

# **MERCHANT NAVY OFFICERS PENSION FUND**

## **STATEMENT OF INVESTMENT PRINCIPLES**

### **Introduction**

The main purpose of the MNOPF is the provision of pensions for Officers in the British Merchant Navy on retirement at normal pension age and annuities for their widows, children or other dependants. The Trustee has the power to extend the qualification for membership to include other Officers or other classes of persons connected with the British Merchant Navy.

The MNOPF comprises two Sections consisting of the Old Section and the New Section as provided for under Clause 14.3 of the Trust Deed and Rules and the two Sections shall at all times be maintained and managed in accordance with and subject to all the provisions of that Clause.

#### 1. The Trustee's Investment Objectives

##### 1.1 The investment objectives of the Trustee are:

1.1.1 to acquire suitable assets of appropriate liquidity which will generate income and capital growth to meet, together with contributions from MNOPF members and employers, the cost of current and future benefits which the MNOPF provides; and

1.1.2 to limit the risk of the MNOPF's assets failing to meet the MNOPF's liabilities over the long term.

##### 1.2 In pursuing these investment objectives, the Trustee intends to have due regard to:

1.2.1 the paramount interests of the members of the MNOPF, for whom the receipt of their promised benefits (with discretionary increases, where awarded) is of prime importance; and

1.2.2 the interests of the employers, upon whom the responsibility for funding those benefits ultimately falls.

#### 2. **The Trustee's Powers to Pursue those Objectives**

2.1 The Trustee will exercise its powers of investment, which are contained in the Trust Deed and Rules (primarily, Clauses 16.0 and 16.1 of the Trust Deed) as supplemented by Section 34(1) of the Pensions Act 1995, in a manner which is consistent with those objectives.

### 3. **The Legal Duties which the Trustee must Observe**

- 3.1 Trust law requires that the Trustee must exercise its powers of investment in the best interests of the members, which will normally mean their best financial interests. Its powers must therefore be exercised so as to aim to yield the best return for the members, consistent with the need for prudence.
- 3.2 Section 36(1) of the Pensions Act 1995 requires that the Trustee must exercise its powers of investment in accordance with the Investment Regulations. Regulation 4 of the Investment Regulations requires:
- 3.2.1 The assets must be invested in the best interests of the members and beneficiaries and, in the case of a potential conflict of interest, in the sole interest of the members and beneficiaries.
- 3.2.2 The powers of investment must be exercised in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio of each Section as a whole.
- 3.2.3 Assets held to cover each Section's Technical Provisions must also be invested in a manner appropriate to the nature and duration of the expected future retirement benefits payable under the Section.
- 3.2.4 The assets of the MNOPF must consist predominantly of investments admitted to trading on Regulated Markets and investment in any assets not so admitted must be kept to a prudent level.
- 3.2.5 The assets of each Section must be properly diversified to avoid excessive reliance on any particular asset, issuer or group of undertakings and to avoid accumulations of risk in the portfolio. Investments in assets issued by the same issuer or by issuers belonging to the same group must not expose the Section to excessive risk concentration. To the extent that the assets of the Section consist of Qualifying Insurance Policies, these policies shall be treated as satisfying the requirement for proper diversification when considering the diversification of assets as a whole.
- 3.2.6 Investment in Derivative Instruments may be made only in so far as they contribute to reduction of risks or facilitate efficient portfolio management (including the reduction of cost or the generation of additional capital or income with an acceptable level of risk) and any such investment must be made and managed to avoid excessive risk exposure to a single counterparty and to other derivative operations.
- 3.3 Section 36(3) of the Pensions Act 1995 requires the Trustee to obtain and consider proper advice on the question of whether the investment is satisfactory, having regard to the requirements of the Investment Regulations so far as relating to the suitability of investments, and to the principles contained in this Statement. Broadly, the reference to the need

for proper advice is a reference to the need to obtain advice from a person authorised to give it by the Financial Services Authority.

- 3.4 To the extent required by law, ultimate responsibility for the investment of the assets of the MNOFF, including responsibility for securing compliance with the requirements of Section 36 of the Pensions Act 1995, rests with the Trustee. However, the implementation of this Statement has been delegated to the Investment Committee, and certain powers and responsibilities have been delegated to the Delegated CIO. The Trustee's powers and duties described in this Statement apply to the Investment Committee, the Delegated CIO and any other party to whom the Trustee may have delegated its powers in the same way as they apply to the Trustee. This arrangement is consistent with the Myners Report, which states that it is good practice for trustee boards to appoint investment committees in order to provide appropriate focus for investment decision-making. Paragraphs 12 and 13 of this Statement set out the specific roles of the Investment Committee and the Delegated CIO.

#### 4. **The Kinds of Investments to be Held**

- 4.1 The Trustee will acquire and hold suitable assets of appropriate liquidity, which will generate income and capital growth to meet, together with contributions from MNOFF members and employers, the cost of current and future benefits, which the MNOFF provides.
- 4.2 The Trustee intends to hold investments that limit the risk of assets failing to meet the liabilities over the long term.
- 4.3 Diversification of the portfolio of assets is achieved through equity, fixed interest, property and other liquid or illiquid investments, which are spread geographically. This diversification through different asset classes and markets seeks to ensure an adequate level of performance without undue risk.
- 4.4 Most of the equities are listed on recognised stock exchanges and are spread across domestic and overseas investment markets. Fixed interest investments are similarly diversified. Investment management companies specialising in the asset classes managed on behalf of the MNOFF are contracted to manage the investments.
- 4.5 No class of financial instruments (whether or not they generate capital growth rather than income) is excluded from investment consideration.

#### 5. **The Balance Between Different Kinds of Investment**

- 5.1 The allocation of the MNOFF's assets between asset classes is determined in accordance with the Strategic Asset Allocation. The Strategic Asset Allocation between asset classes for each Section is determined by the Investment Committee (with appropriate advice), by reference to investment risk budget targets as set by the Trustee.

- 5.2 The Strategic Asset Allocation should reflect the liabilities of the MNOFF and is considered separately for each Section.
- 5.3 The Investment Committee, under the delegated authority of the Trustee, will from time to time agree a Strategic Asset Allocation for each Section which prescribes allocations to various asset classes as defined by the investment markets. The current Strategic Asset Allocation for each Section is set out in Appendix 2 to this Statement. The Strategic Asset Allocation for each Section, as amended from time to time by the Investment Committee, will form part of this Statement.
- 5.4 The Strategic Asset Allocation is reviewed annually (or more frequently if considered appropriate) to ensure that the assets of each Section are appropriately diversified and provide a reasonable expectation of meeting the investment objectives of each Section.

## 6. **Risk**

6.1 The Trustee recognises that a number of risks are involved in the investment of assets of the MNOFF:

6.1.1 Solvency and mismatching risks:

- a. are measured through a qualitative and quantitative assessment of the expected development of the liabilities relative to the current and alternative investment policies; and
- b. are managed by assessing the progress of the actual growth of the liabilities relative to the selected investment policy.

6.1.2 Investment Manager risk:

- a. is measured by the expected deviation of the prospective risk and return, as set out in the Investment Manager(s)' objectives, relative to the investment policy; and
- b. is managed by monitoring the actual deviation of returns relative to the objective and factors inherent in the Investment Manager(s)' investment process.

6.1.3 Liquidity risk:

- a. is measured by the level of cashflow required for each Section over a specified period; and
- b. is managed by assessing the level of cash held in each Section in order to limit the impact of the cash flow requirements on the investment policy.

6.1.4 Geopolitical and currency risks:

- a. are measured by the level of concentration in any one market leading to the risk of an adverse influence on investment values arising from political intervention; and
- b. are managed by regular reviews of the actual investments relative to policy and through regular assessment of the levels of diversification within the existing policy.

6.1.5 Custodial risk:

- a. is measured by assessing the creditworthiness of the global custodian and the ability of the organisation to settle trades on time and provide secure safekeeping of the assets under custody; and
- b. is managed by the review and discussion of regular reports from the global custodian on their performance relative to agreed service levels as set out in paragraph 12.2.7 of this Statement.

6.1.6 Sponsor risk:

- a. is measured and assessed by the level of ability and willingness of the Participating Employers to support the continuation of each Section and to make good any current or future deficits; and
- b. is managed by assessing a number of factors, including the separate and aggregated creditworthiness of the Participating Employers.

6.2 Having taken all of the above factors into consideration, the Trustee believes it appropriate to establish strategic asset allocations and investment objectives for each Section driven by that Section's liabilities.

6.3 The Investment Committee, will, having taken investment advice in accordance with Section 36(3) of the Pensions Act 1995, recommend a risk budget for approval by the Trustee for each Section that reflects the maximum level of investment risk acceptable to the Trustee.

6.4 Where the Trustee deems it appropriate and having regard in particular to the strategic review undertaken in connection with the Old Section, the Trustee will take steps to reduce risk in the investment of assets of the MNOFF, including the following:

6.4.1 the use of appropriate financial instruments and arrangements;

6.4.2 the purchase of annuities, deferred annuities and other relevant insurance policies; and

6.4.3 the alignment of the investment portfolio in a manner consistent with the potential purchase of annuities, deferred annuities and other relevant insurance policies.

7. **Monitoring and Adjustments**

7.1 The Trustee is aware that day-to-day movements in global investment markets can cause asset allocation drifts and therefore the Trustee has delegated authorities in relation to the Strategic Asset Allocation (as set out in this Statement) to the Investment Committee and the Delegated CIO.

7.2 The Trustee is also aware of the likelihood that one or more Investment Managers will underperform relative to their set investment objectives from time to time. The Trustee has delegated the task of monitoring Investment Manager performance to the Investment Committee and the Delegated CIO. The method and frequency of Investment Manager performance monitoring is more fully described in paragraphs 12 and 13 of this Statement (The role of the Investment Committee and the role of the Delegated CIO).

## 8. **Expected Return on Investments**

The Trustee's policy with regard to the expected return on investments is to set, from time to time, an overall objective, for each Section that represents its best judgement of what relative return is necessary to meet the relevant Section's liabilities, given its understanding of the contributions likely to be received. The investment return objective for each Section is set from time to time by the Trustee.

## 9. **The Realisation of Investments**

The Trustee has a policy that there should, at all times, be sufficient investments in liquid or readily realisable assets to meet cashflow requirements such that the realisation of assets will not disrupt the overall investment policy of the MNOPF. The Trustee also requires that sufficient cash be held to meet the likely benefit payments as they fall due.

## 10. **Socially Responsible Investment**

The Trustee has considered how social, environmental and ethical factors should be taken into account in the investment process. The Trustee seeks to understand the extent to which its Investment Managers have taken steps to incorporate these factors into its investment process, and encourages them to do so in the selection, retention and realisation of investments as far as such factors may affect investment performance.

## 11. **Corporate Governance**

11.1 The Trustee recognises the responsibilities of shareholders as owners of capital. Accordingly, the Trustee's objective as a shareholder is to achieve a substantial long-term return on the MNOPF's investments by the preservation and enhancement of shareholder value, which it believes good corporate governance promotes. Matters of corporate governance in general and voting in particular are integral parts of the delegation of duties to the Investment Managers. Voting power must be exercised by the

Investment Managers with the objective of preserving and enhancing long-term shareholder value.

11.2 The Trustee supports the aims of the Stewardship Code, and its Investment Managers are invited to operate in accordance with the guidelines laid out in the Stewardship Code which covers matters of both voting and engagement. The Investment Managers are required to report their adherence to the Stewardship Code using the comply or explain principle where appropriate.

11.3 The Trustee requires its Investment Managers to report on corporate governance, and particularly on their voting and engagement records. In general, Investment Managers are likely to choose to support and vote with incumbent company management, and therefore exception reporting is expected. Significant shareholder action other than voting should also be reported.

## 12. **The Role of the Investment Committee**

12.1 The Investment Committee has the following powers and responsibilities in connection with the implementation of this Statement:

12.1.1 with investment advice and advice from the Scheme Actuary, to develop, adopt and from time to time amend the Strategic Asset Allocations for each Section;

12.1.2 with investment advice and advice from the Scheme Actuary, to develop, and recommend changes to the risk budgets of each Section to the Trustee for approval;

12.1.3 to exercise all of the investment powers otherwise reserved for the Trustee in a manner consistent with this Statement;

12.1.4 to put in place arrangements to monitor and review the performance of the Delegated CIO; and

12.1.5 to review this Statement at least every three years and without delay after any significant change in investment policy and to recommend any changes to the Trustee.

## 13. **The Role of the Delegated CIO**

13.1 The Delegated CIO has the following powers and responsibilities:

13.1.1 determining and implementing investment policy and tactical asset allocation changes, within the Strategic Asset Allocation;

13.1.2 selecting and appointing Investment Managers including, but not limited to, the setting of investment objectives, benchmarks and performance targets in respect of each that should be consistent with the overall investment

objectives of the MNOPF and the specific level of skill and risk expected of each manager;

- 13.1.3 reviewing the performance of the Investment Managers on a quarterly and annual basis, comparing returns achieved against those of relevant market indices and individual benchmarks;
  - 13.1.4 reviewing the performance of the global custodian on a quarterly and annual basis against a series of key performance indicators from time to time (and as currently laid down in the global custodian's service level agreement);
  - 13.1.5 identifying, reviewing and implementing investment strategies;
  - 13.1.6 reviewing on a continual basis the investment risks as set out in the Trustee's risk assessment register; and
  - 13.1.7 reviewing regularly the MNOPF's overall risk tolerance and performance objectives.
- 13.2 The Delegated CIO may also refer decisions to the Investment Committee and provide advice to the Investment Committee from time to time.

#### 14. **Investment Management**

- 14.1 The day-to-day management of the MNOPF's investments will be conducted by individuals and organisations with appropriate authorisation under the financial services legislation of the country in which the investment manager is registered and regulated and in accordance with such investment management agreements as the Delegated CIO shall deem appropriate.
- 14.2 The Delegated CIO shall provide the Investment Managers with a copy of this Statement and any amendments to it. The Investment Managers are required to exercise their delegated powers with a view to giving effect to the principles contained in this Statement, as far as reasonably practicable and to confirm on a regular basis that they have acted in conformity with it.

#### 15. **Appendices**

Copies of the following are appended to this Statement:

- 15.1 Defined terms (Appendix 1); and
- 15.2 the current detailed Strategic Asset Allocation as adopted by the Investment Committee, implementing the principles described in this Statement (Appendix 2).

16. **Compliance with the Pensions Act 1995 and the Preparation of this Statement**

- 16.1 This Statement complies with the Trustee's obligation, under the Pensions Act 1995, to prepare, maintain, and to review this Statement at least every three years and without delay after any significant change in investment policy.
- 16.2 In preparing this Statement, the Trustee has obtained advice from the Delegated CIO and has consulted the Scheme Actuary and the legal advisers to the MNOFF.
- 16.3 In preparing this document, the Trustee has also consulted the representatives of the MNOFF's employers and the members, and the Trustee will similarly consult when revising this document. Copies of this Statement will be sent to employers (as far as possible), will be made available to members on request, will be placed on the MNOFF website and an abridged version will be included in the Annual Report to Members.
- 16.4 The Trustee will review this Statement, with advice from the Investment Adviser, the Delegated CIO and the Scheme Actuary, following an actuarial valuation, when there is a significant change to the MNOFF (or a Section of it) or where the Trustee or the Investment Committee determines that a review is needed for other reasons. The Investment Committee may make recommendations to the Trustee regarding changes to this Statement.

## **Appendix 1: Defined terms**

The following expressions have the following meanings in this Statement:

**Delegated CIO** means the consultant appointed by the Trustee to whom the Trustee has delegated certain of its investment powers;

**Derivative Instrument** has the meaning given by Regulation 4(11) of the Investment Regulations;

**Investment Adviser** means the person appointed by the Trustee to monitor and challenge the actions of the Delegated CIO;

**Investment Committee** means the committee to whom the Trustee has delegated certain of its investment powers, the terms of reference and composition of which is determined by the Trustee from time to time;

**Investment Manager** means a person to whom decisions about investments have been delegated by or on behalf of the Trustee in accordance with Section 34(2) of the Pensions Act 1995;

**Investment Regulations** means the Occupational Pension Scheme (Investment) Regulations 2005;

**MNOPF** means the Merchant Navy Officers Pension Fund;

**Myners Report** means the Review of Institutional Investment in the United Kingdom, published in March 2001;

**New Section** means the Post 78 Section (as defined in the Trust Deed and Rules);

**Old Section** means the Pre 78 Section (as defined in the Trust Deed and Rules);

**Participating Employers** has the meaning given in the Trust Deed and Rules;

**Qualifying Insurance Policies** has the meaning given by Regulation 1(2) of the Investment Regulations;

**Regulated Market** has the meaning given by Regulation 4(11) of the Investment Regulations (as extended by Regulation 4(9) of the Investment Regulations);

**Scheme Actuary** means the individual appointed by the Trustee in accordance with Section 47(1) of the Pensions Act 1995 as actuary of the MNOPF;

**Section** means the Old Section or the New Section (as appropriate);

**Statement** means this Statement of Investment Principles;

**Strategic Asset Allocation** means the document which prescribes the allocation of the MNOPF's assets between asset classes, as developed, adopted and from time to time amended by the Investment Committee (and as more particularly described in this Statement);

**Stewardship Code** means The UK Stewardship Code that was published by the Financial Reporting Council in July 2010 which aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities by setting out good practice on engagement with investee companies;

**Technical Provisions** has the meaning given by Section 222(2) of the Pensions Act 2004;

**Trust Deed and Rules** means the Trust Deed and Rules dated 25 June 1999 (as amended from time to time) by which the MNOPF is currently governed; and

**Trustee** means MNOPF Trustees Limited, the sole corporate trustee of the MNOPF.

**Appendix 2a**

**Strategic Asset Allocation from January 2011**

**Pre 1978 Section ("Old Section")**

<b>Asset Class</b>	<b>%</b>
Equities	5
Property	3
Non-Investment Grade Credit	9
Investment Grade Credit	23
Matching Assets ex Investment Grade Credit	60*
<b>Total</b>	<b>100</b>

\* includes buy-in

**Appendix 2b**

**Strategic Asset Allocation from January 2011**

**Post 1978 Section (“New Section”)**

<b>Asset Class</b>	<b>%</b>
Equities	22
Private equity and Infrastructure	4
Property	4
Hedge funds	10
Commodities	2
Reinsurance	2
Non-Investment Grade Credit	6
Investment Grade Credit	17
Matching Assets ex Investment Grade Credit	33
<b>Total</b>	<b>100</b>