

**Pension
Protection
Fund**

**Statement of
Investment Principles
Fraud Compensation Fund**

September 2005

This Statement of Investment Principles is produced to meet the requirements of the Pensions Act 2004 and to reflect the Government's voluntary code of conduct for Institutional Investment in the UK ("the Myners Principles"). The Board also complies with the requirements to maintain and take advice on the Statement and with the disclosure requirements.

1. Introduction

- 1.1** The Board of the Pension Protection Fund (“the Board”) has prepared this Statement of Investment Principles (“the Statement”) in accordance with Section 114 of the Pensions Act 2004 (“the Act”) and the Pension Protection Fund (Statement of Investment Principles) Regulations 2005 (“the Regulations”)¹.
- 1.2** This written statement outlines the principles and policies governing determinations about investments made by or on behalf of the Board in the management of the assets of the Fraud Compensation Fund (“the Fund”). This Statement also reflects the Myners principles for best practice in institutional investment decision-making.
- 1.3** This Statement will be reviewed annually or when there is, or the Board anticipates that there might be, a significant change in relation to any matter contained in this Statement or to any of the matters which this Statement is required to cover by the Regulations.
- 1.4** This Statement will be published and made available upon request.

2. Governance of the Fraud Compensation Fund

2.1 Investment powers and compliance with the Pensions Act 2004

- 2.1.1** Section 113 of the Pension Act 2004 provides that the Board may invest for the purpose of the prudent management of its financial affairs. When exercising its power to invest the Board will consider the interests of members of occupational pension schemes and the interests of persons affected by the rate of the fraud compensation levy.
- 2.1.2** The Board is responsible for the governance and investment of the Fund’s assets. The Board is satisfied that it has sufficient expertise, information, and resources to carry out its role effectively. The Chair of the Board and at least one third of the Board are familiar with investment issues. The Board has access to in-house investment expertise equivalent to at least one full-time member of staff who is familiar with investment issues. Attached at Annex 2 is a breakdown of the governance structure and the associated responsibilities.
- 2.1.3** The Board has considered written advice received from the Fund’s investment adviser, Mercer Investment Consulting, who is believed to be suitably qualified and is authorised under the Financial Services and Markets Act 2000. The written advice considers the suitability of the investments, the need for diversification and the principles contained in this Statement. The Board will monitor and review the performance of the Fund’s investment adviser at least annually.

2.2 Investment Committee

¹ Statutory Instrument 2005 No 675

2.2.1 The Board has established an Investment Committee to manage, consider and make recommendations on investment issues and the Investment Committee is accountable to the Board.

2.2.2 The initial investment strategy for the Fund is the responsibility of the Board, acting on the recommendation of the Investment Committee and is driven by the Board's investment objective as set out in Section 3. After the initial investment strategy is established, the strategic management of the Fund's assets is the delegated responsibility of the Investment Committee acting on advice from the appointed investment adviser, with only material changes in investment strategy requiring Board approval. The Investment Committee has delegated authority from the Board to implement and generally ensure adherence to the strategic investment policy. The Investment Committee also has responsibility for the allocation of the Fund's assets held between the various available fund managers' funds and accounts.

2.3 Day to day management

2.3.1 The funds will be held on deposit and overseen by the Director of Investment and Finance. The Board is satisfied that the Director has the appropriate knowledge and experience to oversee the investment of the Fraud Compensation Fund.

3. Strategic management of the Fund's assets

3.1 Objective

3.1.1 The Board's investment objective is to have sufficient funds to pay compensation under the Pensions Act 2004 to occupational pension schemes where the scheme assets have been reduced as a result of an offence involving dishonesty.

3.1.2 This objective is to be met by the Fund achieving a balance between securing the compensation payments for schemes whilst setting a fair and proportionate levy.

4. Risk measurement and management

4.1 The Board will assess and consider the following risks at outset and on an ongoing basis:

- The risk of a shortfall of liquid assets relative to the immediate liabilities ("*cash flow risk*"). The Board and its advisers will manage the Fund's cash flows taking into account the timing of future payments and may borrow over the short term, in order to minimise the probability that this occurs.
- The risk of a failure of the bank ("*bank failure risk*") holding the assets of the Fund. The Board will review the financial position of the banks and other vehicles used, at least annually.

5. Investment strategy

5.1 The Board regards the selection of asset classes as the decision which has most influence on its ability to achieve its investment objectives.

5.2 Strategic asset allocation

5.2.1 The strategic asset allocation is set by taking into account the nature and timing of both actual and potential future liabilities. The nature and timing of these liabilities are driven by acts of fraud or misappropriation of assets. These events are by their very nature, unknowable in advance and are driven by idiosyncratic factors and any liability arising from a claim is short term in nature. Therefore, the strategic asset allocation includes cash and deposits. The Board has considered the risk of bank failure and considers this to be remote and therefore will hold the assets with one bank rather than diversify across a number of banks. The Board reserves the right to review this should the size of the Fund's assets exceed £3m.

5.2.2 The liabilities of the Board will change periodically as a result of the Board accepting the legal obligation to pay compensation to occupational pension schemes.

5.2.3 This asset allocation strategy is believed to be appropriate to meet the investment objectives set out in 3.1 above, whilst mitigating the investment risks set out in 4 above.

5.2.4 The strategy will be reviewed annually. An earlier review may be conducted in the event of any significant change in the liabilities of the Fund, or in governing legislation.

5.3 Rebalancing policy and cash flow

5.3.1 All assets are to be invested in cash.

5.3.2 This policy will be reviewed annually. In addition if there is a significant change in the liabilities or circumstances of the Fund, then an earlier review will be conducted.

6. Day to day investment management of the assets

6.1 The assets are held in an account registered in the name of the Fund at Halifax Bank of Scotland.

6.2 Investment performance benchmark

6.2.1 The investment performance benchmark reflects the strategic asset allocation as follows:

Asset class	Weight	Benchmark
Cash	100%	Bank of England Repo rate

6.2.2 The Board's expected return on investments is broadly equivalent to the return on the benchmark.

7. Day to day custody of the assets

7.1 The assets are held in an account registered in the name of the Fund at Halifax Bank of Scotland.

8. Socially responsible investment and corporate governance

The Fund's investments consist of cash and cash instruments. The socially responsible investment and corporate governance policies of the Board of the Pension Protection Fund are set out below.

8.1 Socially responsible investment

8.1.1 The Board's primary concern, in setting investment policy, is to act in the best financial interests of the Fund and its beneficiaries, seeking the best return which is consistent with taking a prudent and appropriate level of risk.

8.1.2 The Board believes that companies and governments with positive social, environmental, ethical and political principles can reasonably be expected to offer strong long term financial performance and stability. It therefore regards a preference for investment in securities issued by such organisations as consistent with the best financial interests of the Fund and its beneficiaries.

8.1.3 In its regular review of fund performance, the Board will monitor the way that social, ethical, environmental and political considerations are reflected in investment decisions.

8.2 Corporate governance

8.2.1 The Board's policy on corporate governance is to exercise any rights (including voting rights) attaching to investments in accordance with the guidelines set down in the Institutional Shareholders' Committee statement of principles on the responsibilities of institutional shareholders and agents.

8.2.2 The Board expects to exercise any rights attaching to investments (including voting rights) on behalf of the Board.

9. Compliance with this statement

9.1 The Investment Committee will monitor compliance with this Statement by the Board annually.

9.2 The National Audit Office will audit and monitor compliance as part of its annual review of the Fund's accounts and statement of internal control.

Annex 1

Investment guidelines and benchmarks

Benchmark	100% Bank of England Repo Rate
Style of management	Passive management

Allowable investments and limitations	Allow the following types of investments	<ul style="list-style-type: none"> • Cash • Deposit account • Money market account • Cash and money market funds
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Annex 2

Governance structure

The governance structure for the oversight of the Board of the Pension Protection Fund's investments is set out below. The Fraud Compensation Fund assets are held on deposit at Halifax Bank of Scotland. A separate Statement of Investment Principles is available for the Pension Protection Fund.

The Board is responsible for	<ul style="list-style-type: none"> • Setting structures and processes for carrying out its role • Setting investment structures and their implementation • Initial appointment of fund managers • Establishing an initial investment strategy • Reviewing the content of this Statement of Investment Policy in conjunction with the investment adviser, the Fund's actuary and legal adviser and modifying it if deemed appropriate • Reviewing the investment policy following the results of each actuarial review and/or asset liability modelling exercise • Consulting with relevant bodies when reviewing investment policy issues.
The Investment Committee is responsible for	<ul style="list-style-type: none"> • Implementing and ensuring adherence to the strategic investment policy • Assessing the quality of the performance and processes of the fund managers by means of regular, but not less than annual, reviews of the investment

	<p>results and other information by way of meetings with the fund managers and written reports</p> <ul style="list-style-type: none"> • Appointing (and dismissing) the fund managers (after 31st December 2006) • Monitoring compliance of the investment arrangements with this Statement on an ongoing basis
The investment adviser is responsible for	<ul style="list-style-type: none"> • Advising on all aspects of the investment of the Fund assets including implementation of strategy • Providing updates as to its view on the fund managers and their likelihood of achieving the performance objectives • Advising on this Statement • Providing training in investment matters to the Board
The fund managers are responsible for	<ul style="list-style-type: none"> • Discretionary management of the portfolio, including implementation (within guidelines given by the Board) of changes in the asset mix and selecting securities within each asset class. • Providing the Board with quarterly statements of the assets together with a quarterly report on actions and future intentions, and any changes to the processes applied to their portfolio. • Informing the Board of any changes in the internal objectives and guidelines of any pooled funds used by the Fund as soon as practicable • The safekeeping of the assets within the pooled funds in which the Fund invests • Investing income paid to the Fund in a timely manner • Reconciling the manager's record of assets held with those of the Custodian
The custodian is responsible for	<ul style="list-style-type: none"> • The safekeeping of all the directly held assets of the Fund • Undertaking all appropriate administration relating to the held assets of the Fund • Processing all income with respect to the Fund in a timely manner • Processing all tax reclaims in a timely manner • Investing cash in a suitable low risk manner consistent with the provision set out in the investment management agreements as agreed by the Board

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| | <ul style="list-style-type: none">• Reconciling records of assets held with those of the managers |
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Investment adviser

Mercer Investment Consulting has been selected as investment adviser to the Board. The Board is satisfied that Mercer Investment Consulting has the knowledge and experience required under the Pension Protection Fund (Statement of Investment Principles) Regulations 2005 and that it has arrangements in place to secure that any individuals who provide advice to the Board have sufficient knowledge and experience to provide that advice. The individuals who will provide advice are Nick Sykes or, in his absence Mark Walker. Mercer Investment Consulting operates under an agreement to provide a service designed to ensure that the Board is fully briefed both to take the decisions it is equipped to do so after training and advice, and to monitor those decisions that it delegates. Mercer Investment Consulting is paid on a fixed fee basis for work which can be anticipated and a time cost basis for projects or additional work.

Dated: 1st September 2005