North East Scotland Pension Fund

nespf

Statement of Investment Principles

June 2021

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Document	**Statement of Investment Principles**
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Introduction

This Statement of Investment Principles (SIP) is produced on behalf of Aberdeen City Council as administering authority of the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF). It has been prepared to comply with guidance set out by the Scottish Ministers and The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended).

Governance

Aberdeen City Council Pensions Committee consists of 9 elected members, with responsibility to fully discharge the Council's duties in terms of the Pension Fund investment regulations.

The Pensions Committee seeks professional investment advice from the Chief Officer-Finance and external advisors as appropriate.

Support to the Pensions Committee is provided by the Pension Board.

Day to day investment management of the Pension Funds is delegated to the Chief Officer-Finance and underlying appointed fund managers.

All investment decisions are governed by The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended).

Further details of all roles and responsibilities can be found in the Pension Fund Governance Policy Statement.

Fund objective

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.

The Fund seeks to maintain a 100% solvency level, by achieving a return of CPI + 1.25% with a future service rate of CPI + 1.50%.

'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.

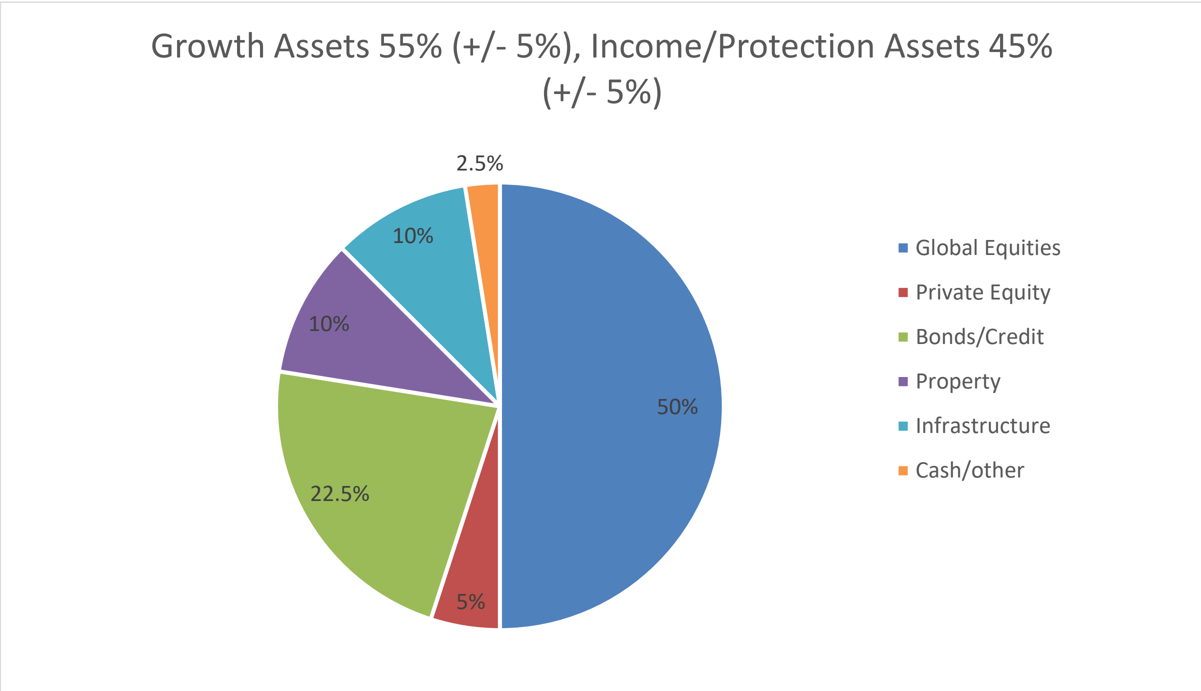
However the additional investment returns from growth assets come with a price: greater volatility relative to the liabilities, thus introducing risk. The risk is evidenced by the potential volatility of both the funding level and the employer contribution rate. There is therefore a trade-off between 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.

The trade-off, and its consequences on both funding level and employer contribution level, was examined by the Pensions Committee and led to the strategic benchmark as described below.

Investment Objective

The Pensions Committee has agreed the investment objective as risk based to deliver the long term funding objective of 100% funding.

As at 1 April 2021 the strategic benchmark was updated and defined as below:



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.

Private Equity is an alternative investment class and consists of capital that is not listed on a public exchange. Private equity is composed of funds and investors that directly invest in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity.

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.

Credit refers to the market through which various parties issue debt to investors. Simply put as payments are received on a debt, the investor earns interest on their security. The credit market includes debt offerings, such as collateralised/structured obligations (including asset backed securities and mortgage backed securities), high yield (B/CCC areas) and Emerging Market Debt (EMD).

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

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.

Infrastructure definitions vary, however typically the term is for the basic physical systems of a business or nation — transportation, communication, sewage, water and electric systems are all examples of infrastructure. These systems tend to be high-cost investments and are vital to a country's economic development and prosperity. Infrastructure is also an asset class that tends to be less volatile than equities over the long term and provides a higher yield. It is also thought to be generally uncorrelated with other asset classes therefore can be a useful diversifier to building a balanced portfolio.

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

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.

Investment	Real Return % p.a.	Volatility % p.a.
Private Equity	13.9	29.3
Equities – UK	6.5	16.4
Equities – International	5.8	15.6
Property	3.6	10.8
Infrastructure	5.7	15.9
Index Linked	-1.5	11.4
Bonds /Credit	2.5	7.5
Cash	0.7	0
Other	Undefined	undefined

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

2. Realisation of Investments

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

3. 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 judgment and is currently split 70/30. However, a Fund should be diversified to include other assets such as Bonds and Cash.

4. Diversification

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

5. 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.

6. Day to Day Management of the Fund's Assets

The Pensions Committee has delegated the day-to-day investment management of the Fund to the Chief Officer-Finance, to ensure the management of the Fund's assets is carried out within the terms of each Investment Management Agreement.

Management Agreements encompass:

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

7. Expected Return

The funding strategy adopted for the 2020 valuation of the Main Fund is based on assumed asset out-performance of 1.25% per annum above the Consumer Price Index (CPI), with a future service rate of 1.50%. The administering authority believes that this is a reasonable and prudent allowance for asset out-performance, based on the current investment strategy as set out in this SIP.

8. Risks

The Fund is exposed to, and manages, a number of financial, funding, governance and operational risks. Details of these, including control actions are set out in the Funds Risk Register. Management of Investment Risk is detailed below.

The global custodian provides custody of the majority of the Schemes' assets, non-segregated holdings are custodied by the respective fund manager.

The Pensions Committee 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:

Private Equity	High
Global Equities	High
Property	Medium
Infrastructure	Medium
Bonds / Credit	Medium/Low
Index Linked	Medium/Low
Cash	Low

Overall Scheme risk is considered through the Funding Strategy Statement (FSS), with fund manager specific risk monitored through regular reporting.

9. Diversification

The Fund seeks to lower investment risk through a policy of diversification by asset class, manager and geography.

10. 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) Regulations 2010 (as amended).

Investment Management Structure

The management structure, detailed in Appendix I, is monitored on an ongoing basis and is subject to a full review at least once every 5 years.

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

Passive Core layer – this is a low cost benchmark/index tracking approach.

Active Satellite layer - this more adventurous and costly layer should achieve higher performance, with each manager being allowed greater flexibility to invest. Different active managers will have different style biases and approaches but will ultimately aim to outperform a chosen benchmark/index.

Monitoring

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

The Pensions Committee will on a regular basis review this Statement of Investment Principles (SIP) taking into account best practice and statutory responsibilities.

Shareholder Activism

The Fund views shareholder engagement as a much more positive and effective strategy for encouraging change rather than disinvestment, which would remove the ability to speak to companies and exert any influence over them.

Engagement aims to encourage responsible behaviour by companies in relation to Environmental, Social and Governance (ESG) issues.

This we accomplish through: -

Our External Fund Managers (NESPF has delegated the investment management of the Funds' assets to a number of fund managers)

- Monitoring the extent to which they incorporate ESG issues in their investment processes;
- A requirement that on a quarterly basis they provide updates on their engagement activity;
- Having good lines of communication to discuss ESG issues that suddenly come to the fore;
- Always have ESG as a discussion topic when carrying out fund manager meetings; and
- Where relevant fund manager updates are summarised to the Pensions Committee every quarter on the extent to which social, environmental and ethical considerations are taken into account or engagement work has been undertaken in respect of assets.

Collaborative Engagement

To maximise the Funds effectiveness on ESG issues we are active members of:

- The Local Authority Pension Fund Forum (LAPFF), a group of 80 Funds and 6 Pools whose aim is to maximise their influence as shareholders while promoting ESG, and
- Principles of Responsible Investment which gives the Fund access to research and the ability to join engagement on a worldwide basis with other likeminded organisations.

Voting

The Fund views voting as such an important avenue of change that we vote inhouse on all our Active Equity mandates rather than leave the decisions in the hands of the external Fund Manager.

It is also another reason against disinvestment as that would mean the Fund could not vote at shareholder meetings. Thereby losing a powerful method of getting companies to make changes to their working practices.

The Pension Fund subscribes to the PIRC voting advice service and voting is carried out directly through a proxy-voting agency. In addition to the UK, PIRC covers the major markets of Europe, North America and the Far East.

Climate Statement

NESPF recognises the risks associated with climate change and the potential for these to impact on the long-term value of the Fund investments, but also the opportunity for investment reward for example in green energy investments, particularly during the period of transition to a lower carbon economy. We believe that company level engagement continues to successfully drive behavior, an outcome we do not believe divestment would have to the same effect. The Fund's approach to managing climate-related risks and opportunities involves both its asset allocation decisions and a robust approach to engagement and voting.

The Fund has been increasing exposure to renewable energy opportunities since 2017, including wind, solar and energy from waste infrastructure projects. Approximately £200 million in dedicated renewables has been funded to date, with a new $100 million commitment made to a Global Renewables mandate still to fund. The Fund continues to seek further investments in low carbon and sustainable initiatives where there are opportunities to meet the Fund's return requirements and risk parameters.

The Fund is a member of the Carbon Disclosure Project (CDP) which focuses on engagement with investors, companies and cities, on taking urgent action to build a truly sustainable economy by measuring and understanding their environmental impact. Further significant engagement progress has been made through participation in the Climate Action 100+ initiative (CA100+). This collaboration of institutional investors is jointly responsible for $47 trillion of assets under management. The CA100+ initiative has three engagement objectives aimed at high carbon emitting companies: robust governance of climate change, business strategies in line with the Paris goals and high quality disclosures on climate risks through the Task Force on Climate-Related Financial Disclosures (TCFD).

Stock Lending

Stock lending is a valuable source of income for the Fund. It is conducted within the parameters prescribed in the regulations. Stock lending does not restrict the investment activity of the underlying fund managers. Safeguards are in place to reduce the risk of financial loss to the Fund in the event of default. These safeguards include receiving liquid collateral in excess of the value of the loan, and regular reviews of the credit worthiness of potential borrowers by the lending agent.

From an ESG perspective the Fund's stock lending policy prohibits any form of naked short selling and voting rights are always maintained by NESPF.

Additional Voluntary Contributions (AVCs)

The Fund provides an in-house AVC arrangement through Prudential. Monitoring the arrangement and investment activity of Prudential is carried out by Fund Officers. Access to information for Scheme members is via the Prudential website at https://www.pru.co.uk/rz/localgov

Compliance with the Myners Principles

The North East Scotland Pension Fund complies with the 6 Myners Principles. Details of the principles and the Fund's compliance are described separate to this document in the Myners Compliance Statement.

Responsibilities

Day to day responsibility for the implementation of this policy sits with the Chief Officer-Finance and dedicated staff within the Pensions Team.

The Pensions Committee is at all times responsible for the Fund's investments, including oversight of this policy and its implementation.

The Pensions Committee will review this policy annually, or in the event of a policy revision and taking account of any emerging issues.

Any questions or feedback on this document should be forwarded to the **Governance Team**:

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Aberdeen
AB10 1BL

Email: governance@nespf.org.uk
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APPENDIX I

North East Scotland Pension Fund Structure

Passive

35% of the total Funds' assets will be managed through a passive mandate. This is through a single manager. The Pensions Committee raised the limit under regulation 14(3) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 from 30% to 35%.

Active

65% of the total Funds' assets are managed on an active basis.

Fund Manager Fee Structure

Fund Manager	Mandate	Fee Basis
Aberdeen Standard	Active – UK Property	Market Value
Aviva	Active – Infrastructure	Market Value
Baillie Gifford	Active – Global Equity	Performance
Blackrock	Active – UK Equity	Performance
Blackrock	Active – DGF	Market Value
Insight	Active – Buy & Maintain Credit	Market Value
Russell	Active – Multi Asset Credit	Market Value
SSGA	Passive – Global Equity	Market Value
SSGA	Passive – Index Linked Bond	Market Value

Private Markets – Debt & Equity

Fund Manager	Mandate	Fee Basis
Aberdeen Standard	Active – European Private Equity	Performance
Aberdeen Standard	Active – UK Residential	Performance
Alcentra	Active – European Private Debt	Performance
Blackrock	Active – Global Infrastructure	Performance
Capital Dynamics	Active – Global Private Equity	Performance
HarbourVest	Active – US Private Equity	Performance
Hayfin	Active – European Private Debt	Performance
Hermes	Active – European Infrastructure	Performance
Maven Capital	Active – UK Private Debt	Performance
Partners Group	Active – Global Property & Infrastructure	Performance
RCP	Active – US Private Equity	Performance
Unigestion	Active – European Private Equity	Performance

APPENDIX II

The Aberdeen City Council Transport Fund

Transport Fund Structure

The Transport Fund objective is to maintain assets equivalent to 100% of projected accrued liabilities, on an ongoing basis. The Fund has merged assets and liabilities with Strathclyde Transport Fund, with an insurance ‘Buy In’ of all pensioner liabilities having been concluded. Remaining assets will be run on a low risk strategy designed to achieve the stated objective above.

The assets are managed actively by a single manager, appointed in 2014/2015.

APPENDIX III

LGPS Regulations – Disclosure Requirements

Use of Headroom Limits

The Fund’s investment activities are subject to the provisions of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended, updated or re-enacted from time to time) – “the Regulations”.

Regulation 14 imposes certain limits on the types of investment which may be held. Regulation 14 also allows an administering authority to increase investments beyond the normal limits up to increased ‘headroom’ limits as set out in Schedule 1 to the regulations. To do this it must comply with certain requirements including disclosure of the use of the increased limits within its Statement of Investment Principles.

The Pensions Committee has agreed 4 instances when the headroom limits should be used. In accordance with regulation 14(3) and item 11 of Part 1 of Schedule 1 of the regulations an increased limit of 35% (of the total Fund) invested with the Passive Manager SSGA and with the Aberdeen City Council Transport Fund (Schroders) under the terms of:-

> *‘All investments in units or other shares of the investments subject to the trusts of unit trust schemes and all investments in open-ended investment companies where the unit trust schemes and the collective investment schemes constituted by those companies are managed by any one body’*

Along with increasing the headroom in accordance with regulation 14(3) and item 13 of Part 1 of Schedule 1 of the regulations, an increase to 35% (of the total Fund) within the Funds Stock Lending program, under the terms of:-

> *‘All securities transferred (or agreed to be transferred by the administering authority under stock lending arrangements’*

Most recently, the decision was taken to increase headroom in accordance with regulation 14(3) and item 3 of Part 1 of Schedule 1 of the regulations to 30% (of the total Fund) under the terms of:-

> *‘All contributions to partnerships’*

The decision was taken to reduce overall risk within the Fund by providing diversification across the Fund’s equity investments and increase the flexibility/opportunities around the investment legal structures which could be accessed.

The above decision is subject to review as part of the Fund’s triennial review of investment strategy.