ISLINGTON

ISLINGTON COUNCIL PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES

LEGAL BACKGROUND

1 This Statement sets out the policy of the Council towards investment and management of the pension fund assets, as required by regulation 9A (1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 as amended. This Statement will be updated regularly and when material changes are made to the strategic asset allocation.

2 Regulation 9A(3A) of the LGPS (Management and Investment of Funds) Regulations 1998, as amended, also requires the Council to state within its Statement of Investment Principles the extent to which it complies with the ten principles of investment practice issued by the Government in October 2001 in response to the recommendations of the Review of Institutional Investment in the UK undertaken by Paul Myners.

3 The Council is the administering authority for the London Borough of Islington Pension Fund, within the Local Government Pension Scheme (LGPS). It is managed within the legal framework set down in the Local Government Pension Scheme regulations 1997 (LGPS Regulations 1997), as amended. The body responsible for decision making in relation to the pension fund is the Pensions Sub-Committee of the Corporate Services Committee.

Supplementary Information available in other Published Statements

4 Details of **governance policy** for the fund is now contained in statement required to be published by regulation 73A of the LGPS Regulations 1997. This covers, for example, policy on delegation within the Council's committee structure, frequency of meetings, terms of reference, and representation and voting rights of committee members. This new statement must be published on or before 1st April 2006, and will be available on the Council's website.

5 From 1st April 2006 the Council must also publish a statements of policy concerning **communications with members and employing authorities** (including non-Scheme employers) under regulation 106B of the LGPS Regulations 1997. This covers, amongst other issues, the manner of publicising the Scheme to members, and employing authorities, and how the Scheme will be promoted to prospective members and their employing authorities. Again, this statement will be available on the Council's website.

6 Finally, under regulation 76A of the LGPS Regulations 1997 and guidance from the Chartered Institute of Public Finance and Accountancy Pensions Panel, the Council has had to publish a **Funding Strategy Statement** (FSS). The FSS recognises that benefits payable under the pension scheme are guaranteed by statute and that thereby the pensions promise is secure. The FSS, however, addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure. The FSS establishes a clear strategy identifying how employers' pension liabilities are best met going forward, taking into account the regulatory requirement to maintain as nearly constant employer contribution rates as possible, whilst taking a prudent longer-term view of funding the liabilities.

THE SCHEME

Pension Fund Liabilities

7 The LGPS is a defined benefit scheme based on the final salary of scheme members. Pension benefits are defined in the LGPS Regulations 1997, and are linked to a formula involving years of service and pensionable pay. Scheme members building up their pension benefits are required to make contributions of 6% of their pensionable pay, as defined in the LGPS Regulations 1997. Pension benefits are not linked to investment performance of the pension fund.

8 The Council appoints an independent actuary who values the liabilities of the fund and determines the level of employer contributions which must be made by the Council and other employers admitted to the fund, to ensure that the investment assets of the fund achieve 100% of the value placed on the liabilities. Where there is a shortfall in the value of the assets, the Council must comply with contribution rates determined by the actuary to recover full funding, and in setting these rates (expressed in a rates and adjustments certificate), section 77 of the Regulations states:

"(5) The actuary must have regard-

(a) to the existing and prospective liabilities of the fund arising from circumstances common to all those bodies, and

(b) to the desirability of maintaining as nearly constant a rate as possible. "

9 As referred to above, further detail on policy towards funding the liabilities is now contained in the Funding Strategy Statement published 31st March 2005.

Investment Policy / Attitude to Risk

10 The Pensions Sub-Committee has adopted policies with the objective of achieving maximum growth of pension fund investments, to reduce the burden of employer contributions on the General Fund. This is, however, tempered by the objective of reducing extreme variations of employer contribution that could occur at any triennial revaluation of the fund by the fund actuary.

11 At the last triennial valuation as at 31st March 2004, the funding level or ratio of asset value to the discounted value of the liabilities was 78.7%. An interim valuation carried out as at 31st March 2005 showed the funding level had remained level at 78.9% but projected an improvement at 30th September 2005 with a funding level of approximately 84%.

12 The Council has agreed a strategy with the Fund actuary to return this to 100% through making additional employer contributions over a period of 25 years. The balance between major asset classes in the strategic asset allocation, and particularly the weighting to equities, is expected to contribute significantly, over the longer term, to the achievement of this objective. Further detail may be found in the Funding Strategy Statement.

13 The risk profile adopted by the Pensions Sub-Committee has been established following detailed asset/liability studies of the fund. These studies examined the balance of active contributing scheme members to pensioner members and deferred members (no longer employed by the Council but not yet drawing benefits), and related this "scheme maturity" to asset allocation strategies for fund investment. The risk of significant variation in future employer contribution outcomes could then be modelled on a variety of economic assumptions.

14 A strategy of limiting risk by matching to a degree the types of assets invested in, to the obligations or liabilities of the Fund has been adopted. The balance between investing for growth and investing in assets with the best fit or match to liabilities is a judgement requiring regular reappraisal.

15 Policy is determined in compliance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998, as amended. As required by these Regulations the

suitability of various types of investments has been considered, as also has the need to diversify investments to reduce the risk of being invested in too narrow a range of assets. In addition, this process has benefited from the provision of independent, professional investment advice.

16 The most significant asset allocation strategy decision for the pension fund has been to split assets between company shares or equities, (private and publicly quoted)) at 70% and bonds/property at 30%. The full asset allocation is set out in Appendix A, showing the various asset classes, the target for each asset class at the level of the total fund, and the permitted ranges within which this may vary due to the relative movements in asset values over time.

17 Appendix B shows how this is reflected across individual portfolios, the current managers of those portfolios, and the benchmarks against which the manager's performance is measured. These portfolios have been established to ensure diversification, and take into account the suitability of the type of investment for the fund, and are managed as follows:

- UK Index Fund, comprises company shares listed in the Financial Times/Stock Exchange index of the top 350 UK companies (FTSE350). This portfolio is passively managed to track the FTSE350 index within plus or minus 0.5%. This portfolio is the only portfolio managed in-house. External managers manage the other active specialist portfolios. This portfolio is regarded as a low risk core portfolio around which other actively managed portfolios will provide more aggressively targeted returns.

- UK smaller company shares. The benchmark is the Hoare Govett Smaller Companies Index (excluding Investment Trusts). This portfolio is actively managed and the managers are required to seek significant outperformance against this index.

- Overseas equities. The split between UK and overseas equities is based on 50% UK and 50% overseas (following a decision at Pensions Sub-Committee 28th November 2005, and due to be implemented March 2006), from the proportion of the pension fund allocated to equities. A specially tailored benchmark against which to measure performance has been constructed from published indexes for the major global markets as follows:

	Index Benchmark	**New Weight %**
Europe (ex UK)	FTSE AWD Europe ex UK	37
North America	FTSE AWD North America	33
Japan	FTSE AWD Japan	13
Pacific (ex Japan)	FTSE AWD Asia Pacific ex Japan	10
Emerging Markets	MSCI Emerging Markets Index with Net Dividends	7

  The manager is required to achieve at least 1.5% outperformance over this composite benchmark measured on rolling three year periods net of fees.

- Global Private Equity investments. An allocation of 4% of the pension fund may be invested in such arrangements. The benchmark is currently a composite derived from the FTSE US and FTSE Europe including UK indices. However, the weighting in the overall customised benchmark set for the whole fund is adjusted quarter by quarter to reflect sums actually invested in private equity. This reflects the long term nature of the investment process in this asset class.

- UK Government Bonds. The benchmark for the bond portfolio(s) is composed 30% of the FTSE Actuaries Government Securities UK Gilts; 20% FTSE Actuaries Government Securities Index Linked > 5 Years; and 50% iBOXX All Stocks Corporate Bonds Index. The performance target is set at 0.75% outperformance of the benchmark per annum, measured over rolling three year periods. In any year, the return should not be below the benchmark by more than 2%.

- Managers will be allowed to invest in overseas bonds to give flexibility and scope to add value and achieve the targeted returns. Constraints will apply to the amounts that can be invested in these types of assets, and by how much UK government bond holdings and UK index-linked bond holdings may vary from the benchmark weights, in order to control risk. These constraints will be agreed with the Director of Finance and Property Services.

- An allocation to property assets has been made of 5% of the total fund value. A pooled property fund with a "high lease to value" structure has been selected as the most appropriate match for pension fund assets from this asset class. To reflect this, and the gilt-like characteristics of this fund, a tailored benchmark has been applied based on government gilt indices. The benchmark is a composite of 50% FTSE Over 15 Year Gilts Index and 50% FTSE 5-15 Year Gilts Index.

- The risk exposure from currency fluctuations associated with the overseas equity portfolio is managed through a passive hedging programme, targeted on the major currencies. The Pensions Sub-Committee has also decided to seek additional return through an active currency overlay portfolio. The active overlay is to be implemented through investment in two pooled vehicles with a cash buffer allocated to allow rebalancing between the pooled vehicles. The buffer also allows settlement of quarterly passive hedging positions. The passive hedging is implemented at a level of 50%. The cash buffer and pooled vehicles are managed against a benchmark of the S&P500 and thus included against the overseas equity strategic asset allocation.

- Managers are currently remunerated through fee scales based on percentage rates applied to the market value of funds under management. In most cases the rate reduces for funds under management above threshold values. Performance related fee structures have been taken into account on retendering of fund manager contracts and a performance related fee structure has been judged appropriate for the operation of the active currency overlay contract.

Exercise Of Shareholder Rights (Including Voting Rights)

18 The Pensions Sub-Committee takes its responsibilities as a company shareholder seriously and exercises its votes at company AGMs wherever practically possible. The Panel has decided to use the Corporate Governance Service provided by Pension Investments Research Consultants (PIRC), and votes cast at UK company AGMs for FTSE350 companies will follow PIRC recommendations unless specifically agreed otherwise.

19 The Pensions Sub-Committee has also agreed a policy to extend voting to include European shares and currently uses the PIRC European Corporate Governance Service to achieve this. Votes are lodged in-house using software provided through the custody contract.

Social, Environmental or Ethical Considerations

20 The Pensions Sub-Committee takes the view that well managed companies that evaluate and assess their social and environmental risks are likely to add shareholder value in the long term more successfully than companies that do not manage these risks. The Council is reviewing its policies on socially responsible investment issues and will increase the use of its position as shareholder to actively engage with companies by appropriate means collectively or directly, to ensure best practice in the management of these risks and in line with the Council's One Islington corporate policy objectives, in particular the key policy objectives of promoting sustainability and regeneration.

21 The Pensions Sub-Committee has also decided to join with other local authorities to use its shareholder rights in a responsible manner to influence company behaviour, through membership of the Local Authority Pension Fund Forum (LAPFF), and supports the mission statement of the LAPFF:

22 "The LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest, commensurate with statutory regulations"

March 2006

Myners Investment Principles - Compliance Statement

In accordance with regulation 9A(3A) of the LGPS (Management and Investment of Funds) Regulations 1998, as amended the Council is required to 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 Chartered Institute of Public Finance and Accountancy, and called "CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom (Guidance note issue No. 5)"; and give the reasons for not complying where they do not do so. This CIPFA publication is based on ten principles proposed by the Myners review of Institutional Investment in the United Kingdom, and adopted by the Government as a model for best practice in 2001.

Principle 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 any 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 sub-committee to provide the appropriate focus.

Trustees should assess whether they have the right set of 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.

Comment

The Fund is generally compliant with the requirements of this Principle. The Pensions Sub-Committee requires new members serving on the Sub-Committee to source appropriate training within 6 months of joining the Sub-Committee. The three-day course run by the Local Government Pensions Committee of the Employers Organisation is recognised as particularly relevant training for new Members, but other routes and courses, and requisite experience are also recognised as appropriate. Where several new Members are appointed together, tailor-made training will be considered.

A business plan is in preparation for the pension fund. An annual business plan and budget for the Fund, will need to be prepared and presented to a future meeting of Pensions Sub-Committee to achieve compliance with the Principle.

Principle 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
- takes 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 that have no relationship to the fund' s liabilities, such as performance relative to other pension funds, or to a market index.

Comment

The Council has set objectives, policy and benchmarks for the Fund that are in compliance with this Principle

Principle 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 contribution they can make towards achieving the fund' s investment 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.

Comment

All asset classes have been considered by the Council in forming its asset allocation strategy, following asset/liability studies carried out in 1999 and 2002. Following the most recent study, strategic asset allocation decisions to invest in private equity, and in property have been made, in compliance with this Principle and taking into account the Fund's own characteristics, and more recently in the first quarter of 2006 an active currency overlay portfolio has been introduced.

Principle 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.

Comment

The Council has two contracts for investment advice, one with Pension Investments Research Consultants (PIRC), and the second with Mercer Investment Consulting. The actuarial and investment consulting contracts will be subject to separate tender for contract renewal at appropriate times.

Principle 5 - Explicit mandates

Trustees should agree with both internal and external investment managers an explicit written mandate covering agreement between trustees & managers on:

- An objective, benchmark(s) and risk parameters that together with all the other mandates are coherent with the fund' s aggregate objective 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

Trustees, or those to whom they have delegated the task, should have a 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.

Comment

The Council is compliant with this Principle in relation to the requirements for written mandates with fund managers. The Council has also worked with its fund managers to ensure that no soft commission arrangements are employed in managing the Council's portfolios.

A commission recapture programme is in operation through the fund custodian.

The portfolio fund managers now provide considerable data on transaction costs following their adoption and implementation of the Investment Manager Association Code of Practice on the disclosure of costs and charges. A transaction cost analysis service is under evaluation.

Principle 6 - Activism

The mandate and trust deed should incorporate the principle of the US Department of Labour Interpretative Bulletin on activism. Trustees should also ensure 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.

Comment

The Council has adopted the principle of shareholder activism and uses external corporate governance advice services in casting proxy votes on all shares held in the core UK equity portfolio. The Council also votes at AGMs of major European companies.

Well managed companies that evaluate and assess their social and environmental risks are likely to add shareholder value in the long term more successfully than companies that do not manage these risks. The Council is reviewing its policies on socially responsible investment issues and will use its position as shareholder to actively engage with companies by appropriate means collectively or directly, to ensure best practice in the management of these risks and in line with the Council's One Islington corporate policy objectives.

The Council also belongs to the Local Authority Pension Fund Forum, a grouping of authorities with common interests to further compliance with corporate governance best practice amongst companies, and to further socially responsible investment objectives to achieve long term improvements in shareholder value.

Principle 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 the 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.

Comment

The Council has set appropriate benchmarks for its specialist portfolios on the basis of asset liability studies, and has set targets and risk controls for the portfolios based on the overall strategic asset allocation strategy. These benchmarks, target and risk parameters have been set taking into account the specific attributes of each asset class and the objective for the portfolio within the overall strategic asset allocation.

Principle 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.

Comment

Overall Fund performance and detailed portfolio performance is measured quarterly, annually and over longer periods by external independent measurement specialists (WM Company). Performance is also monitored against the local authority peer group of pension funds, also based on WM Company data (for the local authority universe), although in line with the Myners Principles the peer group is no longer the benchmark for overall fund performance. The overall benchmark is specific and customised to the fund's objectives based on the outcome of the successive asset/liability studies.

Performance of the fund is also subject to annual review by external auditors (the District Audit service) and by internal audit through regular audits programmed into the Audit Plan.

Pension benefits administration performance is reported regularly to Pensions Sub-Committee.

Principle 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.

Comment

This SIP is compliant with the main recommendations of the Principle.

Principle 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.

Comment

The Council's SIP is currently published and available to scheme members on the Council website. Summaries of performance and monitoring of managers are reported in the Pension Fund Annual Report and distributed to employees each year with payslips. Further performance reporting is provided to contributors and pensioners at the AGM. The full Pension Fund Report and Accounts are published as part of the Council's overall Annual Report and Accounts and available to all members of the public.

Overall communication and publicity strategy for the fund is set out in the Communications Policy Statement which is available on the Council's website from 1st April 2006.

APPENDIX A

From March 2006

STRATEGIC ASSET ALLOCATION	**Target**	**i.e Permitted Range +/- %**
UK FTSE350 passive	**32.9%**	**2.0%**
UK smaller companies	**3.8%**	**2.0%**
Total UK equities	**36.7%**	**4.0%**
Europe (ex UK)	**10.7%**	**3.0%**
North America	**9.6%**	**4.5%**
Japan	**3.8%**	**2.5%**
Pacific (ex Japan)	**2.9%**	**2.0%**
Emerging markets	**2.0%**	**1.5%**
Currency	**4.0%**	**2.0%**
Total overseas equities	**33.0%**	**4.0%**
Global venture capital	**0.3%**	**2.0%**
Total equities	**70.0%**	**5.0%**
UK index linked	**5.0%**	**3.8%**
UK fixed interest	**7.5%**	**3.8%**
Overseas bonds	**0.0%**	**5.0%**
Corporate bonds	**12.5%**	**3.8%**
Property	**5.0%**	**2.0%**
Cash	**0.0%**	**4.0%**
Total bonds/property/cash	**30.0%**	**5.0%**
Total	**100.0%**	
UK index linked	**20%**	Share of Bonds
UK fixed interest	**30%**	
Corporate bonds	**50%**	

NB i) 3.7% of private equity allocation currently included in UK Equities and is subject to continual change as private equity drawdown proceeds.

ii) resource allocated to the currency portfolio is benchmarked to S&P 500 and listed under overseas equities

APPENDIX B

Portfolio	*Manager(s)*	*Sector/Market*	*Target Weight within portfolio at 01/01/2006*	*Permitted Range*	*Index*
UK Index Fund	In-house	UK Equity	100%		FTSE350
UK Small Companies	Framlington	UK Equity	100%		the Hoare Govett Smaller Companies index excluding Investment Trusts
Overseas Equity	Capital International	Europe	37%	28% - 46%	FTSE AWD Europe ex UK
		North America	33%	19% - 47%	FTSE AWD North America
		Japan	13%	5% - 21%	FTSE AWD Japan
		Pacific ex Japan	10%	4% - 16%	FTSE AWD Asia Pacific ex Japan
		Emerging Markets	7%	2% - 12%	MSCI Emerging Markets Index with Net Dividends
Global Private Equity	i) Standard Life (private Equity) Ltd	Europe	50%		FTSE US
	ii) Pantheon	US	50%		FTSE Europe inc UK
Bond Portfolios – Customised Benchmark	i) UBS ii) Insight	UK Government	30%	15% - 45%	FTSE Actuaries Govt Securities UK Gilts over 15 years
		UK Index Linked	20%	5% - 35%	FTSE Actuaries Govt Securities Index Linked over 5 years
		UK Non-Governm’t	50%	35% - 65%	iBOXX All Stocks
Property Portfolio	Morley Fund Management – Lime Property Fund	Property	100%		Composite Gilt index: 50% FTSE Over 15 yr Gilts 50% FTSE 5-15 yr Gilts
Currency Overlay	Goldman Sachs Asset Management International	Currency	100%		USD$ LIBOR (Active Funds) S&P 500 Cash Buffer