

October 2011

Statement of Investment Principles Fraud Compensation Fund

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 institutional investment decision-making.
- 1.3 This Statement will be reviewed periodically 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 is specifically concerned with the investment of:
 - any property and rights transferred following dissolution of the Pensions Compensation Board which the Board designates as assets of the Fund;
 - the accumulated fraud compensation levy contributions paid into the Fund;
 - interim payments;
 - fraud compensation payments;
 - fraud compensation transfer payments; and
 - money required for the repayment of, and payment of interest on interim payments.
- 1.5 This Statement will be published and made available upon request.

¹ Statutory Instrument 2005 No 675

2. Governance of the Fraud Protection Fund

2.1 Investment powers and compliance with the Act

2.1.1 Section 113 of the Act 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 in relation to whom a fraud compensation levy applies and the effect on the level of any levy and the interests of persons affected by the rate of such 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. Several members of the Board have significant working experience in the investment industry. The Board also has access to in-house investment expertise within the Financial Risk Management Team. Attached at Annex 2 is a breakdown of the governance structure and the associated responsibilities.

2.1.3 In preparing this Statement, the Board considered written advice received from the Fund's investment adviser, Mercer Limited, 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.

2.2 Investment Committee

2.2.1 The funding strategy, which comprises a funding objective and a defined appetite for investment risk, are the responsibility of the Board.

2.2.2 The Board has established an Investment Committee to set an appropriate mix of assets consistent with the Board's funding objective and appetite for risk, and provide oversight of its implementation. The Investment Committee is accountable to the Board.

2.2.3 The initial investment strategy for the Fund was the responsibility of the Board, acting on the recommendation of the Investment Committee and was driven by the Board's investment objective as set out in Section 3. The strategic management of the Fund's assets is now 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 fund management

2.3.1 The day to day fund management of the assets is performed by professional fund managers, each of whom is authorised and regulated by the Financial Services Authority and appointed in accordance with Section 113(4) of the Act. The Investment Committee is satisfied that the appointed fund managers have sufficient expertise and experience to carry out their role.

2.3.2 The appointment, monitoring and termination of professional fund managers is the responsibility of the Investment Committee.

3. Strategic Management of the Fund's Assets

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

3.2 This objective is to be met by the Fund achieving a balance between protecting and securing the compensation payments for actual and potential members of eligible schemes whilst setting a fair and proportionate levy.

4. Risk measurement and management

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

- **Cashflow risk**

The risk of a shortfall of liquid assets relative to the immediate liabilities. 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 shortfall occurs.

- **Manager risk**

The failure by the fund managers to achieve a rate of investment return consistent with the investment objectives of their funds. This issue has been considered by the Board on the initial appointment of the fund managers and thereafter will be considered as part of the investment review procedures the Board has put in place.

These risks are monitored on a periodic basis by the Investment Committee.

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 **Establishing the 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, deposits and other money market instruments.

5.2.2 The Board has considered manager risk and therefore will hold the assets with at least two fund managers, as required by Section 113(4) of the Act.

5.2.3 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.

5.2.4 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.

5.2.5 The strategy will be reviewed annually by the Investment Committee. An earlier review may be conducted in the event of any significant change in capital markets, 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, deposits or other money market instruments.

5.3.2 The Board is satisfied that the spread of assets, the fund managers' policies on investing in individual securities and the Board's investment guidelines to fund managers provide adequate diversification of investments. The Board is also satisfied that the mandates awarded to the fund managers mean that the majority of

assets held will be readily realisable to provide cash to meet payments by the Fund.

6. Day-to-day investment management of the assets

6.1 Fund management

6.1.1 For the management of the portfolios, the Board employs the services of investment experts as its fund managers and has specified investment guidelines to control the level of day-to-day decision making. The fund managers make their investment decisions independently of the Board.

6.1.2 The fund managers are set a specific benchmark and performance objective by the Investment Committee. Fund manager performance and risk is monitored annually by the Investment Committee. Material or unexpected deviations may result in a formal review

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%	LIBID 7 Day GBP

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

6.3 Fund manager fees

- The Board will pay such fees and expenses as are negotiated with fund managers from the Fund in accordance with the Pension Protection Fund (Payment to meet Investment Costs) Regulations 2005².
- The fund managers are currently remunerated by an *ad valorem* fee based on the level of assets under management.

² Statutory Instrument 2005 No 1610

- The costs of management and transactions will be reviewed from time to time, and if appropriate, renegotiated.

7. **Day to day custody of the assets**

- 7.1 Custodians provide safekeeping for assets and perform the associated administrative duties e.g. trade settlement, dividend collection, corporate actions, tax reclamation and proxy voting. For the pooled fund investments in which the Fund invests, each investment manager is responsible for the appointment of custodians.

8. **Socially responsible investment and corporate governance**

- 8.1 The Board's primary concern, in setting its investment policy, is to act in the best financial interests of the Fund and its beneficiaries, seeking the best return that is consistent with a prudent and appropriate level of risk. The Fund's investments consist of cash and cash instruments.
- 8.2 The Board believes that in order to fulfil this commitment and to protect and enhance the value of the Fund's investments over the long-term, it must act as a responsible and vigilant asset owner and market participant.
- 8.3 The Board further believes that the environmental, social and governance (ESG) factors can have an impact on the long-term performance of its investments, and that the management of ESG risks and exploitation of ESG opportunities can add value to its portfolio.
- 8.4 The Board is a signatory of the UN Principles of Responsible Investment (UN PRI), a set of global best practice principles on Responsible Investment (RI). The Board uses these Principles as a benchmark with which to guide its own approach to RI, and in doing so, seek to apply RI principles across all in which it invests.
- 8.5 The Board defines ESG factors as the interaction of its investments with
- the physical environment (environmental)
 - communities, workforces, wider society and economies (social), and
 - the governance structures of the organisations and markets in which the Fund invests, as well as of the agents used (governance, including corporate governance).
- 8.6 The Board will integrate the consideration of ESG issues across all asset classes and markets in which it invests. In particular the Board, or its agents

on its behalf, will exercise its ownership rights, including voting rights, in order to safeguard sustainable returns in the long-term.

- 8.7 The Board expects its fund managers, where appropriate, to have integrated ESG factors as part of their investment analysis and decision-making process. Appropriate weight will be given to ESG factors in the appointment of fund managers. The Board will hold fund managers to account in this regard as part of its regular monitoring process.
- 8.8 In line with its commitment to transparency, the Board will report to its stakeholders on its responsible investment activities.

9. **Compliance with this statement**

- 9.1 The Investment Committee will monitor compliance with this Statement annually. In particular it will obtain written confirmation from the fund managers that they have complied with this Statement as supplied to them and the Investment Committee undertakes to advise the fund managers promptly and in writing of any material change to this Statement.
- 9.2 The National Audit Office will audit and monitor compliance as part of its annual review of the Fund's accounts and statement in internal control.

Annex 1 – Investment guidelines and benchmarks

Benchmark 100% Bank of England Repo Rate

Style of management Active 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 Board is Responsible for
 - Setting structures and processes for carrying out its role.
 - Setting the investment framework, including objectives and an acceptable investment risk appetite within that framework.
 - Initial appointment of fund managers.
 - Establishing an initial investment strategy.
 - Reviewing the content of this Statement in conjunction with the investment adviser, the Fund's actuary and legal adviser and modifying it if deemed appropriate.
 - Providing oversight of the Investment Committee.
 - Consulting with relevant bodies when reviewing investment policy issues.
- The Investment Committee is responsible for
 - Developing and approving the PPF's and FCF's Statement of Investment Principles and strategy and recommending material changes to the Board.
 - Developing and overseeing the overall approach to investment risk management, including appropriate delegations and periodic reviews.
 - Overseeing the implementation of the risk and investment strategies. Maintaining and engaging in a forward looking review of strategic risks and opportunities.

- Developing and maintaining the Fund's responsible investment policies.
 - Developing the principles for dealing with the investments of schemes in assessment and subsequent transfer to the Fund.
 - Oversight of the annual investment report of the Fund.
 - Approving and overseeing the framework for the appointment, retirement and contractual review of the fund managers including the assessment of appropriate knowledge and experience.
 - Approving and overseeing the framework for the appointment, retirement and contractual review of the investment adviser.
 - Approving and overseeing the framework for the appointment, retirement and contractual review of the custodian to the funds.
- The investment adviser is responsible for
 - Advising on all aspects of the investment of the Fund assets including implementation of strategy.
 - Providing updates 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
 - Discretionary management of the portfolio, including implementation (within guidelines given by the Investment Committee) of changes in the asset mix and selecting securities

within each asset class.

- Providing the Investment Committee 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 Investment Committee 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.

19 October 2011