

WILTSHIRE PENSION FUND

Statement of Investment Principles

Introductory Comment

The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999 requires administering authorities to produce Statements of Investment Principles (SIPs).

The SIP for the Wiltshire Pension Fund has now been refined a number of times and this latest version is fully updated to take account of the revisions to the Investment Strategy implemented in 2007. The SIP gives a comprehensive description of the thinking behind the way in which the investments of the Fund are managed.

The Government introduced a code in October 2001 based on the results of HM Treasury's review of institutional investment in the UK, carried out by Paul Myners. This code sets out ten principles that are intended to improve the investment management of pension funds. Administering authorities are required to publish the extent of their compliance with these ten principles.

Sandra Schofield
Chief Financial Officer
June 2007

Approved by Wiltshire Pension Fund Committee on 20 June 2007

Background to the Wiltshire Pension Fund

Outline of Local Government Pension Scheme

The Local Government Pension Scheme (LGPS) is available to all local authority employees and the staff of certain other public and associated bodies, apart from police and fire officers and teachers, who have their own specific schemes.

The LGPS is a funded defined benefit scheme. It is based on statutory provisions, issued by the central government department - Communities and Local Government. The rate of contributions paid by Scheme members and the calculation of benefits paid to them are contained in the statutory provisions. Employer bodies also contribute to the cost of the Scheme (see "Objectives of the Pension Fund").

Role of the Administering Authority

The LGPS is administered by individual "administering authorities", these being prescribed in statute. Wiltshire County Council is the administering authority for the County area of Wiltshire, including Swindon. It has delegated this function to the Wiltshire Pension Fund Committee (the Committee).

Administering authorities are responsible for the administration of a Pension Fund established on behalf of all employer bodies in their Scheme. The Funds are NOT separate legal entities from administering authorities and therefore are not covered by trust law. Nevertheless, the role of the administering authority is very similar to that of a trustee and members of the Committee therefore act in a quasi trustee role.

Objectives of the Pension Fund

The Pension Fund is established to meet all future pension liabilities of Scheme members, whilst at the same time seeking to minimise the contributions that need to be paid in to the Fund by employer bodies. The level of employer contribution is assessed every three years through an actuarial valuation of the Fund.

This valuation establishes the solvency position of the Fund, that is, the extent to which the assets of the Fund are sufficient to meet the Fund's pension liabilities accrued to date. The objective is that the Fund should be at least 100% funded on an ongoing basis, taking account of any additional contributions paid by employer bodies to cover any past service deficit.

Liabilities of the Pension Fund

A fund's potential liabilities increase with every employee admitted to the Scheme, although these liabilities do not come into payment until scheme members reach retirement. The ratio of contributors to pensioners therefore impacts on the cash position of a fund. This is referred to as the maturity position of the fund.

Objectives of Investment Policy

The basic objective of LGPS pension fund investment is to minimise the level of contributions paid into the Fund by employer bodies to ensure its solvency. The

primary requirement of investment policy will therefore be to achieve a real return over the long term which is over and above both the rate of both wage and price inflation.

Funding Strategy Statement

All Local Government Pension Scheme (LGPS) funds have to produce, consult on and publish a document called a “Funding Strategy Statement” (FSS). The purpose of the FSS has been defined as being:

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

However, there will be conflicting objectives which need to be balanced and reconciled. For example, for most employers objective a) implies low contribution rates, because they would see pension liabilities being “best met” by gaining as much help as possible from the investment strategy over the long term, which would lead you towards an equity-biased investment strategy. By contrast, objectives b) and c) imply stability and prudence of employer contribution rates, which would lead you towards a bond biased investment strategy.

Therefore, the best that can be achieved is a sensible balance between these different objectives.

Investment Powers

These are set out in the Local Government Pension Scheme (Management and Investment of Funds) Regulations, which provide wide investment powers, subject to certain restrictions. These regulations were amended in 2003 to allow investment committees to increase their Fund’s exposure to certain type of investments, but only where proper advice has been obtained.

Responsibility for Decisions

The Committee is responsible for overall investment policy and for the implementation of appropriate investment management arrangements. In carrying out this role, the Committee receives advice from independent external advisors and from the Chief Financial Officer. It appoints external investment managers to implement investment policy, who are therefore responsible for day to day investment decisions.

The Committee believes these arrangements strike the right balance between their own overall responsibilities in acting in a quasi trustee role and having decisions taken with the most appropriate level of expertise available.

Policy on Investments

Types of Investments held

The Committee has freedom to operate within the Regulations. Its expectation, however, is that the majority of assets are invested in major stock markets, where the underlying investments can be easily traded if required.

The Fund therefore invests in quoted UK and overseas securities (equities, government and corporate fixed interest and index linked bonds), pooled funds managed by properly authorised organisations (property, equities, active currency and long-short equity hedge funds) and sterling and overseas cash deposits. The Fund also hedges 50-75% of its overseas currency exposure (obtained from equities). It may also invest in futures and options, as well as limited investment in direct property. The Fund, for the present, chooses not to invest in private equity, venture capital or commodities.

The Committee places specific constraints on the use of futures and options, but there are no constraints on the selection of individual investments.

Balance between the Various Types of Investments

An explanation of the relative amount to be invested in each type of investment is provided in the Section below on the strategic benchmark adopted by the Committee (see "Overall Investment Strategy"). In very broad terms, the result is that the Fund is to be invested 70% in equities, 20% in bonds, 10% in property. However, that does not mean that these percentages need to be rigidly maintained.

Expected Returns on Investments

The Committee recognises that the past is not a reliable guide to the future in respect of predicted returns on investment. In addition, it recognises that the range of expected returns is greater for some asset classes than others and that the prospect of higher returns is usually accompanied by higher levels of risk.

Risk Control

The Committee regards the major control of risk to be required at the strategic asset allocation level and this has been taken into account in setting its overall investment strategy.

Further control on the Fund is imposed by employing three active equity managers of differing, but complementary styles (ie. growth, value, unbiased). The employment of a currency manager to manage a passive hedging currency mandate also reduces risk.

The Committee is less attracted to tight regional benchmarks that encourage managers to stay close to the benchmark for their own risk control reason, so the Fund's investments are increasingly moving towards to unconstrained approaches, typically benchmarking against the World Index.

The Committee does not impose specific portfolio risk limits on its equity managers, as it believes the out performance target set for each manager provides sufficient guidance as to the level of risk that each manager should be taking.

Realisation of Investments

The Fund does not currently need to realise investments to meet its pension liabilities and it is projected that this will be the case for a number of years ahead.

Corporate Governance

The Council seeks to use its position as a shareholder to actively encourage good corporate governance practice in those companies in which it invests. It does this by subscribing to the Pensions & Investment Research Consultants Limited (PIRC) Corporate Governance Service and requires its direct equity managers to follow PIRC voting recommendations in the UK.

It is also a member of the Local Authorities Pension Fund Forum (LAPFF), to enable it to act with other local authorities on corporate governance issues. The Forum currently has 40 member funds with assets of more than £75 billion.

Socially Responsible Investment

The County Council expects its investment managers to take account of social, environmental and ethical considerations in the selection, retention and realisation of investments as an integral part of the normal investment research and analysis process, This is insofar as these matters are regarded as impacting on the current and future valuations of individual investments. Taking account of such considerations is seen as forming part of the investment managers' normal fiduciary duty.

As such, the County Council also believes it has a commitment to ensuring that companies in which it invests adopt a responsible attitude toward the environment, and adopt high ethical standards. Generally, such companies are expected to behave in a socially responsible manner by taking account of the interests of all stakeholders.

The County Council seeks to achieve this objective by raising issues with companies in which it invests, to raise standards in a way that is consistent with long term shareholder value. Again, the County Council primarily uses its membership of LAPFF to affect this policy.

Other Matters

The County Council participates in a securities lending programme managed by its global custodian. It will also underwrite, or sub-underwrite, new issues where the investment managers are prepared to hold the relevant shares.

A Commission Recapture programme was introduced in 2003-04, where an element of the commission that is paid to brokers on stock market transactions is recovered.

Current Investment Strategy

Solvency Position of the Wiltshire Pension Fund

The results of the actuarial valuation of the Fund as at 31 March 2004 showed that Fund liabilities totalled £950 million, whilst assets stood at £710 million. The Fund therefore had a deficit of assets of £240 million, or expressed another way, had a solvency level of 75%. This compared with a solvency position at 31 March 2001 of 80%. Whilst regrettable, this drop of 5% is amongst the lowest for local authority funds over the 3 years in question and puts the Wiltshire Fund about mid-table among local authorities in terms of its solvency level. The Fund is currently being actuarially valued (as at 31 March 2007) and the results of this exercise will be available later during 2007-08 – the funding level is expected to improve substantially.

Funding Policy

The objectives of the Wiltshire Fund's funding policy, as expressed in its Funding Strategy Statement, include the following:

- to achieve a funding level of 100%, both at the whole Fund level and for the share attributable to individual employers, within a timescale that is prudent and affordable;
- to ensure that sufficient liquid funds are available to meet all benefits as they fall due for payment;
- not to restrain unnecessarily the investment strategy of the Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to help employers recognise and manage pension liabilities as they accrue;
- to maximise the degree of stability in the level of each employer's contributions to the extent that the Administering Authority (in consultation with the actuary) is able to do so in a prudent and justifiable way;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations; and
- to address the different characteristics of the disparate employers or groups of employers to the extent that this is practical and cost-effective.

Fulfilment of Funding Strategy through Investment Strategy

The Fund has a very strong employer covenant, being funded substantially by tax-raising local authorities. Therefore, the Committee can adopt a long-term view, without concern about the ability of its sponsors to meet their liabilities.

Although the Fund is maturing slowly, cash flow is very strong and is unlikely to be a problem for many years and so there is no need to plan for the forced selling of investments to meet pension liabilities. This also lends itself to a long-term view.

As the Fund has a deficit of assets against liabilities, the Committee wishes to achieve the maximum assistance from investments in reducing this shortfall. This would suggest a higher risk strategy in an attempt to generate returns, but this is moderated by the realisation that such a strategy can also lose significant amounts of money in the short-medium term.

It is ultimately the local tax-payer who feels the result of unstable employer rates, either through the Council Tax or through service levels. Therefore, another very important consideration is the need for relative stability of investment returns, given that employee rates are fixed by statute and the tools available in the actuarial valuation process for smoothing of returns are limited. This can be achieved by investments that are inherently more stable, such as bonds). However, it is also aided by diversification (so that the ups and downs on particular investments do not arise together), and by seeking returns from both markets (“beta”) and investment managers (“alpha”) whose returns are skill based and relatively independent of the market.

Consequently, the Committee has set an overall investment goal that reflects these four factors.

Investment Goal

The Wiltshire Pension Fund’s investment objective is to achieve a relatively stable “real” return above the rate of inflation over the long term, in such a way as to minimise and stabilise the level of contributions required to be paid into the Fund by employer bodies in respect of both past and future service liabilities.

Investment Strategy

The Wiltshire Fund Pension Committee has put in place a strategy to achieve this goal through use of the following elements:

- A relatively large allocation to equity investment to achieve higher returns.
- Allocations to more diversified and less correlated asset classes such as bonds, property, hedge funds and income-based equity products to achieve stabilisation.
- The achievement of some “alpha” (manager) returns independently of “beta” (market) returns, through currency, high alpha equity and hedge fund strategies.

In terms of equity investment, there is significant concentration in the UK market and many of the larger companies in the UK Index derive a high proportion of their earnings overseas, so the extent to which they should be regarded as UK companies is questionable. As a consequence, the Fund’s proportion invested in UK equities has gradually been reduced to 40% of total equity holdings, with a corresponding

increase in the proportion invested in overseas/global equities, which now stands at 60%.

In July 2006, the Committee finalised its review of the Fund's investment strategy, which had had two aims; to increase *expected* returns and reduced *expected* volatility. Both objectives were achieved, at least in theory, based on the modelling available from the Fund's investment consultant. Clearly, the proof (or not) will be seen in the coming years. The resulting asset allocation is shown below:

ASSET ALLOCATION	
Equities	
Long-Only - Core:	
UK	18.5%
Overseas (Regional)	14.0%
Long-only - Global Constrained (inc UK)	<u>20.0%</u>
	52.5%
Bonds	17.5%
Property	13.0%
Alternatives:	
Income Biased (long-only equities & bonds)	10.0%
Long-Short Equities - Global	5.0%
Currency (Active)	<u>2.0%</u>
	17.0%
TOTAL	100.0%

However, around 13% of the Alternatives shown above are equity based, so the effective equity allocation is just over 65%.

Investment Management Mandates

As a result of this review, and following a subsequent tender exercise, the Committee decided to dispense with the services of one of its equity managers (Northern Trust) and appointed a new global equity manager (Edinburgh Partners), a long-short manager (Fauchier) and a currency manager (Record).

The table overleaf shows the new manager and mandate line-up, which is expected to take effect from 1 July 2007:

MANAGER/MANDATE ALLOCATION	
Capital International Core Equity (UK & Regional) Income Based Product (Equities, Bonds & Cash)	19.0% 10.0%
Baillie Gifford Core Equity (UK) Unconstrained Global Equities (Growth style)	12.5% 12.5%
Western Asset Management Bonds (UK & Overseas)	17.5%
ING Real Estate Property Fund of Funds (UK & Europe)	13.0%
Edinburgh Partners Unconstrained Global Equity (Value style)	7.5%
Fauchier Partners Equity Long-Short Fund of Funds (Global)	5.0%
Record Currency Management Active Currency Fund Passive Currency Hedge (with cash equitised to FTSE 100)	2.0% 1.0%
TOTAL	100.0%

Timeframe for Investment Managers' Targets

Three year targets are generally preferred because of the need to see clear evidence of added value as soon as possible. The Committee recognises, however, that three year periods may not be appropriate for particular managers' styles, or for specific asset classes. Five year rolling periods, rather than three year periods, are therefore adopted where appropriate.

Review and Policy

The Committee formally monitors the investment performance of the managers against their individual performance targets and meets them on an annual basis, although it does receive quarterly performance, asset allocation and risk figures from a report provided by the County Council's global custodian, ABN AMRO.

An annual check is made on how the overall strategic benchmark of the Fund is performing, relative to other funds, and in relation to the financial assumptions contained in the previous actuarial valuation.

The Committee also formally reviews its investment strategy once a year, although it is hoped that given the scale of change recently, a period of relatively stability for 2-3 years may be possible now to allow the new arrangements time to work.

Other Matters

Fee Structures

The Committee generally expects to have an ad-valorem fee scale applied in respect of the investment management services it receives. This is generally accepted practice and is easily understood. A performance related fee basis is sometimes set, however, if it is believed to be in the overall financial interests of the Fund. For investment advisory services, a fee is charged by the hour.

Compliance with Government (Myners) Investment Principles

The extent of the Fund's compliance with the ten investment principles set out in the Government's Voluntary Code, issued in October 2002, and is set out in the supplement to this document.

The Committee believes that these principles are complied with in broad terms and as set out in the following supplement.

Supplement

The Myners Principles

Compliance with Investment Principles for Defined Benefit Schemes

1. Effective decision-making

Under a delegation direct from Wiltshire County Council (WCC), the Wiltshire Pension Fund Committee (the Committee) agrees overall investment strategy and policy. Decision making is therefore completely independent of the executive function of the WCC (through its Cabinet), which is vital because WCC is just one of 60+ employers that the Fund serves.

Operational decision making is delegated to the Chief Financial Officer (CFO), supported by the Head of Pensions (HOP). Day to day decision making on investment activity is delegated to the Fund's investment managers.

The Committee meets on a quarterly basis, and receives advice from the Chief Financial Officer and its independent investment and pensions consultants. It also meets with its investment managers on a regular basis, a minimum of once a year.

In reaching decisions on the most appropriate investment strategy and investment management arrangements for the Fund, the Committee is provided with in-depth advice and training by the CFO and independent advisors, to enable it to understand the issues and scrutinise the advice being given. Committee Members are also encouraged to attend external seminars and training events. There is a Members' Training Plan, which is particularly important following a change of Committee membership.

The Fund has a Governance Policy Statement and every two years the Committee approves a Forward Plan of future business. Given that the Committee has only 9 voting Members, it focussed enough in its own right not to warrant an Investment Sub Committee.

2. Clear objectives

The Fund has a Funding Strategy Statement, one of the purposes of which is to bring together the funding of liabilities and the investment strategy into one coherent policy. From this flows the Fund's Investment Goal and Investment Strategy, as set out below:

Investment Goal

The Wiltshire Pension Fund's investment objective is to achieve a relatively stable "real" return above the rate of inflation over the long term, in such a way as to minimise and stabilise the level of contributions required to be paid into the Fund by employer bodies in respect of both past and future service liabilities.

Investment Strategy

The Wiltshire Fund Pension Committee has put in place a strategy to achieve this goal through use of the following elements:

- A relatively large allocation to equity investment to achieve higher returns.
- Allocations to more diversified and less correlated asset classes such as bonds, property, hedge funds and income-based equity products to achieve stabilisation.
- The achievement of some “alpha” (manager) returns independently of “beta” (market) returns, through currency, high alpha equity and hedge fund strategies.”

The Committee confirmed this strategy during 2006-07, with the benefit of advice from the Fund’s officers and independent advisers and it is being implemented during 2007- 08 (details are set out in the Statement of Investment Principles - SIP). This Strategy indicated a relative reluctance to accept too much underperformance due to market conditions as this will impact adversely on funding levels and employer contribution rates.

Whilst the investments are largely measured against market indices or other investment measures, the Fund receives quarterly monitoring from its actuary enabling a regular monitoring of the movements in the investment assets relative to the liabilities.

3. Focus on asset allocation

The Committee focuses on asset allocation, as it sees this as the biggest single contributor to achieving the Investment Goal. In its 2006-07 Review, the Committee considered all major asset classes and made positive decisions for and against them in the context of the objectives of the Wiltshire Fund, without reference to the allocation of other Funds.

The Fund leaves stock selection to the appointed fund managers.

4. Expert advice

The Fund receives both actuarial advice and investment advice from Hymans Robertson - but different individuals within the firm deliver the respective services under separate contracts.

The Fund also employs a retained independent pension consultant (an ex-local authority treasurer) to provide advice across the broad range of the Fund’s considerations, including investments.

The Fund is prepared to pay other than the lowest tendered fee to ensure that it receives the best quality advice.

5. Explicit mandates

The Committee is of the view that having a written mandate reflecting an agreement between it and its investment managers setting out specific risk parameters and describing a manager's approach to achieving objectives is too prescriptive and potentially restrictive for good active managers.

A clearly defined performance objective over an appropriate time frame against indices discussed and agreed with the appointed managers should suffice. Thereafter, the critical action is to ensure a regular and effective dialogue between the Fund's representatives and the investment managers to ensure a continuing understanding on both sides of what is required and what is being delivered. The Fund would never terminate mandates before the end of the pre-agreed measurement period, unless there is an unavoidable imperative (eg. the manager loses his FSA registration).

The Committee does not have a policy of restricting the use of financial instruments in its mandates, unless they are prohibited by the Local Government Pension Scheme Regulations.

The Committee's general view is that managers should have enough of an incentive to manage their transaction costs, because ultimately they affect the manager's performance. However, transaction costs are monitored on a quarterly basis and managers are made aware of the Fund's view of their performance in this area.

The Committee has implemented a Commission Recapture Programme as a further way of minimising the costs of the Fund and none of the Fund's managers participate in soft commissions.

6. Activism

The Committee is of the view that the primary duty of its equity investment managers is to identify and invest in companies that will generate returns for the Fund and avoid those that do not. It is the primary duty of the management of those companies to generate the returns for shareholders, subject to recognising the interests of other stakeholders in those companies.

However, the Committee does not agree that it is incumbent on its manager to set out the circumstances in which they should intervene in a company, the approach they will use or how they measure the effectiveness of this strategy. That is a matter for their discretion in each situation that arises.

The Fund has a policy of collaboration of other local authority funds on corporate governance issues through its membership of the Local Authority Pension Fund Forum and it is primarily through this body that the Fund expects to directly exercise engagement with the companies in which it invests.

The Committee expects its managers' to exercise proxy votes in line with the Fund's own voting policy, unless the managers believe it is in the Fund's fiduciary interests not to do so. In such situations, the manager is required to seek the prior approval of

the Chief Financial Officer/Head of Pensions. At present the Fund allows managers to adopt their own voting policies overseas, but has a standard policy for the UK, which follows PIRC's voting recommendations.

7. Appropriate benchmarks

The choice of indices in constructing the Fund benchmark has been undertaken with the benefit of advice from independent investment advisors and the investment manager concerned. Appropriate elements of the Fund benchmark have been included within the mandates for each of the investment managers

The major risk control for the Fund is considered to be at the strategic benchmark level, with additional risk control being applied through the recruitment of active equity managers possessing complementary styles. Informal tracking error ranges have been included within some mandates, in addition to requiring the relevant out-performance margin over the benchmark, which gives the manager a clear indication of the Fund's risk expectations.

The managers are encouraged to pursue genuinely active strategies and the Committee anticipates some volatility from their equity managers over the shorter term, particularly on its more aggressive global equity mandates. It is for this reason that several managers have been given five year rolling performance targets.

Increasingly the Fund's benchmarks are moving away from narrow market indices that may put perverse (risk avoidance) incentives into the manager's process, towards wider global (All World) indices and absolute measures such as CPI, Income Yield and Cash plus.

The actual asset allocation position of the Fund against the overall strategic benchmark is formally reviewed on an annual basis, but it is informally monitored every month as part of the allocation of new cash to managers, and quarterly as part of routine performance monitoring by the Committee.

8. Performance measurement

The Fund currently employs the services of two investment performance measurement services. These are both independent of the investment managers, and provide detailed analysis from monthly periods to ten years and more.

From time to time (at least annually), the Committee formally reviews the effectiveness of its strategic benchmark for the Fund, the choice of detailed benchmarks and targets, its chosen investment management arrangements, and selection of investment managers. In doing so, a judgement on the quality of external advice it has received will be made.

All performance is measured net of manager's fees, so as to gain a true understanding of the value that the managers are adding. The fee structures for the Fund's mandates are ad-valorum, but performance fees will be used when considered appropriate.

The Committee believes that its effectiveness can ultimately be measured by the level of success achieved in minimising and stabilising the level of contributions paid into the Fund by employing bodies to ensure its solvency. The primary requirement of investment policy will therefore be to achieve a real return over and above the rate of both wage and price inflation, over the long term. The Committee also recognises that the effectiveness of its arrangements for the benefit of the Fund will also be the subject of external inspection.

9. Transparency

The Fund's Statement of Investment Principles fulfils the Myners' requirements on transparency.

10. Regular reporting

The Fund's Statement of Investment Principles (which includes compliance with these Myners' principles) is revised annually and made available alongside the Fund's Annual Report and Financial Statements, which includes the investment performance of the Fund. These are available on the Fund's website, so any stakeholder or other interested party has access to this information.