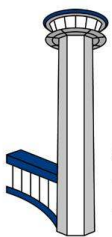


**ABERDEEN CITY COUNCIL
PENSION FUND
STATEMENT OF INVESTMENT PRINCIPLES**



Aberdeen City Council
Pension Fund

Revised June 2009

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STATEMENT OF INVESTMENT PRINCIPLES

1. BACKGROUND

- 1.1 This statement sets out the principles governing decisions about investments for the Aberdeen City Council Pension Main Fund and Transport Fund and is effective from 3 June 2009. It complies with the requirements in Sections 35, 36 and 47 of the Pensions Act 1995. In its preparation, the Council has obtained appropriate professional advice.
- 1.2 All investment decisions are governed by 'The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998 as amended.
- 1.3 Aberdeen City Council **Pensions Panel** consists of 4 elected members, with responsibility to fully discharge the Council's duties in terms of the Pension Fund investment regulations.

A Joint Investment Advisory Committee consists of:

4 elected members from Aberdeen City Council,
4 elected members from Aberdeenshire Council,
2 elected members from The Moray Council,
1 from the Colleges,
1 from Scottish Water.

The Committee acts as an advisory body to the City Council Pensions Panel.

In addition to the above, the Pensions Panel seeks professional investment advice from the City Chamberlain and external advisors as appropriate.

A copy of this statement has been given to the Fund's external advisors and fund managers.

2. FUND OBJECTIVE

- 2.1 The fund's objective is to meet the benefit liabilities as they fall due at a reasonable cost to the participating employers, given that employee contributions are fixed. Reasonable, in this context, refers to both the absolute level of contribution – normally expressed as a percentage of pensionable payroll – and its predictability. The employer contribution rates are impacted by both the assessed level of funding – ratio of the value of assets to liabilities – and the assumptions underlying the actuarial valuation.
- 2.2 The fund targets a 100% funding level. 'Growth' assets, such as equities, are expected to give a higher long-term return than 'liability-matching' assets, such as bonds. The benefit of higher investment returns is, over the long-term, a higher level of funding should achieve lower employer contribution rates. However the additional investment returns from growth assets come with a price: greater volatility relative to the liabilities, thus introducing risk. The risk is evidenced by the potential volatility of both the funding level and the employer contribution rate. There is therefore a trade-off between the additional investment return from greater exposure to growth assets and its benefits - higher funding level, lower employer contribution level - and the benefits of greater predictability - of both funding level and employer contribution rate - from having greater exposure to liability matching assets.
- 2.4 The trade-off, and its consequences on both funding level and employer contribution level, was examined by both the Pensions Panel and Joint Investment Advisory Committee and led to the strategic benchmark as described in section 3.2.

3. INVESTMENT OBJECTIVE

- 3.1 The Pensions Panel has defined a strategic benchmark, 85% Equity (Inc Property) and 15% Bonds (Inc Cash) as the benchmark to achieve the long term investment returns required to achieve the fund objective.

3.2 Agreed asset structure as at March 2004.

Asset Class	%
Equities	70
Bonds	15
Property	10
Private Equity	5
Total	100

4. **INVESTMENT STRATEGY**

4.1 Kind of Investments

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

UK 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.

International Equities are similar to UK Equities but with 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.

Bonds are debt instruments issued by Governments and other borrowers (In the UK Government Bonds are known as Gilts.). 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.

Index Linked 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).

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.

Cash is usually deposited with institutions for very short terms and will attract interest at about money market rates.

Alternative Assets is a combination of number of alternative asset strategies such as private equity, hedging, absolute return and currency overlay.

The table below gives a summary of the salient features of the different kinds of investment, including the long-term real (in excess of price inflation) returns thought to be reasonable expectations.

<u>Investment</u>	<u>Inflation Linking</u>	<u>Real Returns % p.a.</u>	<u>Marketability</u>
Equities – UK	Good	4 - 6	Good
Equities – International	Reasonable	3 - 7	Good
Property	Reasonable	3 - 5	Poor
Index-Linked	100%	1 - 3	Reasonable
Bonds	Poor	2 - 4	Good
Cash	Variable	0 - 3	Good
Alternatives	Poor	undefined	Variable

'Real' (as opposed to Monetary) Assets are equities and property.

4.2 Suitability

All the major investments listed above, and representative individual holdings, are considered suitable investments for pension funds.

4.3 Realisation of Investments

The vast majority of the assets are readily marketable, usually within a couple of weeks. However some investments, such as Property and Private Equity may take some time - possibly many months to realise.

4.4 General Principles

The emphasis of investment over the long term should be on real assets, especially equities. These are most likely to maximise the long-term returns.

The balance between UK and International equities is a matter of investment judgement and is currently split 50/50. However, a fund should be diversified to include other assets such as Bonds and Cash.

4.5 Diversification

The strategic benchmark, comprising a mix of different assets, is sufficient to provide adequate diversification.

4.6 Balance

The strategic balance of investments will reflect the compromise between enhanced long-term investment returns from holding equities and the consequent greater short-term market price risk.

The Pensions Panel has delegated the day-to-day investment management of the fund to the City Chamberlain, to ensure the management of the funds assets is carried out within the terms of each investment management agreement.

Management Agreements encompass:

- Investment Objectives and Restrictions
- Custody and Banking arrangements
- Fees and Charges
- Communication
- Performance Monitoring

4.7 Expected Return

Over the long term appropriate to the liabilities of the scheme it is expected that the investment return will be at least in line but modestly ahead of the assumption underlying the ongoing funding rate of 4% p.a. above earnings inflation, 2.5% p.a. above price inflation.

5. **RISKS**

5.1 Custody

The global custodian provides custody of the majority of the Schemes' assets, the passive manager in respect of the passive pooled vehicle holdings.

5.2 Hierarchy of Risk

The Panel recognises the level of risk associated with investment in the various asset classes. Risk in this context is a measure of the confidence around the market value of the asset. These views are subjective and based on a scale of low, medium and high risk.

Currencies	High
Private Equity	High
Quoted Equities	High
High Yield Bonds	High
Property	Medium
Fixed Income	Medium
Cash	Low

5.3 Investment Restrictions

The Investment manager has full discretion over the choice of investments, subject to any specific restrictions detailed in the Investment Management Agreement and the restrictions of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) 1998 regulations as amended.

5.4 Investment Management

The Investment Manager provides monthly reporting to the Council, including a portfolio valuation, transaction reports and cash reconciliation.

6. **INVESTMENT MANAGEMENT STRUCTURE**

6.1 Management Structure, is detailed in **Appendix I**, which is monitored on an ongoing basis and subject to a full Review at least once every 5 years.

6.2 The management structure has been constructed to balance the risks, rewards and costs of investing the schemes assets. In particular because of the size of the fund, it is appropriate to have diversification between asset managers, following different approaches.

6.3 Passive Core layer, which provides diversification by investment management approach and improves the overall efficiency of the structure in terms of risk profile and costs.

6.4 Active Satellite layer, this more aggressive – more costly - layer should achieve higher performance, but each manager is allowed greater volatility. It is invested with enterprising and focused styles of specialist manager.

7. **MONITORING**

7.1 A report on the investment decisions of the Pensions Panel as minuted by Aberdeen City Council is available on request from The Aberdeen City Council City Solicitor.

7.2 The Pensions Panel will keep under review the suitability of the fund managers, the fund investments, the appropriate use of realisations and the fund custodian.

7.3 An independent performance measurement company provides advice and performance measurement monitoring to the Pensions Panel and Joint Investment Advisory Committee. (Other services such as actuarial and investment services are tendered separately).

- 7.4 The Joint Investment Advisory Committee reviews the investment performance of the fund and individual fund managers on a quarterly and annual basis.
- 7.5 The Pensions Panel will on a regular basis review the statement of investment principles taking into account best practice and statutory responsibilities.

8. **SHAREHOLDER ACTIVISM**

8.1 Corporate Governance and Corporate Social Responsibility

Aberdeen City Council has delegated the investment management of the funds assets to a number of fund managers. Each Fund Manager has been requested to report to the Joint Investment Advisory Committee every six months on the extent (if any) to which social, environmental and ethical considerations are taken into account in the selection, retention and realisation of investments.

The Aberdeen City Council Pension Fund is a member of the Local Authority Pension Fund Forum (LAPFF). LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting corporate social responsibility and high standards of corporate governance amongst the companies in which they invest.

Formed in 1990, the LAPFF Forum brings together a diverse range of local authority pension funds with combined assets of over £70 billion.

8.2 Corporate Governance Policy

The Pensions Panel recognises the role of the shareholder in good corporate governance as expressed through Cadbury, Greenbury and Hempel reports. The Pension Fund therefore subscribes to the *RREV** voting advice service and voting is carried out directly through a proxy-voting agency. In addition to the UK *RREV** covers the major markets of Europe, North American and the Far East.

9. STOCK LENDING

The Pension Fund participates in a stock-lending programme, managed on behalf of the Fund by the global custodian. The aim of the programme is to enhance the return on the Funds' investments in order to offset some of the operational costs of the fund.

The portfolio of assets – the custodian can draw on all directly held equity and fixed stocks up to a maximum of 20% of the portfolio for stock lending.

10. COMMISSION RECAPTURE

- 10.1 The Aberdeen City Council Pension Fund reclaims a portion of the commission that the fund's investment managers' pay to brokers when purchasing and selling securities. Income from commission recapture offset some of the operational costs of the fund.

APPENDIX I**Main Fund Structure****Passive Core layer:**

30% of the total funds assets will be managed through a passive mandate. The purpose of this layer is to control manager risk and limit costs. It is invested with an index-tracking manager. A tracking error of +/- 0.5% p.a. against the composite benchmark has been agreed.

Active satellite layer:

70% of the total funds assets will be managed on an active basis. This more aggressive – more costly - layer should achieve higher performance but each manager is allowed greater volatility.

Fund Manager Structure

<u>Fund Manager</u>	<u>Mandate</u>	<u>% of Fund</u>
SSGA	Passive Balanced	30
Baillie Gifford	Global Active	20
Blackrock	UK Equity Active	10
Capital International	Global Ex UK Active	10
Barings	Global Bonds	4
Rogge	Global Bonds	4
To be appointed	(As at 31 March 2009 held as cash)	7
HarbourVest	Private Equity – US)
Standard Life	Private Equity – Europe) 5
Aberdeen Asset Mgrs	Private Equity - residual)
Aberdeen Asset Mgrs	Property	10

Fund Manager Fee Structure

<u>Fund Manager</u>	<u>Mandate</u>	<u>Fee based upon</u>
SSGA	Passive Equity	Market Value
Baillie Gifford	Global Equity	Performance
Blackrock	UK Equity	Performance
Capital International	Global EX UK Equity	Performance
Barings	Global Bonds	Performance
Rogge	Global Bonds	Market Value
HarbourVest	Private Equity – US	Performance
Standard Life	Private Equity - Europe	Performance
Aberdeen Asset Mgrs.	Private Equity – residual	Performance
Aberdeen Asset Mgrs.	Property	Market Value

APPENDIX II

Transport Fund Structure

The Transport Fund objective as per the Main Fund is to achieve and then maintain assets equivalent to 100% of projected accrued liabilities, on an ongoing basis.

An asset mix of 70% equities and 30% bonds has been agreed to achieve the fund objective. The assets are managed actively by a single manager – Aberdeen Asset Managers. 'De-risking' of the equity portion of the portfolio to 'lock-in' future added value, will be subject to consultation with the scheme employer.

Aberdeen Asset Managers fees structure is market value based.

APPENDIX III

With regard to the amendment to the LGPS regulations in Scotland effective from 31 March 2003. The Aberdeen City Council Pension Scheme “state the extent to which the administering authority comply with the ten principles of investment practice set out in the document published in April 2002 by CIPFA.

The Ten Myners Principles

1. Effective Decision Making

- Decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. Where trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically advice they take.
- Trustees should ensure that they have sufficient in-house staff to support them in their investment responsibilities. Trustees should also be paid, unless there are specific reasons to the contrary.
- It is good practice for trustee boards to have an investment subcommittee to provide the appropriate focus.
- Trustees should assess whether they have the right skills, both individually and collectively, and the right structures and processes to carry out their role effectively. They should draw up a forward-looking business plan.

ACTION TAKEN

- **Training for elected members is incorporated within the quarterly meetings of the Joint Investment Advisory Committee with a training element included within the annual visit of the Committee to the offices of a Fund Manager. Periodically a day of training is held to cover a range of subjects in greater depth than is possible at the quarterly meetings.**
- **In-house support is given to the Pensions Panel and Joint Investment Advisory Committee by the City Chamberlain and the Pension Fund Investment Service.**

- **The two tier structure of Pensions Panel and Joint Investment Advisory Committee ensures efficient scrutiny of the Investments Management of the Pension Fund.**
- **A service plan for the Investment Management of the Pension Fund forms part of the overall Pension Fund service plan**

2. Clear Objectives

Trustees should set out an overall investment objective for the fund that:

- represents their best judgement of what is necessary to meet the fund's liabilities given their understanding of the contributions likely to be received from employer(s) and employees; and
- take account of their attitude to risk, specifically their willingness to accept underperformance due to market conditions.
- Objectives for the overall fund should not be expressed in terms which have no relationship to the fund's liabilities, such as performance relative to other pension funds, or to a market index.

ACTION TAKEN

- **A customised benchmark of 85% real assets and 15% monetary assets has been agreed as appropriate to achieve the overall fund objective.**

3. Focus on asset allocation

- Strategic asset allocation decisions should receive a level of attention (and, where relevant, advisory or management fees) that fully reflect the contributions they can make towards achieving the fund's objective. Decision-makers should consider a full range of investment opportunities, not excluding from consideration any major asset class, including private equity. Asset allocation should reflect the fund's own characteristics not the average allocation of other funds.

ACTION TAKEN

- Following due consideration of the all major asset classes the following combination of assets has been agreed as appropriate to achieve the fund objective:

UK Equities	35%
Overseas Equities	35%
Bonds	15%
Property	10%
Private Equity	5%

The Pensions Panel will on an ongoing basis consider the full range of investment opportunities in order to ensure that asset allocation reflects the funds own characteristics.

4. Expert Advice

- Contracts for actuarial services and investment advice should be opened to separate competition. The fund should be prepared to pay sufficient fees for each service to attract a broad range of kinds of potential providers.

ACTION TAKEN

- **Aberdeen City Council contracts actuarial and investment services separately.**

5. Explicit Mandates

- Trustees should agree with both internal and external investment managers an explicit written mandate covering agreement between trustees and managers on:
 - An objective, benchmark(s) and risk parameters that together with all the other mandates are coherent with the fund's aggregate objectives and risk tolerances;
 - The manager's approach in attempting to achieve the objective; and
 - Clear timescale(s) of measurement and evaluation, such that the mandate will not be terminated before the expiry of the evaluation timescale for

underperformance alone.

The mandate and trust deed and rules should not exclude the use of any set of financial instruments, without clear justification in the light of the specific circumstances of the fund.

ACTION TAKEN

- **The fund has in place a detailed fund management agreement with each fund manager. Which details, objective, timescale for measurement and evaluation. Future mandates will focus in greater detail on not only objective and target but risk tolerances:**

Trustees or those whom they have delegated the task, should have full understanding of the transaction related costs they incur, including commissions. They should understand all the options open to them in respect of these costs, and should have an active strategy – whether through direct financial incentives or otherwise – for ensuring that these costs are properly controlled without jeopardising the fund’s other objectives. Trustees should not without good reason permit soft commissions to be paid in respect of their fund’s transactions.

ACTION TAKEN

- **The fund has in place a programme to monitor fund transaction and commission costs. With these to be reported bi-annually to the Joint Investment Advisory Committee The Fund has also in place a Commission Recapture programme to enhance return to the fund.**

6. Activism

The mandate and trust deed should incorporate the principle of the US Department of Labor Interpretative Bulletin on activism. Trustees should also insure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and how they measure the effectiveness of this strategy.

ACTION TAKEN

- **The Fund votes all UK Equity holdings and Overseas markets where the Fund has the right to vote. Advice is taken from the *RREV** voting service.**
- **Through membership of the Local Authority Pension Fund Forum, LAPFF the fund engages with companies in order to encourage improvement in areas of Environmental Management, Climate Change, Deforestation, Labour Standards and Human Rights.'**

7. Appropriate benchmarks

Trustees should;

- Explicitly consider, in consultation with their investment manager(s), whether the index benchmarks they have selected are appropriate; in particular, whether the construction of the index creates incentives to follow sub-optimal investment strategies;
- If setting limits on divergence from an index, ensure that they reflect the approximations involved in index construction and selection;
- Consider explicitly for each asset class invested, whether active or passive management would be more appropriate given efficiency, liquidity and level of transaction costs in the market concerned; and
- Where they believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving the managers the freedom to pursue genuinely active strategies.

ACTION TAKEN

- The allocation of 30% of the funds equity assets to passive management reflects the funds consideration of risk management and cost.
- Detailed discussion has taken place with external advisors and fund managers as to the appropriate benchmarks, targets and tolerances set in respect of each fund manager mandate.

8. Performance Measurement

Trustees should arrange for measurement of the performance of the fund and make formal assessment of their own procedures and decisions as trustees. They should also arrange for a formal assessment of performance and decision-making delegated to advisers and managers.

ACTION TAKEN

- The Pension Fund employs an independent performance measurement company to report quarterly to the members of the Joint Investment Advisory Committee on the investment performance of the Fund.
- The Joint Investment Advisory Committee undertakes a formal assessment of the performance and decision-making delegated to the fund managers on annual basis.

9. Transparency

A strengthened Statement of Investment Principles should set out:

- Who is taking which decisions and why this structure has been selected;
- The fund's investment objective;
- The fund's planned asset allocation strategy, including projected investment returns on each asset class, and how the strategy has been arrived at;
- The mandates given to all advisers and managers; and

- The nature of the fee structures in place for all advisers and managers, and why this set of structures has been selected.

ACTION TAKEN

- **This SIP sets out to provide clear and concise detail on the decision-making processes that govern the management of the Aberdeen City Council Pension Fund.**

10. Regular reporting

Trustees should publish their Statement of Investment Principles and the results of their monitoring of advisers and managers. They should send key information from these annually to members of these funds, including an explanation of why the fund has chosen to depart from any of these principles.

ACTION TAKEN

- **A copy of the SIP is published on the Aberdeen City Council Pension Fund website accpf.org.uk and a summary included in the annual Pension Fund Review.**