



Transport for London

TfL Trustee Company Limited

STATEMENT OF INVESTMENT PRINCIPLES

1. Introduction

- 1.1 This document describes the investment policy being pursued by TfL Trustee Company Limited (“the Trustees”), trustee of TfL Pension Fund (“the Fund”).

Pensions Act 1995 and Subsequent Legislation

- 1.2 Under the Pensions Act (“the Act”) and subsequent legislation, principally the Occupational Pension Schemes (Investment) Regulations 2005, the Trustees are required to prepare a statement of the principles governing investment decisions. This document fulfils that requirement.
- 1.3 The Trustees are responsible for all aspects of the operation of the Fund including this statement. As required by the Act, it has been drawn up and revised after consultation with Transport for London (TfL) as Principal Employer under the Fund in which capacity it is authorised to act on behalf of all the other Participating Employers according to the terms of the Deeds under which they respectively participate in the Fund.
- 1.4 In drawing up this document, the Trustees have sought advice from the Fund’s Investment Adviser and other advisers. The Trustees will review this document at least once a year, or where the Trustees consider a review is needed for other reasons.
- 1.5 The Trustees have had regard to the requirements of the Act concerning diversification of investments and suitability of investments and the Trustees will consider those requirements on any review of this document or any change in the investment policy.

2. Fund Structure

- 2.1 Since 1999 and following the organisational changes connected with the transition from London Regional Transport to Transport for London under the Greater London Authority Act 1999, the Public Private Partnership for the London Underground and certain Private Finance Initiatives, the Fund has been converted, with effect from 1 May 2001, into a centralised scheme for non-associated employers, with both public and private sector participants.

- 2.2 There are currently eleven separate sections. Eight of them are in respect of the members employed by the private sector Participating Employers. The other sections are the LUL SSL and LUL BCV sections and the "TfL Section", which is the largest. The TfL, LUL SSL and LUL BCV sections have the liabilities in respect of members employed by TfL and its subsidiaries and also in respect of all pensioners and deferred pensioners, whether formerly employed by TfL or another Participating Employer. When the Fund was converted to a scheme for non-associated employers, the Participating Employers decided that, whenever a member of a private sector section becomes entitled to a deferred pension, retires with an entitlement to an immediate pension, or dies, a transfer payment will be made in respect of him or her from the Participating Employer's section to the TfL Section. Contributions and transfers-in by and for the active members of a section are held in that section. Nearly all benefits, apart from some cash equivalents, are currently paid out of the TfL Section.
- 2.3 The assets of the Fund are invested in accordance with the principles described in this Statement, but to enable the value of each section to be separately identified the investments of the Fund have been unitised. Each separate section is credited with bond units and equity units as determined under Rule 2C of the Fund. The TfL Section may also hold additional assets such as cash. Further types of units may be made available if, in future, the Trustees so decide.

3. Division of Responsibilities

- 3.1 Only persons or organisations with the necessary skills, information and resources are actively involved in taking investment decisions affecting the Fund. The Trustees draw on the expertise of external advisers including the investment managers, Investment Adviser and the Scheme Actuary.

Financial Services and Markets Act

- 3.2 In accordance with the Financial Services and Markets Act 2000, the Trustees will set general investment policy, but will delegate the responsibility for selection of specific investments to the appointed investment managers.

Trustees and the Investment Committee

- 3.3 No decision about investments of the Fund will be made other than by a valid majority of the Directors of the Trustees at a quorate meeting, or by a resolution in writing signed by all the Directors. This will not apply, however, to a decision taken by investment managers appointed by the Trustees and in accordance with powers delegated to them by the Trustees, or to any decision made by the Trustees' Investment Committee where this has been delegated to the Committee.

4. Objectives of the Fund

- 4.1 The primary objective of each section of the Fund is that the existing assets together with future contributions will be sufficient to meet the cost of the accrued and future service benefits provided under the Rules of the Fund.
- 4.2 Part 3 of the Pensions Act 2004 and the Occupational Pension Schemes (Scheme Funding) Regulations 2005 introduced new scheme-specific funding requirements to help ensure that pension schemes are funded to an appropriate level. This legislation applies to each section of the Fund separately. Each section has a Schedule of Contributions. In addition any section that did not meet the statutory funding objective at the most recent actuarial valuation also has a Recovery Plan. These factors are taken into account by the Trustees when considering the appropriate investment strategy for that section.
- 4.3 While the primary objective is to hold sufficient assets to meet the liabilities of each section, the Trustees have recognised that the level of funding within each section and the strength of the employers' covenants permit some risk (i.e. deviation from a liability matched portfolio) being taken in pursuit of growth. The aim is to take on risk in a controlled fashion in order to achieve incremental excess return.
- 4.4 In summary, the investment policy therefore pays regard to the following:-
- (1) the security of members' benefits;
 - (2) the need to comply with scheme-specific funding requirements;
 - (3) a desire to control the cost of benefits by preserving the Fund's wealth;
 - (4) a desire to limit instability in contribution rates as a result of any failure of the investment strategy;
 - (5) notwithstanding the above, a willingness to embrace risk in a controlled fashion in order to achieve incremental excess return.

Additional Voluntary Contributions (AVCs)

- 4.5 The Fund provides facilities for members to pay AVCs that are invested in a range of options through the Equitable Life Assurance Society, the Clerical Medical Investment Group Limited and the Standard Life Assurance Company. Only the Standard Life options remain open to new members. The Trustees' objective is to provide a choice of investments which will give a suitable long term return for members. The Trustees monitor the suitability of these investments and seek expert advice from time to time as to whether they remain appropriate.

5. Environmental, social and governance issues (ESG)

- 5.1 The Fund recognises its responsibility as an active and long term institutional investor to support and encourage good corporate governance practices in the companies in which it invests. By encouraging responsible corporate

behaviour, the Fund can contribute to business prosperity through greater accountability between boards, shareholders and other stakeholders. It also expects such behaviours to enhance the value of the Fund's investments over the longer term.

This includes challenging companies which do not meet such standards.

- 5.2 The Fund therefore requires its fund managers in their stewardship of the Fund's assets to pay appropriate regard to relevant corporate governance, social, ethical and environmental considerations when considering the purchase, retention or sale of investments.
- 5.3 Specifically within its arrangements with investment managers, the Fund communicates with companies and exercises the rights attaching to its investments and these activities are reported back to the Trustees by these managers. The Fund also expects these managers will also use their own influence as major institutional investors to promote good practice. The Fund considers these activities are consistent with achieving the long-term interests of the Fund's beneficiaries.
- 5.4 By monitoring corporate governance, social, ethical and environmental issues, the aim is to identify problems at an early stage so that through engagement with company management an appropriate resolution of these problems can be agreed. Such resolution is likely to be effective through collaboration between investors and the Fund's investment managers are encouraged to participate in such joint action.
- 5.5 The Trustees have asked the investment managers to exercise their voting and other rights as shareholders in a manner they believe to be consistent with best practice in relation to Corporate Governance and in accordance with the Institutional Shareholders' Committee's (ISC) Statement of Principles on the Responsibilities of Institutional Shareholders and Agents. These Principles state that institutional shareholders and/or agents will:
 - set out their policy on how they will discharge their responsibilities, clarifying the priorities attached to particular issues and when they will take action
 - monitor the performance of, and establish, where necessary, a regular dialogue with investee companies
 - intervene where necessary
 - evaluate the impact of their engagement
 - report back to clients/beneficial owners
- 5.6 The ISC is currently reviewing its Statement of Principles on the Responsibilities of Shareholders and Agents and the Trustees will consider the revised guidance when issued.
- 5.7 The investment manager's quarterly reports include coverage of ESG matters including details of voting activity and engagement with company management. The Trustees meet regularly with their investment managers and, as part of their review, monitor and discuss ESG matters.

6. Strategic Asset Allocation

- 6.1 TfL commissioned an Asset Liability Modelling Study (ALMS) in 2003, based on the results of the actuarial valuation of the Fund as at 31 March 2003. Based on the ALMS, the Trustees reviewed their Investment Strategy during 2004, and approved revised asset allocations for all sections in March 2005.
- 6.2 TfL commissioned a risk budgeting exercise that took place during 2006 and 2007. Based on the outcome of the risk budgeting exercise, the TfL Section has started introducing additional diversifying alternative asset classes. In addition, the results of the valuation as at 31 March 2006 have been used to produce an updated review of the investment strategy and to specify a risk reduction programme for the this Section.
- 6.3 The Trustees set investment guidelines for each section of the Fund in the light of the funding level and maturity of each section. The Trustees also take account of the strengths of the employer's covenant in setting the strategy for each section of the Fund. In determining this strategy, the Trustees take advice from the Scheme Actuary and the Investment Adviser on the appropriate balance between, in particular, equity, bond and alternative asset class investments, the balance between the portfolios to be held by each of the specialist investment ("active") managers and the proportions of the Fund under "passive" management.
- 6.4 The Trustees measure the performance of the Fund overall both relative to the performance of the liabilities for the overall Fund and by reference to the performance benchmarks set for each of the asset classes, for both active and passive portfolios. Active investment managers take positive decisions relative to their given performance benchmark. These decisions are in terms of allocating assets between different markets and the choice of individual investments within markets. In contrast, passive management aims to invest in line with the benchmark position.

Risks

- 6.5 The Trustees recognise a number of risks involved in the investment of the assets including:
- Solvency risk and mismatching risk – addressed through the asset allocation strategy and through ongoing triennial actuarial valuations.
 - Manager risk – addressed through the diversification of the Fund's assets across multiple investment managers and through the ongoing monitoring of the managers.
 - Currency risk – addressed through a currency overlay strategy

- Liquidity risk – the Trustees together with the Fund’s administrators monitor the level of cash held in order to limit the impact of the cash flow requirements on the investment policy.
 - Diversification risk – the Trustees have sought to minimise this risk by the allocation of funds to specific markets. These are designed to prevent over-concentration in any one type of investment or over-exposure to a particular company.
 - Illiquidity risk – the Trustees have invested a portion of the Fund’s assets in investments for which there is no recognised market. The Trustees have taken this into account when sizing the allocation to such investments; they also expect to receive an appropriate return premium for this risk.
- 6.6 Investment values can also be adversely affected by political intervention. The Trustees have little control over this apart from restricting the size of investments in jurisdictions which are seen as risky.
- 6.7 The Trustees have put in place safeguards to protect the Fund’s investments from fraud. There are also strict controls on who can authorise the transfer of cash and the accounts to which transfers can be made.
- 6.8 The Trustees recognise that active management introduces a risk of under-performance. However, they believe that by use of a mixture of “passive” and “active” portfolios, overall out-performance can be achieved within acceptable risk parameters.
- 6.9 The Trustees measure and monitor the risks identified above through a combination of quarterly investment monitoring reports which include assessments of the investment managers and estimates of the impact on the funding level of the Fund; regular actuarial valuations; regular strategy reviews; and ad-hoc investigations.

Rates of Return

- 6.10 The expectation of the Trustees is that the strategic asset allocation for each section will achieve a real return on the assets that, in the longer term, equates to or exceeds the assumed real rate of return set out in the section’s Statement of Funding Principles.

Liquidity

- 6.11 There needs to be significant cash available, in the TfL section in particular, to pay the Fund benefits every month. The administrator in conjunction with the investment managers ensures that sufficient cash balances are available and should there be a cash demand on the Fund, that assets can be converted easily into cash.

- 6.12 The investment managers' discretion extends to whether or not to sell particular investments at prevailing prices and which investments to sell to raise cash, as and when required for meeting cash flow requirements.

7. Investment Manager Structure

- 7.1 The Fund employs a number of investment managers, for whom the overall benchmark and asset ranges specified are designed to ensure that the Fund's assets are adequately diversified and suitable for the Fund given the liability profile of each section. In this regard, the Trustees have taken advice from the Investment Adviser.

| Portfolio | Manager |
|--|--|
| <u>Core</u> Index tracking – all asset classes including Bonds and cash | Legal & General Assurance (Pensions Management) Limited |
| <u>Liability Matching</u> Enhanced Index Funds | Legal and General Assurance (Pension Management) Limited |
| <u>Active Specialist</u> Bonds | Goldman Sachs Asset Management |
| Far East equities | Nomura Asset Management UK Limited |
| <u>Alternatives</u> Infrastructure assets | Semperian PPP Investment Partners |
| Pure Alpha (Global Macro Fund) | Bridgewater Associates |

- 7.2 The decision regarding use of active and passive management includes consideration of the efficiency, liquidity and level of transaction costs likely to prevail within each market as well as the impact of the investment manager fees on future expected returns net of fees.
- 7.3 The proportionate investment held by each manager at any point in time may vary from the overall benchmark and specified asset ranges due to market movements and/or differential performance relative to benchmark. These variations will be monitored and the Investment Adviser will advise the Trustees quarterly if, in his opinion, the degree of variation requires rebalancing. In addition, Legal & General are mandated to rebalance the total Fund's allocations to broad asset classes to within specified control ranges.

- 7.4 The Trustees have instituted controlled Commission Recapture and Securities Lending programmes to help offset investment expenses. These are managed and are reported upon by the appointed Global Custodian, JP Morgan Investor Services. JP Morgan also operate a currency hedging programme on behalf of the fund.

Monitoring

- 7.5 The Investment Committee of the Trustees holds regular meetings with the investment managers and receive their reports to satisfy themselves that the managers continue to carry out their work competently and have appropriate knowledge and experience to manage the investments of the Fund.
- 7.6 The Investment Adviser provides quarterly updates of performance to assist in the reviews of the Fund's and investment managers' performance against the benchmarks.
- 7.7 These engagements and monitoring of the investment managers with the assistance of the Investment Adviser provides suitable evidence that the managers are complying with the terms of their respective investment management agreements, including the exercise of their delegated powers and benchmark reference. The investment managers maintain internal control processes to identify any instances where a potential breach has occurred and any such instances are reported promptly to the Trustees.
- 7.8 The Trustees, after consulting with the Investment Adviser, will consider at least once every 12 months whether they are satisfied with the managers' past performance and their potential to, at least, perform in line with their benchmark and target in the future. If they are not satisfied they will require the investment manager concerned to take such steps as will then satisfy them in this respect, or will remove that manager and appoint another.
- 7.9 The Trustees also carry out specific monitoring in respect of ESG matters which is covered in section 5 above.

8. Myners Principles

- 8.1 The Trustees have adopted the updated Myners principles:
- **Effective decision making** – Trustees should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation. Trustees should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.
 - **Clear objectives** – Trustees should set out an overall investment objective(s) for the fund that takes account of the scheme's liabilities, the strength of the sponsor covenant as well as the attitude to risk of both the trustees and the

scheme sponsor, and clearly communicate these to advisers and investment managers.

- **Risk and liabilities** – In setting and reviewing their investment strategy, trustees should take account of the form and structure of the liabilities. These include the strength of the sponsor covenant, the risk of sponsor default and longevity risk.
- **Performance assessment** – Trustees should arrange for the formal measurement of the performance of the investments, investment managers and advisers. Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body and report on this to scheme members.
- **Responsible ownership** – Trustees should adopt, or ensure that their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents. A statement of the scheme's policy on responsible ownership should be included in the Statement of Investment Principles. Trustees should report periodically to members on the discharge of such responsibilities.
- **Transparency and reporting** – Trustees should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives. Trustees should provide regular communication to members in the form they consider most appropriate.

8.2 Compliance with the principles will be assessed at least annually.

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