Item: 13

Pension Fund Sub-committee, together with Pension Board:
22 November 2017.

1. Recommendations

It is recommended:

1.1.

That the Committee approves the attached minute as a true record, noting that Councillor James W Stockan was not present for Items 1 to 4.

1.2.

That the Committee considers the recommendation at paragraph 9.5.

2. Appendix

Draft Minute of the Meeting of the Pension Fund Sub-committee, together with the Pension Board, held on 22 November 2017.

Minute

Pension Fund Sub-committee, together with the Pension Board

Wednesday, 22 November 2017, 10:30.

Council Chamber, Council Offices, School Place, Kirkwall.

Present

Pension Fund Sub-committee:

Councillors W Leslie Manson, Steven B Heddle, Rachael A King, Stephen Sankey, Graham L Sinclair and James W Stockan.

Pension Board:

Employer Representatives:

Councillors J Harvey Johnston, Owen Tierney and Duncan A Tullock, Orkney Islands Council.
Andrew Blake, Orkney Ferries Limited.

Trade Union Representatives:

Karen Kent (Unison), Eoin Miller (Unite) and Eileen Swanney (Unison).

Clerk

- Sandra Craigie, Committees Officer.

In Attendance

- Gareth Waterson, Head of Finance.
- Colin Kemp, Corporate Finance Senior Manager.
- Shonagh Merriman, Accounting Manager (Corporate Finance).
- Michael Scott, Solicitor.

Audit Scotland:

- Neil Reid, Senior Auditor.

Apology

- Councillor John A R Scott.

Not Present

Pension Board:

- Mark Vincent, Trade Union Representative.

Declarations of Interest

- No declarations of interest were intimated.

Chair

- Councillor W Leslie Manson.

1. Disclosure of Exempt Information

The Sub-committee noted the proposal that the public be excluded from the meeting for consideration of Items 8 and 9, as the business to be discussed involved the potential disclosure of exempt information of the classes described in the relevant paragraphs of Part 1 of Schedule 7A of the Local Government (Scotland) Act 1973 as amended.

2. Revenue Expenditure Monitoring

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Corporate Finance Senior Manager, the Sub-committee:

Noted:

2.1. The revenue financial summary statement in respect of Pension Fund services for the period 1 April to 30 September 2017, attached as Annex 1 to the report by the Head of Finance, indicating a surplus position of £13,992,300.

2.2. The revenue financial detail by Service Area statement in respect of Pension Fund services for the period 1 April to 30 September 2017, attached as Annex 2 to the report by the Head of Finance.

2.3. The explanations given and actions proposed in respect of significant budget variances, as outlined in the Budget Action Plan, attached as Annex 3 to the report by the Head of Finance.

3. Internal Audit Report – Pensions Administration

After consideration of a report by the Head of Finance, copies of which had been circulated, the Sub-committee:

Noted:

3.1. That Internal Audit had undertaken an audit to review the processes for administering the Council's Local Government Pension Scheme.

3.2. The findings contained in the internal audit report, attached as Appendix 1 to the report by the Head of Finance, relating to the review of pensions administration, which was reported to the Monitoring and Audit Committee on 28 September 2017.

3.3. That an action plan, to address the improvements identified and included within the internal audit report, had been agreed with the responsible officers, with the actions to be implemented by March 2018.

4. Pension Risk Register

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Corporate Finance Senior Manager, the Sub-committee:

Noted the updated Risk Register relating to the Orkney Islands Council Pension Fund, attached as Appendix 1 to the report by the Head of Finance.

Councillor James W Stockan joined the meeting during discussion of this item.

5. Review of Pension Fund Training

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Accounting Manager (Corporate Finance), the Sub-committee:

Noted:

5.1. That, in April 2015, the Council adopted a Training Policy Statement in respect of the Orkney Islands Council Pension Fund, attached as Appendix 1 to the report by the Head of Finance.

5.2. The record of training provided to members of the Pension Fund Sub-committee and the Pension Board for the period May 2016 to September 2017, attached as Appendix 2 to the report by the Head of Finance, which had been developed to monitor and formally record attendance at training events.

5.3. Progress made to date in relation to meeting the training needs for both members of the Pension Fund Sub-committee and the Pension Board, against the core areas of Public Sector Pensions Finance Knowledge and Skills Framework, attached as Appendix 3 to the report by the Head of Finance, as detailed in section 6 of the report by the Head of Finance.

5.4. That training needs would continue to be assessed on a collective rather than on an individual needs basis, based on the self-assessment competency template, attached as Appendix 4 to the report by the Head of Finance.

On the motion of Councillor W Leslie Manson, seconded by Councillor Rachael A King, the Sub-committee resolved, in terms of delegated powers:

5.5. That the Head of Finance should develop an Annual Training Plan for members of the Pension Fund Sub-committee and the Pension Board, commencing for financial year 2018 to 2019 and annually thereafter.

5.6. That the Head of Finance should give further consideration to a differentiated programme of training, together with a recommended minimum level of attendance.

6. Statement of Investment Principles

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Corporate Finance Senior Manager, the Sub-committee:

Noted:

6.1. That, on 20 September 2017, the Pension Fund Sub-committee deferred consideration of a revised Statement of Investment Principles to enable the Head of Finance to consider comments and concerns raised by members.

6.2. That the prime objective of the Pension Fund was to be able to meet employers' pension liabilities into the future, as set out in the Funding Strategy Statement.

6.3. The Statement of Investment Principles, attached as Appendix 1 to the report by the Head of Finance, which set out a number of detailed investment principles for achieving the objective referred to at paragraph 6.2 above.

6.4. The Statement of Investment Beliefs, attached as Appendix 2 to the report by the Head of Finance, which set out a number of themes as a basis for ensuring a consistent approach in developing an investment strategy and making investment decisions over time.

6.5. That further revisions had been made to the Statement of Investment Principles and the Statement of Investment Beliefs, including the addition of reference to the United Nations' Principles for responsible investment.

On the motion of Councillor Rachael A King, seconded by Councillor James W Stockan, the Sub-committee resolved, in terms of delegated powers:

6.6. That the Statement of Investment Principles, including the Chartered Institute of Public Finance and Accountancy Compliance document, attached as Appendix 1 to this Minute, be approved.

6.7. That the Statement of Investment Beliefs, attached as Appendix 2 to this Minute, be approved.

7. Exclusion of the Public

On the motion of Councillor W Leslie Manson, seconded by Councillor James W Stockan, the Sub-committee resolved that the public be excluded for the remainder of the meeting, as the business to be considered involved the disclosure of exempt information of the classes described in Part 1 of Schedule 7A of the Local Government (Scotland) Act 1973 as amended.

8. Statement of Managed Pension Funds

Under section 50A(4) of the Local Government (Scotland) Act 1973, the public had been excluded from the meeting for this item on the grounds that it involved the disclosure of exempt information as defined in paragraph 6 of Part 1 of Schedule 7A of the Act.

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Corporate Finance Senior Manager, the Sub-committee:

Noted:

8.1. The review of investment performance by Hymans Robertson, the Council's appointed investment advisors, for the quarter to 30 September 2017, attached as Appendix 1 to the report by the Head of Finance.

8.2. That Pension Fund investments continued to perform strongly over the quarter to 30 September 2017, increasing in value by 2.8%.

8.3. That the performance of the Pension Fund had been exceptional over the 12 month period to 30 September 2017, with the value of the Fund increasing by 15.1%, being 5.8% ahead of the benchmark.

8.4. That an average return of 13.7% per annum for the Pension Fund remained well ahead of the mandate over the three year period.

8.5. The performance review commentary provided by the Fund Manager, attached as Appendix 2 to the report by the Head of Finance.

8.6. The Governance Summary extracted from the Fund Manager's performance report for the quarter ending 30 September 2017, attached as Appendix 3 to the report by the Head of Finance.

9. Pension Section

Review of Staffing Levels

Under section 50A(4) of the Local Government (Scotland) Act 1973, the public had been excluded from the meeting for this item on the grounds that it involved the disclosure of exempt information as defined in paragraph 1 of Part 1 of Schedule 7A of the Act.

After consideration of a report by the Head of Finance, copies of which had been circulated, with reference to the Minute of the Meeting of the Policy and Resources Committee held on 22 September 2015, paragraph 20, the Sub-committee:

Noted:

9.1. That, following a staffing review in November 2015, the Pension Section had operated as a small team with the following staffing establishment:

- Pensions Manager.
- Senior Pensions Administrator.
- 0.5 full-time equivalent permanent post of Administrative Assistant (Pensions).
- 0.5 full-time equivalent temporary post of Administrative Assistant (Pensions).

9.2. That new and more complex work, increased customer demands and a continuing increase in the volume of transactions was impacting on the Pension Section's ability to comply with statutory requirements, completion of essential returns and management reporting.

9.3. The proposal to increase the staffing establishment within the Pension Section to four permanent posts as follows:

- Pensions Manager.
- Two posts of Senior Pensions Administrator.
- Administrative Assistant (Pensions).

9.4. That the costs associated with the proposed increased staffing establishment, referred to at paragraph 9.3 above, estimated at £31,600, rising to £34,800 by year 4, could be contained within existing resources.

On the motion of Councillor James W Stockan, seconded by Councillor Steven B Heddle, the Sub-committee resolved to **recommend to the Council**:

9.5. That the staffing levels within the Pension Section be increased from 2.5 full-time equivalent permanent and 0.5 full-time equivalent temporary post to four full-time permanent posts.

10. Conclusion of Meeting

At 12:25 the Chair declared the meeting concluded.

Signed: L Manson

Statement of Investment Principles

This is the Statement of Investment Principles (the “Statement”) required by the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (the “2010 Regulations”).

The Statement has been adopted by the Pension Fund Sub Committee (the “Committee”), which acts on the delegated authority of the Orkney Islands Council, the administering authority for the Orkney Islands Council Pension Fund (“the Fund”). The Statement is subject to review from time to time and certainly within six months of any material change in investment policy or other matters as required by law. In preparing this Statement the Committee has consulted with the administrating authority and has taken and considered written advice from the Investment Practice of Hymans Robertson LLP.

Fund Objective

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependents, on a defined benefits basis.

The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary increases.

This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

Investment Strategy

The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund (details of which are set out in the Fund’s CIPFA Adherence document, attached to this Statement). The strategic benchmark is reflected in the investment structure adopted by the Committee; this comprises a mix of segregated and pooled investments. The Fund benchmark is consistent with the Committee’s views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund’s liabilities.

The Committee monitors investment strategy relative to the agreed asset allocation benchmark. It is intended that investment strategy will be reviewed at least every three years following actuarial valuations of the Fund.

Limits on Investments

In 2010, the Committee agreed to increase the limit on investments in open-ended investment companies where the collective investment schemes constituted by the companies are managed by one body, from 25% to 35% (the upper limit specified in Schedule 1 of the 2010 Regulations). Before taking this decision, the Committee took appropriate advice from its investment adviser, Hymans Robertson LLP, in relation to the impact of the increase on overall risk within the Fund and how the Committee monitors and manages that risk. The Committee made this decision on the basis that investment in the pooled funds concerned was effective both in terms of cost and in terms of broader portfolio diversification within the pooled funds concerned.

This decision has recently been reviewed in light of amendments to the existing Fund structure and the exposure to underlying pooled funds. The Committee continues to believe the upper limit is appropriate and has also taken written advice on this matter. The decision will be reviewed on a triennial basis or more frequently if required.

Types of investment to be held

The Fund may invest in quoted and unquoted securities of UK and overseas markets, including equities, fixed interest and index linked bonds, cash, property, infrastructure and commodities, either directly or through pooled funds.

The Fund may also make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products, for the purpose of efficient portfolio management or to hedge specific risks. The Committee considers all of these classes of investment to be suitable in the circumstances of the Fund.

The strategic asset allocation of the Fund includes a mix of asset types across a range of geographies in order to provide diversification of returns.

Balance between different kinds of investments

The Committee has appointed an investment manager who is authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Committee, after seeking appropriate investment advice, has agreed a specific benchmark with the manager so that it is consistent with the overall asset allocation for the Fund. The Fund's investment manager will hold a mix of investments which reflects its views relative to its respective benchmark. Within each major market and asset class, the manager will maintain diversified portfolios through direct investment or pooled vehicles.

Risk

The Fund is exposed to a number of risks which pose a threat to the Fund meeting its objectives. The principal risks affecting the Fund are:

Funding risks:

- Financial mismatch – 1. The risk that Fund assets fail to grow in line with the developing cost of meeting Fund liabilities. 2. The risk that unexpected inflation increases the pension and benefit payments and the Fund assets do not grow fast enough to meet the increased cost.

- Changing demographics –The risk that longevity improves and other demographic factors change increasing the cost of Fund benefits.

- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting Fund liabilities. .

The Committee measures and manages financial mismatch in two ways. As indicated above, it has set a strategic asset allocation benchmark for the Fund. It assesses risk relative to that benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. It also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

The Committee keeps under review mortality and other demographic assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation.

The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset risks

- Concentration - The risk that significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Manager underperformance - The failure by the fund manager to achieve the rate of investment return assumed in setting its mandate.

The Committee manages asset risks as follows. It provides a practical constraint on Fund investments deviating greatly from the intended approach by setting itself diversification guidelines and by investing in a range of investment approaches each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrain risk within the Committees' expected parameters. By investing across a range of assets, including quoted equities and bonds, the Committee has recognised the need for some access to liquidity in the short term. The decision to appoint only one investment manager does involve some degree of risk (from potential underperformance of that manager) which the Committee accept as a reasonable in the circumstances of the Fund.

Other provider risk

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee takes professional advice and considers the appointment of specialist transition managers.
- Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers and audit of the operations they conduct for the Fund.

Expected return on investments

Over the long term, the overall level of investment returns is expected to exceed the rate of return assumed by the actuary in funding the Fund.

Realisation of investments

The majority of assets held by the Fund may be realised quickly if required.

Environmental, Social and Governance (ESG) Considerations

The Committee recognises that ESG issues including 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. The manager has produced statements setting out its policy in this regard. The manager has been delegated by the Committee to act accordingly. The Committee requires all managers appointed to manage assets for the Fund to be signatories to the United Nations Principles for Responsible Investment (UN PRI). The principles are set out in the appendix to this document.

Exercise of Voting Rights

The Committee has delegated the exercise of voting rights to the investment manager(s) on the basis that voting power will be exercised by it with the objective of preserving and enhancing long term shareholder value alongside ensuring that investments meet the ESG considerations outlined in their policy statements in this regard. Papers to committee will include information on voting, engagement and disinvestment activity which seeks to effect change on ESG considerations. Accordingly, the manager has produced written guidelines of its process and practice in this regard. The manager is encouraged to vote in line with its guidelines in respect of all resolutions at annual and extraordinary general meetings of companies.

Stock Lending

The policy on stock lending reflects the nature of the mandate awarded to the investment manager by the Committee, which includes both pooled and segregated holdings.

Within segregated mandates, the Committee has absolute discretion over whether stock lending is permitted. The Committee has considered its approach to stock lending, taking advice from its investment adviser. After consideration of that advice, the Committee has decided not to permit stock lending within any of its segregated investment mandates.

The manager may undertake a certain amount of stock lending on behalf of unitholders within its pooled fund holdings. Where a pooled fund engages in this activity, the extent to which it does is disclosed by the manager. The Committee has no direct control over stock lending in pooled funds; nevertheless, it is comfortable that the extent and nature of this activity is appropriate to the circumstances of the Fund.

The Committee reviews its policy on stock lending (including the amount and type of collateral used) on a regular basis.

Additional Voluntary Contributions (AVCs)

The Committee gives members the opportunity to invest in a range of vehicles at the members' discretion.

CIPFA Compliance

The Committee has set out details of the extent to which the Fund complies with the six principles set out in the Chartered Institute of Public Finance and Accountancy’s publication, ‘Investment Decision Making and Disclosure in the Local Government Pension Scheme – a guide to the application of the Myners Principles’ in the Fund’s CIPFA Adherence document which is attached to this Statement.

Signed For and on Behalf of the Pension Fund Sub Committee of the Orkney Islands Council as Administering Authority for the Orkney Islands Council Pension Fund

Position	Position

Appendix – UN Principles for Responsible Investment

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In signing the Principles, investors publicly commit to adopt and implement them, where consistent with their fiduciary responsibilities. They also commit to evaluate the effectiveness and improve the content of the Principles over time. They believe this will improve the ability to meet commitments to beneficiaries as well as better align investment activities with the broader interests of society.

The six principles are as follows:

Principle 1
We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2
We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3
We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4
We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5
We will work together to enhance our effectiveness in implementing the Principles.

Principle 6
We will each report on our activities and progress towards implementing the Principles.

Orkney Islands Council Pension Fund

Statement of Compliance with the CIPFA Principles

November 2017 Version 2017 V8

Prepared by the Pension Fund Sub Committee of Orkney Islands Council

Contents

STATEMENT OF COMPLIANCE WITH CIPFA PRINCIPLES — PAGE

CIPFA Principles of Investment Practice

This document forms the Statement of Compliance with the Principles of Investment Practice as set out by CIPFA, the Chartered Institute of Public Finance Accountancy. It is maintained by Hymans Robertson LLP and the Head of Finance on behalf of the Pension Fund Sub Committee ("the Sub Committee") of Orkney Islands Council.

This document was brought into force on 30 June 2003. The practices described within this document form the basis for investment decision making by the Sub Committee. This document is reviewed from time to time, and is made available to members on request. Details of version control and changes are provided in the Appendix to this document.

The document also provides information on all of the Fund's investment service providers (investment manager(s), custodian(s), adviser(s), etc.) along with details of the nature of the services they provide and how their performance in these roles is assessed.

This is current version of the document (2017 V8) was agreed by the Committee Members in November 2017.

Signed:

Chairman of the Pension Fund Sub Committee

Orkney Islands Council Pension Fund

November 2017

1 Effective decision making

Principle

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
- That those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Orkney Islands Council

The Council is responsible for the following activities.

- The Council will determine the allocation of new money to the manager. Similarly, in the event that assets need to be realised in order to meet the Fund's liabilities, the Council will determine the source of this funding.
- The Council will be responsible for any changes to the terms of the mandates of existing managers.
- The Council will be responsible for the appointment and termination of managers.
- The Council is responsible for socially responsible investment, corporate governance and shareholder activism. It has delegated these tasks to the Fund's managers, who conduct the delegated tasks in line with the Council's policies.
- The Council will be responsible for the appointment and termination of AVC providers.
- The Council is responsible for maintenance of the Statement of Investment Principles (SIP) and the document setting out the Fund's CIPFA Principles of Investment Practice disclosure.

The Council has delegated the Fund's monitoring responsibilities to the Pension Fund Sub Committee.

Pension Fund Sub Committee Terms of Reference

- The Sub Committee is responsible for monitoring all aspects relating to the investment of the assets of the Fund. Their specific responsibilities are as follows:
- The Sub Committee will formally review the Fund's asset allocation at least annually, taking account of any changes in the profile of Fund liabilities and any guidance regarding tolerance of risk. They will recommend changes in asset allocation to the Council.
- The Sub Committee will consider and monitor the Quarterly Reports produced by their Investment Manager. In addition to managers' portfolio and performance reporting, the Sub Committee will also receive and review information from the managers on risk analysis, transaction costs, and details of corporate governance (including SRI, voting activity and engagement with management).
- The Sub Committee will formally review annually the manager's mandate, and its adherence to its expected investment process and style. The Sub Committee will ensure that the explicit written mandate of each of the Fund's managers is consistent with the Fund's overall objective and is appropriately defined in terms of performance target, risk parameters and timescale.
- The Sub Committee will consider the need for any changes to the Fund's investment manager arrangements (e.g. replacement, addition, termination) at least annually.
- In the event of a proposed change of managers, the Sub Committee will evaluate the credentials of potential managers.

- The Sub Committee will monitor the Fund's approach to social, ethical and environmental issues of investment, corporate governance and shareholder activism.
- The Sub Committee will review the Fund's AVC arrangements annually. If they consider a change is appropriate, they will make recommendations to the Council.
- The Sub Committee will monitor the investment advice from their investment consultant and investment services obtained from other providers (e.g. custodian) at least annually. The Sub Committee will be responsible for the appointment and termination of providers.
- The Sub Committee will conduct and conclude the negotiation of formal agreements with managers, custodians and other investment service providers.
- In order to fulfil their roles, the members of the Sub Committee will be provided with appropriate training, initially and on an ongoing basis.
- The Sub Committee is able to take such professional advice as it considers necessary.
- The Sub Committee will keep Minutes and other appropriate records of its proceedings, and circulate these Minutes to the Council.
- The Sub Committee may also carry out any additional tasks delegated to it by the Council.

Any changes to the membership of the Sub Committee require the approval of the Council.

Membership of the Sub Committee consists of a minimum of seven members with a quorum of three members. All Sub Committee members are expected to have or, for new members, to develop sufficient expertise in investment matters to be able to conduct their Sub Committee responsibilities and to interpret the advice which they receive.

Other Delegated Investment Decisions

Delegation to Officers

Preparation of annual budgets and business plan for the Fund.

Delegation to Investment Manager

Day to day management of the Fund's investment portfolios and related activities has been delegated to the Fund's investment manager, Baillie Gifford. This includes:

- Investment of the Fund's assets.
- Tactical asset allocation around the Fund's strategic benchmark.
- Preparation of quarterly reporting including a review of investment performance, voting, and engagement activity in relation to ESG considerations and the purchase, retention and disinvestment of assets.
- Attending meetings of the Investment Sub Committee.
- Providing Fund accounting data concerning the investment portfolio and transactions.

Delegation to Custodian

The Custodian is responsible for settlement of all investment transactions, collection of income, tax reclaims and corporate action administration.

Actuary to the Fund

The Actuary is responsible for

- Undertaking a triennial valuation of the Fund's assets and liabilities.
- Setting the Fund's contribution rate.
- Providing advice on the funding level and maturity of the Fund which the Pension Fund Sub Committee can take into consideration when balancing the Fund's investment and funding objectives.

Expert Advice

- The Sub Committee receives investment and actuarial advice from Hymans Robertson LLP.
- At the time of appointment of consultants, the Sub Committee did not invite tenders for actuarial and investment advice separately. The Sub Committee will arrange for separate competition when it next tenders either activity.
- At present there are no separate contracts in place.

Other Advice

- In addition to the investment consultant, the Sub Committee also seeks advice (where relevant) from the Fund's Actuary and the Council's Head of Finance.
- There are no independent advisers appointed to the Pension Fund Sub Committee.

Assessment of Advice

All advice is assessed as described in Section 4.

2 Investment objective

Principle

An overall investment objective 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 advisers and investment managers.

Fund Objective

The Fund is a Local Government Pension Scheme (LGPS).

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependants, on a defined benefits basis. Benefits for active members increase in line with salaries. Benefits for preserved members are subject to statutory increases.

The Council aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is agreed by the employer (Orkney Islands Council) to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary increases.

Basis of Evaluation

An actuarial valuation of the Fund is conducted at least every three years in accordance with the LGPS regulations. The last actuarial valuation was conducted as at 1 April 2014. The results disclosed an ongoing funding level of 114%.

The position of the Fund is monitored each year in consultation with the employers and the Actuary.

Strategic Asset Allocation and Manager Structure

The Fund's investment manager arrangements are summarised in Table 2.1 below:

Table 2.1

Manager	Appointed	Brief	%
Baillie Gifford	April 1995	Multi-asset	100

Custody

The Fund's custodian is the Bank of New York Mellon.

Baillie Gifford

Baillie Gifford's mandate was formally reviewed in 2015/16. The detail of the investment structure has recently been reviewed with a new strategy and structure implemented during February 2017. The benchmark and range guidelines that will apply as at 1 April 2017 are shown in Table 2.2. Baillie Gifford's target is to outperform the aggregate benchmark, with underlying outperformance targets for each of the different asset classes that are assessed over rolling 5 year periods, effective from February 2017.

Table 2.2

Asset Class	Target (%)	Range (%)
Total Equities	58	48 - 68
UK Equities	*9*	
Overseas Equities	*49*	
Alternatives	27	17 - 37
UK Gilts	7.5	2.5 – 12.5
Index-linked gilts	7.5	2.5 – 12.5
Cash	0	0 - 10
Total	100	

Baillie Gifford manages the fund in line with the LGPS regulations. There are no restrictions in Baillie Gifford's agreement which prevents it from investing in any financial instrument permitted in these regulations, except to the extent that derivative instruments may only be used on a segregated basis for the purposes of risk reduction and efficient portfolio management.

The Sub Committee recognises that the pursuit of superior performance through active management also carries the risk of underperformance. However, they believe and the manager accepts that the range guidelines set will contain risk within the tolerance that the Sub Committee deems acceptable.

The Sub Committee has considered the extent to which their managers expect to achieve outperformance through stock and sector selection and asset allocation. They have considered the risks associated with stock and sector concentration in each of the markets in which they invest.

Baillie Gifford provides details on its level of turnover and commission levels on a quarterly basis. The Sub Committee will monitor Baillie Gifford's transaction costs (every 6 months) (in line with the transaction cost reporting framework of the Fund Management Association with which the Baillie Gifford complies).

Baillie Gifford does not make use of soft commission arrangements.

The Sub Committee takes advice from its investment consultant relating to Baillie Gifford's transaction costs.

Benchmarks

Since only one manager is employed, the Scheme and investment manager share the same benchmark.

The benchmark is used

- To evaluate the manager's relative performance
- To monitor the extent of the manager's deviations from benchmark performance
- To specify the limits on manager's asset allocation deviations (specified by size of active bets and aggregate tracking error).

At the asset class level, the manager's activity is assessed relative to specific stock market indices (e.g. the FTSE All-Share index for UK equities).

The use of benchmarks for assessing managers, providers, officers and the Sub Committee is discussed in Section 4.

Benchmark Indices

The Sub Committee discusses the appropriateness of the asset class indices with its investment manager and investment consultant on an annual basis. The review takes account of changes in the constituency of indices, their degree of concentration, changes made by index providers, new classes of assets, and changes in the profile of liabilities which may affect the duration of bond indices. The benchmarks in place as at 1 April 2017 are set out in the table below:

Table 2.3

Asset Class	Target (%)	Benchmark
UK Equities	9	FTSE All Share
Overseas Equities	49	MSCI All Countries World
Alternatives	27	UK base rate +3.5%
UK Gilts	7.5	FTSE UK Gilts All Stocks
Index-linked gilts	7.5	FTSE Over 5 years index-linked gilts
Total	100	Composite

The Sub Committee recognises that the setting of benchmark targets can encourage managers to closet index, i.e. to hug the index too closely to be able to deliver the performance target set. The Sub Committee has discussed this subject with its manager and investment consultant. In setting tracking error guidelines, the Sub Committee has indicated limits to its manager so that the risk it takes is consistent (i.e. neither too little or too great) in relation to its performance target. The Sub Committee monitors the manager's tracking error (see Section 4).

Investment Structure

The Sub Committee has considered its investment structure, the choice between active and passive management, the number of managers it might employ, and where risk might best be exploited.

It employs a single active manager who is responsible for all of the asset classes within the benchmark and for asset allocation around that benchmark within the guideline ranges set. In choosing a single active multi-asset manager, the Sub Committee has considered, and is prepared to tolerate the potential risks associated with that manager's pursuit of outperformance.

3 Risk and liabilities

Principle

In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.

These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

Basis for Determining Fund Benchmark

The Benchmark of the Fund is a bespoke and reflects the objectives and circumstances of the fund.

The asset mix takes account of diversification between asset classes.

The Investment Manager has its own individual benchmark as outlined in Section 2. The manager's benchmark is consistent with the Scheme benchmark.

Risk

The return assumptions required to achieve and maintain the Fund Objective are set out in the Actuarial Valuation. The benchmark adopted by the Sub Committee for the Fund is designed to achieve that return over the long term. The Sub Committee recognises that there will be periods when market conditions do not permit those assumptions to be met and that the benchmark needs to be kept under periodic review in order to confirm that it is still suitable for the purpose for which it was designed.

Asset Classes

In setting the Scheme benchmark, the Sub Committee considered all the principal asset classes listed in the CIPFA Guidance.

Periodic Review

The Sub Committee most recently reviewed the Fund benchmark at their meeting in July 2016.

4 Performance assessment

Principle

Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.

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.

Investment managers

Baillie Gifford provides summary and detailed portfolio valuations, consolidated transaction reports and balance sheet and income statements on a quarterly basis. It also provides details of performance at the individual asset class and aggregate level. The Sub Committee obtains independent measurement of returns from a specialist agency and regular performance and manager monitoring from Hymans Robertson LLP with effect from 1 April 2017.

Manager Monitoring Activity

The Sub Committee monitors the relative and absolute performance of its investment manager, Baillie Gifford, on a quarterly basis. However, it reviews Baillie Gifford's performance more formally once a year. This review considers not only investment returns but also an assessment of Baillie Gifford's adherence to its mandate requirements including the full range of activities delegated to them. The Sub Committee also considers the manager's investment process, stability of key personnel, market position and Environmental, Social and Governance considerations.

Investment Consultant Monitoring Activity

The Sub Committee monitors performance of its investment consultant, Hymans Robertson, largely on a qualitative basis. The consultant provides guidance on asset allocation, benchmark setting, risk and goal setting of the investment manager, manager monitoring, manager selection and general information on legislation, industry background and securities markets (all from an investment perspective).

Sub Committee and Officers

The Sub Committee reviews the investment decisions undertaken by officers and by the Sub Committee, to check their appropriateness and whether outcomes might have been improved. This includes:

- How the overall Fund benchmark has performed relative to liabilities and relative to its comparable LGPS peers.
- How the Sub Committee interpreted advice provided by the investment consultant.
- Sub Committee recommendations and Council decisions undertaken over year concerning service provider and manager changes, benchmark changes, mandate changes, and transitions between mandates.
- How the managers performed on voting rights and engagement to address ESG concerns.

5 Responsible ownership

Principle

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.

Governance and Voting

The Council has delegated the following tasks to the investment manager.

- Engaging with companies in which the Fund invests concerning ESG matters.
- The exercises of voting rights on the basis that voting power will be exercised by the manager with the objective of preserving and enhancing long term shareholder value and exposure to the risks associated with poor ESG records.

Accordingly, Baillie Gifford has produced written guidelines of its process and practice in both matters.

Baillie Gifford is encouraged to vote in line with its guidelines in respect of all resolutions at annual and extraordinary general meetings of companies.

Engagement and Activism

Baillie Gifford has disclosed its own policy on ESG, engagement and activism which it exercises on behalf of client's investment mandates when the client has delegated responsibility for these activities to Baillie Gifford. It votes proxies on behalf of the Fund and engages with the UK companies (and larger international companies) in which it invests. Baillie Gifford reports its voting activity to the Sub Committee on a regular basis.

In general, Baillie Gifford does not intervene in companies, except in unusual circumstances and then generally as part of an investment industry grouping. The Sub Committee accepts that it is not in the economic interests of the Fund for its manager to intervene more generally.

UN Principles for Responsible Investment (PRI)

The Sub Committee have made it a requirement that all managers appointed to manage assets on behalf of the Fund are signatories to the UN PRI. Baillie Gifford are a signatory under UN PRI and therefore meet this requirement.

6 Transparency and reporting

Principle

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 objectives.
- should provide regular communication to scheme members in the form they consider most appropriate.

Approach

This document should be read in conjunction with the Fund's Statement of Investment Principles. Taken together, these documents provide the framework for the Fund's investment operations.

Section 1 of this document describes the structure for making investment decisions for the Fund, the split of responsibilities among the Council, Pension Fund Sub Committee, Investment Manager, Custodian, Scheme Actuary, Investment Consultant and other providers.

Sections 2 describes the roles and mandates of external providers (consultant, investment manager, etc).

Other Advice

In addition to the investment consultant, the Sub Committee also seeks advice (where relevant) from the Fund's Actuary and the Council's Head of Finance.

There are no independent advisers appointed to the Pension Fund Sub Committee.

Assessment of Advice and Decision Making

All advice and decision making is assessed as described in Section 4.

Regular reporting

The Council makes the following documents available to Fund members on request.

- The Statement of Investment Principles.
- Details of the Fund's adoption of the CIPFA Principles of Investment Practice (i.e. this document).

Both documents are revised periodically, in any event, and when changes occur.

Appendix A - Version control record

Table of Amendments

The attached Table records changes to this document.

Version	Nature of Change	Implemented
2003 V1	Initial Creation	30 June 2003
2004 V2	Final Document	31 October 2004
2007 V3	Benchmark change	10 July 2007
2009 V4	Review document	30 June 2009
2010 V5	Update following structure change and consolidation on principles from 10 to 6	21 December 2010
2011 V6	Increase range limit on cash holding from 0-5% to 0-10%	27 September 2011
2013 V7	Regular review and update following valuation and proposal on pooled funds	28 February 2013
2017 V8	Review and update following completion of strategic review, discussions on ESG and adopting and implementation of new Fund specific benchmark	22 November 2017

Statement of Investment Beliefs

This document sets out the investment beliefs of the Pension Fund Sub Committee (the "Committee") of the Orkney Islands Council as administering authority to the Orkney Islands Council Pension Fund (the "Fund").

Belief: Clear and well defined objectives are essential to achieve future success

The Committee is aware that there is a need to generate a sufficient level of return from the Fund's assets, while at the same time having a clear understanding of the potential risks and ensuring there is sufficient liquidity available to pay members' benefits as they fall due. The Committee have considered their own priorities and believe that setting clear objectives for the Fund is key in providing focus for the way the investment strategy is implemented.

Belief: Strategic asset allocation is a key determinant of risk and return, and thus is typically more important than manager or stock selection

The Committee understands that having the appropriate strategy in place is a key driver of the Fund's future success. As a result, priority is given to more strategic investment matters.

Belief: Funding and investment strategy are linked

The Committee understands that a number of funding related aspects feed into investment strategy decisions, including maturity, scheme objectives and level of required return. Given this, actuarial and investment matters, most notably setting investment strategy, are looked at in tandem by the Committee.

Belief: The Committee will take an appropriate level of investment risk

As a long term LGPS Fund the Committee acknowledge the need to take investment risk to ensure the affordability and sustainability of the Fund. However, the level of risk will be set which is aligned to the long term objectives, with a view to taking appropriate and not unnecessary levels of risk.

Belief: Equities are expected to generate superior long term returns

The Committee believes that, over the longer term, equities are expected to outperform other liquid assets, in particular government bonds. The Committee is therefore comfortable that the Fund maintains a significant allocation to equities in order to support the affordability of contributions.

Belief: Diversification can provide more stable investment returns and help manage volatility

The Committee believes that diversification across asset classes can help reduce the volatility of the Fund's overall asset value and improve its risk-return characteristics. The Committee believes that investing across a range of asset classes (including, but not restricted to, equities, bonds and multi asset or diversified growth funds) will provide the Fund with diversification benefits.

Belief: Fees and costs matter

The Committee recognises that fees and costs reduce the Fund's investment returns. The Committee considers the fees and costs of its investment arrangements to ensure the Fund is getting value for money and to minimise, as far as possible, any cost leakages from its investment process. The Committee will pay higher fees for active management where it has conviction in the manager's ability to add value net of fees. The Committee will also consider concentrating the asset allocation with a manager where this helps reduce overall costs and fees.

Belief: Funding level movements will be reflected in both the levels of cash contributions and investment risk

Should the funding level of the Fund improve or fall away from current levels the Committee will consider both the approach to funding and investment risk and will not solely look to minimise/maximise contributions or investment risk but find a balanced approach to investment and funding requirements that is aligned to the long term objectives of the Fund.

Beliefs: Market inefficiencies will provide opportunities to add value over time

The Committee belief that at times relative market movements or dislocations will provide opportunities to generate additional returns for the Fund. However, the Committee do not believe that they are best placed to capitalise on these opportunities. The Committee will therefore set mandates with the flexibility for the manager to add value through allocation decisions where deemed appropriate. Alongside this the Committee will assess the position of the Fund against the long term strategic benchmark and any requirements to rebalance back toward the long term target.

Belief: Active management can add value but is not guaranteed

The Committee recognises that active managers may be able to generate higher returns for the Fund (net of fees) than equivalent passive exposure. The Committee uses active management for the majority of the Fund’s assets. By carefully selecting and monitoring its active manager and recognising that periods of underperformance may arise, the Committee seeks to minimise the additional risk from active management, and continues to monitor its active manager to ensure its mandates remain appropriate for the Fund.

Belief: Responsible Investment is important to the Committee and can have a material impact on the long term performance of its investments

The Committee recognises that Responsible Investment issues incorporating all forms of Environmental, Social and Governance (ESG) issues can impact the Fund’s returns and reputation. Given this, the Committee aims to be aware of, and monitor, ESG-related risks and issues through the Fund’s investment manager. The Committee is continuing to review its Responsible Investment policy to ensure it reflects latest industry developments and regulations.

Prepared by the Pension Fund Sub Committee of the Orkney Islands Council Pension Fund

September 2017