset class	Mandate	Manager
Global equity portfolios	Active Global Alpha Paris Aligned	Baillie Gifford
	Active Global Sustainable Equity Fund	Mirova
	Active Global Stock Fund	Dodge and Cox
Protected global equities	Passive World Futures Index with equity protection strategy overlays	LGIM
Gilts	Passive Gilts	
Index linked gilts	Passive Index linked gilts	
Private Equity	Active various private equity funds	Partners Group
Absolute return strategy	Active Alternative risk premia strategies	Man Group
Bonds	Active Sustainable UK Aggregate Bond Fund	Fidelity
Multi asset credit	Active Sustainable development goals	Robeco
UK Property	Active various property funds	Schroders
Global Infrastructure equity	Active Diversified Core Infrastructure	KKR
Private Credit – Property Debt	Active UK property secured lending	BGO
	Active UK property secured lending	Abrdn
Private Credit – Corporate Debt	Active European direct lending	CVC

The breakdown of assets by manager is included in the Fund's Annual Report & Accounts which is published annually.

<https://www.highlandpensionfund.org/resources/annual-report-and-accounts-2022-23/>

Appendix 4 – Custodian, External Advisers, & Auditor Details

Service	Provider	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 Advisor	Aon Investments Limited	Aon Investments Limited Atria One 144 Morrison Street Edinburgh EH3 8EX
External Auditor	Audit Scotland	4th Floor 102 West Port, Edinburgh EH3 9DN

Appendix 5 – Investment Roles and Responsibilities**1. Investment Managers**

1.1 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.

1.2 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 or limited Partnership 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 Fund's request;
- Preparation of an annual certificate of compliance with this document;
- Notifying the Fund 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.

1.3 Management agreements are in place for each Investment Manager, which set out the relevant benchmark performance target, asset allocation ranges, and any investment restrictions.

1.4 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.

2. The Fund

2.1 The Fund is responsible for:

- Preparing the Statement of Investment Principles;
- Monitoring compliance with the Statement and reviewing its contents, at least annually;

Appendix 5 – Investment Roles and Responsibilities

- 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);
- 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; and
- Compliance with relevant legislation including the Markets in Financial Instruments Directive II (MiFID II).

3. Global Custodian

3.1 The Global Custodian is responsible for:

- Safekeeping of assets
- Servicing of assets including income collection
- Execution of transactions in accordance with the Custody and Securities Lending Agreements, corporate actions and proxy voting
- Record keeping and primary accounting
- Compliance with prevailing legislation
- Providing the Fund with quarterly holding lists of the Fund's assets and details of all transactions during the quarter
- Cash management
- Performance measurement reporting

4. Actuary

4.1 The Actuary is responsible for:

- Providing the Fund 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.
- Measurement, monitoring advice and information relating to the Fund's liabilities and the relationship between its investment assets and liabilities.

5. Investment Advisor

5.1 The Investment Advisor is responsible for

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

Appendix 5 – Investment Roles and Responsibilities**6. Pensions Committee**

- 6.1 The Pensions Committee's specific functions include setting the Funds' objectives and ensuring that appropriate strategies, policies and procedures are put in place to achieve these objectives. This requires setting and agreeing strategies, policies and procedures and reviewing these.

7. Investment Sub Committee

- 7.1 The Investment Sub-Committee will exercise the delegated powers and duties of the Pension Committee in relation to the management and investment of the Fund's assets.

8. Pensions Board

- 8.1
- Assist the Scheme Manager (Highland Council) in the operational delivery of the pension scheme in line with scheme regulations and expectations set by The Pensions Regulator (e.g. in Codes of Practice)
 - Key role of the Pension Board is to help ensure the Highland Council Pension Fund complies with governance and administration requirements.

Appendix 6 Statement of Compliance with CIPFA Principles for Investment Decision Making

PRINCIPLE	COMPLIANCE	EVIDENCE
<p>1. Effective Decision Making <i>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.</i></p>	<p>Fully compliant</p>	<p>Members are formally briefed on their fiduciary responsibility in the stewardship of the Pension Fund.</p> <p>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.</p> <p>Successive Councils have agreed to establish an Investment Sub-Committee to consider pension fund investment issues and make recommendations to the Council’s Pensions Committee and Board.</p>
<p>2. Clear Objectives <i>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.</i></p>	<p>Fully compliant</p>	<p>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.</p> <p>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.</p>
<p>3. Risk and Liabilities <i>In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.</i></p>	<p>Fully compliant</p>	<p>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 when assessing risk tolerance. Asset-liability modelling is undertaken by the investment advisor who</p>

Appendix 6 Statement of Compliance with CIPFA Principles for Investment Decision Making

PRINCIPLE	COMPLIANCE	EVIDENCE
<p><i>These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.</i></p>		<p>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.</p> <p>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.</p> <p>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.</p> <p>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 Pension Committee.</p> <p>https://www.highland.gov.uk/meetings/meeting/4938/pensions_committee_and_board</p>
<p>4. Performance Assessment <i>Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors.</i></p>	<p>Fully compliant</p>	<p>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.</p> <p>The Investment Sub-Committee monitors performance against planned activities detailed in the Highland Council Pension Fund</p>

Appendix 6 Statement of Compliance with CIPFA Principles for Investment Decision Making

PRINCIPLE	COMPLIANCE	EVIDENCE
<p><i>Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.</i></p>		<p>portfolio mandates and reviews the appointment of advisers when appropriate. Investment managers attend the Investment Sub-Committee on a rotational basis for members to review their performance.</p> <p>Training and attendance of members of the Investment Sub-Committee is monitored and recorded.</p>
<p>5. Responsible Ownership <i>Administering authorities should:</i> <i>Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents</i> <i>Include a statement of their policy on responsible ownership in the statement of investment principles</i> <i>Report periodically to scheme members on the discharge of such responsibilities.</i></p>	<p>Fully compliant</p>	<p>The Fund's Investment Managers have adopted the UK Stewardship Code. The seven principles in the Code cover, and expand upon, the main issues highlighted in the Institutional Shareholders' Committee Statement of Principles. The Highland Council Pension Fund delegates its voting responsibilities to relevant Investment Managers</p> <p>The Fund's policy on Social, Environmental and Ethical Considerations is included in the Statement of Investment Principles and the Responsible Investment policy.</p> <p>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.</p>
<p>6. Transparency and reporting <i>Administering authorities should:</i> <i>Act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its</i></p>	<p>Fully compliant</p>	<p>Members have access to information on the Pension Fund website, Council's web site, regular seminars and newsletters.</p> <p>The Statement of Investment Principles (SIP), Responsible Investment policy, Funding Strategy Statement and Pension Fund</p>

Appendix 6 Statement of Compliance with CIPFA Principles for Investment Decision Making

PRINCIPLE	COMPLIANCE	EVIDENCE
<p><i>governance and risks, including performance against stated objectives.</i></p> <p><i>Provide regular communication to scheme members in the form they consider most appropriate.</i></p>		<p>Compliance Statement along with the Pension Fund Annual Report are published on the Fund's web site. https://www.highlandpensionfund.org/resources/</p> <p>The Fund's policy statements, including its Governance Policy Statement, SIP and FSS are maintained regularly. Documents are available on the Fund's website for stakeholders and other interested parties.</p> <p>The Fund produces an Annual Report and Accounts, referring to the availability of the key documents (listed above) on the Council's website. https://www.highlandpensionfund.org/resources/annual-report-and-accounts-2022-23/</p> <p>The Fund produces regular newsletters for pensioner members and for active members and briefings for employers. The website is updated regularly.</p> <p>The Investment Sub-Committee Minutes are submitted for approval to the Council's Pensions Committee and are published on the Council's website.</p>