North East Scotland Pension Fund

nespf

Statement of Investment Principles

May 2025

Contents

Document	**Statement of Investment Principles**
Draft/Review Date	May 2025
Approval Date	June 2025
Author & Team	Laura Colliss & Graham Buntain
Review Date	May 2026

Introduction

This Statement of Investment Principles (SIP) is produced on behalf of Aberdeen City Council as administering authority of the North East Scotland Pension Fund (NESPF). It has been prepared to comply with guidance set out by the Scottish Ministers and The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended).

Governance

Aberdeen City Council Pensions Committee consists of 9 elected members, with responsibility to fully discharge the Council's duties in terms of the Pension Fund investment regulations.

The Pensions Committee seeks professional investment advice from the Chief Officer-Finance and external advisors as appropriate.

Support to the Pensions Committee is provided by the Pension Board.

Day to day investment management of the Pension Fund is delegated to the Chief Officer-Finance and underlying appointed fund managers.

All investment decisions are governed by The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended).

Further details of all roles and responsibilities can be found in the Pension Fund Governance Policy Statement.

Fund objective

The Fund's objective is to meet the benefit liabilities as they fall due at a reasonable cost to the participating employers, given that employee contributions are fixed. Reasonable, in this context, refers to both the absolute level of contribution (normally expressed as a percentage of pensionable payroll) and its predictability.

The employer contribution rates are impacted by both the assessed funding level (the ratio of the value of the Fund's assets to liabilities) and the assumptions underlying the actuarial valuation.

The Fund seeks to maintain a 100% funding level, by achieving a return of CPI + 2.00% with a future service rate of CPI + 1.50%.

'Growth' assets, such as equities, are expected to give a higher long-term return than 'liability-matching' assets, such as bonds. The benefit of higher investment returns is, over the long-term, a higher level of funding should achieve lower employer contribution rates.

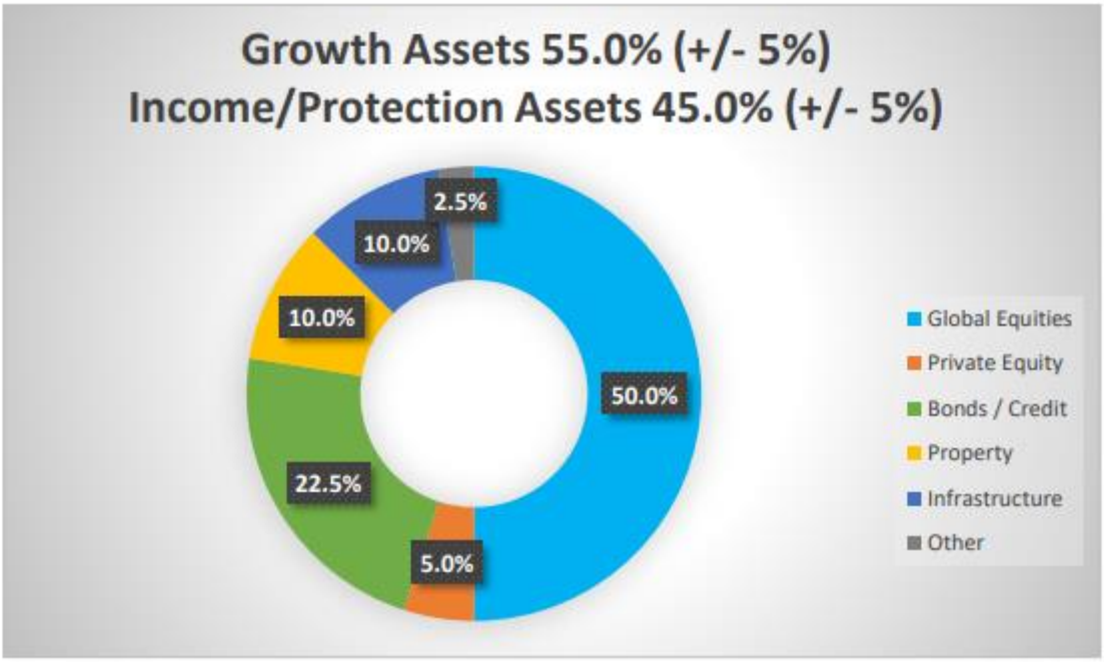
However the additional investment returns from growth assets come with a price: greater volatility relative to the liabilities thus introducing risk. The risk is evidenced by the potential volatility of both the funding level and the employer contribution rates. There is therefore a trade-off between the additional investment return from greater exposure to growth assets and its benefits (higher funding level, lower employer contribution level) and the benefits of greater predictability (both funding level and employer contribution rates) from having greater exposure to liability matching assets.

The trade-off, and its consequences on both funding level and employer contribution level, was examined by the Pensions Committee and led to the strategic benchmark as described below.

Investment Objective

The Pensions Committee has agreed the investment objective on a risk-adjusted basis to deliver the long term funding objective of maintaining a 100% funding level.

As at 1 July 2024 the strategic benchmark was updated and defined as below:



1. Kind of Investments

Investment returns are a combination of income and capital gains/losses. The major kinds of investments and their characteristics are:

UK Equities are shares in the ownership of a company when it goes public. In the UK most shares are listed on the London Stock Exchange. The value of your investment will increase if the shares you own become worth more than what you paid for them giving you a capital gain. Income is also gained from when the company pays a dividend of their profits to their shareholders.

International Equities are similar to UK Equities but with exposure to the currency of the market where the share's price is listed. The investment returns will be enhanced or reduced by the appreciation or depreciation respectively of the market currency against sterling.

Private Equity is an alternative investment class and consists of capital that is not listed on a public exchange. Private equity is composed of funds and investors that directly invest in private companies, or that engage in buyouts of public companies, resulting in the delisting of public equity.

Bonds are debt instruments issued by Governments and other borrowers (in the UK Government Bonds are known as Gilts). Bonds provide a fixed rate of interest and are generally redeemed at par by the issuer at a known future date. The price primarily reflects the fixed level of interest, the term of the redemption and the overall return (the yield) demanded by the investors. Prices of bonds tend to fluctuate less than the price of equities. Index Linked bonds are issued by the UK Government and provide interest and redemption value directly linked to the price of inflation.

Credit refers to the market through which various parties issue debt to investors. Simply put as payments are received on a debt, the investor earns interest on their security. The credit market includes debt offerings, such as collateralised/structured obligations (including asset backed securities and mortgage backed securities), high yield (B/CCC areas) and Emerging Market Debt (EMD).

Credit opportunities are typically higher yielding comparative to Government issued bonds such as Gilts but do come with a slightly higher risk profile.

Property is investment in land and/or buildings such as offices, retail and industrial. The income comes from the rents payable. Property prices primarily reflect the rents they are able to produce and investors demand.

Infrastructure definitions vary, however typically the term is for the basic physical systems of a business or nation — transportation, communication, sewage, water and electric systems are all examples of infrastructure. These systems tend to be high-cost investments and are vital to a country's economic development and prosperity. Infrastructure is also an asset class that tends to be less volatile than equities over the long term and provides a higher yield. It is also thought to be generally uncorrelated with other asset classes therefore can be a useful diversifier to building a balanced portfolio.

Cash is usually deposited with institutions for very short terms and will attract interest at the prevailing money market rates.

The table below gives a summary of the different kinds of investment, including the returns thought to be reasonable expectations.

Investment	Return % p.a.	Volatility % p.a.
UK Equities	6.9	14.5
International Equities	8.1	18.4
Private Equity	10.4	24.4
Bonds / Credit	5.4	7.1
Property	6.9	15.3
Infrastructure	7.9	15.8
Cash / Other	3.5	0.0

Figures shown are 10 years to 31/03/2023, annualised, GBP, in line with the triennial actuarial review

All the major investments listed above, and representative individual holdings, are considered suitable investments for pension funds.

2. Liquidity of Investments

The vast majority of the Fund's assets are readily liquid or readily realisable assets, usually within a couple of weeks. Some investments such as Private Equity, Property & Infrastructure are more illiquid and may take some time to realise.

3. Diversification

The Fund seeks to lower investment risk through a policy of diversification by asset class, fund manager, geographical areas, sectors and companies.
The strategic benchmark, comprising a mix of different assets, is sufficient to provide adequate diversification.

4. Day to Day Management of the Fund's Assets

The Pensions Committee has delegated the day-to-day investment management of the Fund to the Chief Officer-Finance, to ensure the management of the Fund's assets is carried out within the terms of each Investment Management Agreement.

Investment Management Agreements encompass:

- Investment Objectives and Restrictions
- Custody and Accounting arrangements
- Fees and Charges
- Communication
- Performance Monitoring

5. Expected Return

The funding strategy adopted for the 2023 valuation is based on assumed asset out-performance of 2.00% per annum above the Consumer Price Index (CPI), with a future service rate of 1.50%. The administering authority believes that this is a reasonable and prudent allowance for asset out-performance, based on the current investment strategy as set out in this SIP.

6. Risks

The Fund is exposed to, and manages, a number of financial, funding, governance and operational risks. Details of these, including control actions are set out in the Funds Risk Register. Management of Investment Risk is detailed below.

The global custodian provides custody of the majority of the Fund's assets, non-segregated holdings are custodied by the respective fund manager.

The Pensions Committee recognises the level of risk associated with investment in the various asset classes. Risk in this context is a measure of the confidence around the market value of the asset. These views are subjective and based on a scale of low, medium and high risk:

Global Equities	High
Private Equity	High
Property	Medium
Infrastructure	Medium
Bonds/Credit	Medium/Low
Cash	Low

Overall Scheme risk is considered through the Funding Strategy Statement (FSS), with fund manager specific risk monitored through regular reporting.

7. Investment Restrictions

The investment manager has full discretion over the choice of investments; subject to any specific restrictions detailed in the Investment Management Agreement and the restrictions of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended).

Investment Management Structure

The management structure, detailed in **Appendix I**, is monitored on an ongoing basis and is actively changed in line with the investment strategy as required.

The management structure has been constructed to balance the risks, rewards and costs of investing the Fund's assets. In particular because of the size of the Fund, it is appropriate to have diversification between asset managers, following different approaches;

Passive Core layer – this is a low cost benchmark/index tracking approach.

Active Satellite layer - this more adventurous and costly layer should achieve higher performance, with each manager being allowed greater flexibility to invest. Different active managers will have different style biases and approaches but will ultimately aim to outperform a chosen benchmark/index.

Monitoring

The Pensions Committee will keep under review the suitability of the fund managers, the Fund's investments, the appropriate use of realisation of investments and the Fund's custodian.

The Pensions Committee will on a regular basis review this Statement of Investment Principles (SIP) taking into account best practice and statutory responsibilities.

Shareholder Engagement

Shareholder engagement aims to encourage responsible behaviour by companies in relation to environmental, social and governance (ESG) issues.

The Fund views shareholder engagement as a much more positive and effective strategy for encouraging change rather than disinvestment, which is moving or selling investments. Proactive engagement is a much more effective approach to drive change within companies and their practices. The Fund has a duty to engage with the companies we invest in on environmental, social and governance (ESG) themes, and to work with others to effect change on ESG issues.

The Fund believes moving to a carbon neutral position in strategies that tackle climate change need to incorporate the full environmental, social and governance (ESG) dimensions of responsible investment. Achieving a Just Transition, in line with the Paris Agreement on Climate Change, will help to accelerate climate action. As responsible investors we accomplish this through :-

Our External Fund Managers (The Fund has delegated the investment management of the Funds' assets to a number of fund managers)

- Monitoring the extent to which they incorporate ESG issues in their investment processes;
- A requirement that on a quarterly basis they provide updates on their engagement activity;
- Having good lines of communication to discuss ESG issues that suddenly come to the fore;
- Always have ESG as a discussion topic when carrying out fund manager meetings; and
- Fund manager updates are summarised to the Pensions Committee every quarter reporting on ESG issues relevant to the Fund's investments.

Collaborative Engagement

To maximise the Funds effectiveness on ESG issues we are active members/signatories of:

- The Local Authority Pension Fund Forum (LAPFF). LAPFF is a group of 87 funds and 7 pooled companies with combined assets of over £350 billion, whose aim is to maximise their influence as shareholders while promoting ESG. LAPFF is the UK's largest collaborative shareholder forum, engaging across a broad range of ESG themes.

- Principles of Responsible Investment (PRI). This is a United Nations supported and investor led global coalition promoting the incorporation of ESG factors. Being a PRI signatory gives the Fund access to research and the ability to join engagement on a worldwide basis with other likeminded organisations. The Fund implements the six PRI Principles incorporating them into our responsible investment practice.
- Climate Action 100+ (CA 100+). An investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change.
- The Carbon Disclosure Project (CDP). This is a not-for-profit charity that runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts.

Voting

NESPF encourages the companies we invest in to operate to the highest standards of corporate governance and corporate social responsibility. As a major long term shareholder, the main tools open to the Fund to influence behaviour is by the responsible exercise of its voting power and engagement on environmental, social and governance factors.

The Fund subscribes to the Pensions & Investment Research Consultants Ltd (PIRC) voting advice service. PIRC are an independent corporate governance and shareholder advisory consultancy. In addition to the UK, PIRC covers the major markets of Europe, North America and the Far East. The Fund also publishes PIRC's quarterly report on voting recommendations including notable oppose votes with analysis on the Fund's website. All voting on behalf of our investments, including both active and passive investments, is now conducted in-house. We have assumed responsibility for voting on our passive investments managed by State Street Global Advisors, with the support of PIRC.

Climate-related financial risks are greatest for the biggest carbon emitters. These companies also create significant systemic risks as they contribute most to emissions driving climate change which is in turn creating economy-wide risks. The Fund votes to ensure that large emitters have adequate targets aligned to a credible 1.5 degree Celsius pathway. This will limit the financial costs of climate change. Directors and auditors for high emitting companies will be expected to state whether their financial statements or their accounts have these targets, or explain the reasons if they do not. Failure to do so may expose the company to significant financial risks and the Fund will vote in opposition to the accounts, chair of the audit committee and/or the auditors in these scenarios.

Further information on the Fund's voting record is on the NESPF website
https://www.nespf.org.uk/about/investment/responsible-investment/voting/

Climate Statement

The Fund recognises the risks associated with climate change and the potential for these to impact on the long-term value of the Fund's investments, but also the opportunity for investment reward for example in green energy investments, particularly during the period of transition to a lower carbon economy. The Fund believes that company level engagement continues to successfully drive behaviour, an outcome we do not believe disinvestment would have to the same effect. The Fund's approach to managing climate-related risks and opportunities involves both its asset allocation decisions and a robust approach to engagement and voting.

The Fund is a member of the Carbon Disclosure Project (CDP) which focuses on engagement with investors, companies and cities, on taking urgent action to build a truly sustainable economy by measuring and understanding their environmental impact. Further significant engagement progress has been made through participation in the Climate Action 100+ initiative (CA 100+). This collaboration of institutional investors is jointly responsible for over $68 trillion of assets under management. The CA 100+ initiative has three engagement objectives aimed at high carbon emitting companies: robust governance of climate change, business strategies in line with the Paris Agreement goals and high quality disclosures on climate risks through the Task Force on Climate-Related Financial Disclosures (TCFD).

We published our first TCFD report at the beginning of 2025, marking a significant milestone in our commitment to transparency and proactive climate risk management. Working closely with our Fund Managers to collate relevant TCFD metrics, we have incorporated these insights into our comprehensive report which can be accessed below. This report reflects our commitment to early adoption of TCFD recommendations and provides detailed insights into our governance, strategy, risk management, and metrics and targets related to climate change.

The transition to a lower carbon economy requires transparency in reporting risks and opportunities. Consistent production of TCFD report metrics and targets over time will allow for trend analysis and easily determine if targets are being met and improvements are being made. Reporting of these measures will continue to evolve as more organisations contribute and their reports are analysed, allowing the information to become more consistent and standardised, improving the quality of data.

ESG issues are rapidly evolving and we also have to consider the preservation of biodiversity as a necessity alongside climate change. As with climate change we also engage with our fund managers on environmental risks and the impact of the companies in which they invest.
Environmental risks include water or air pollution, loss of biodiversity and land degradation. Environmental objectives include pollution prevention and control, biodiversity conservation, climate change mitigation and control and natural resource conservation.

For example one of our fund managers aim to achieve at least 10% biodiversity net gain on property developments. This shows a healthy ecosystem and the impact on nature. Biodiversity assessments are completed on developments. On buildings already standing where we have control, sites have been optimised for nature as much as possible including installing bird and bat boxes for native species. Installing a green roof on property can be energy saving and reduce noise levels as well as being beneficial to wildlife.

Another example of biodiversity is where the Fund invests in a wind farm asset that released flat oyster tables on the base of the turbines. A research team detected multiple life species around the foundations with ongoing analysis of the species development. Other assets include an energy company that transforms sites at the end of their useful life into large areas of biodiversity. One such example being the creation of a lake in Spain on a former open cast mine. This is one of the largest

environmental restoration projects undertaken in Spain. The lake has almost 900 animal and plant species repopulating naturally including endemic species and can also supply water for large populations.
Further information on these projects can be found on the NESPF website:
https://www.nespf.org.uk/about/investment/responsible-investment/climate/

Just Transition

Moving towards a low carbon economy, whilst ensuring that everyone can prosper, regardless of status or income, is known as a 'Just Transition'. The Fund aims to integrate the principles of a Just Transition into our policies and practices. The transition to a low carbon future will have significant implications for those working in the energy intensive industries, and affected local communities.

As a responsible investor the Fund votes in a way to enable this transition and TCFD reporting will also help with the systemic risk of climate change. Investing in areas such as renewable energy helps to support a Just Transition.
Further information on the delivery of a Just Transition can be found here:
https://www.justtransition.scot

Direct Investment In Renewables

The Fund has been increasing exposure to renewable energy opportunities since 2017, including wind, solar and energy from waste infrastructure projects. Approximately £150 million in dedicated renewables has been funded to date. The Fund has investments in a grid infrastructure investment which should be operational in 2024 and help to manage the stability of the national grid and the move towards decarbonisation of electricity; a solar panel installation on the roof of a distribution warehouse where the electricity generated is sold to the tenant with any excess sold to the grid; and also energy centres on NHS hospital sites that are fully operational and mean a reduction in grid electricity demand thereby supporting NHS hospitals.
Further information on these direct investments can be found on the NESPF website:
https://www.nespf.org.uk/about/investment/responsible-investment/climate/direct-investment/

The Fund continues to seek further investments in low carbon and sustainable initiatives where there are opportunities to meet the Fund's return requirements and risk parameters.

Exclusion Policy

The Fund believes that stewardship and engagement are more effective than disinvestment. However the Fund does have a policy of screening out any investment in companies which are deemed to have controversial weapons or are violators of UN Global Compact Principles. As a responsible investor the Fund engages with our fund managers on our holdings to drive change in the companies held.

Information on the Fund as a responsible investor is on the NESPF website:
https://www.nespf.org.uk/about/investment/responsible-investment

Stock Lending

Stock lending is a valuable source of income for the Fund and is managed by our global custodian. It is conducted within the parameters prescribed in the regulations. Stock lending does not restrict the investment activity of the underlying fund managers. Safeguards are in place to reduce the risk of financial loss to the Fund in the event of default. These safeguards include receiving liquid collateral in excess of the value of the loan and regular reviews of the credit worthiness of potential borrowers by the lending agent.

From an ESG perspective the Fund's stock lending policy prohibits any form of naked short selling. Rights are retained to recall shares to exercise voting rights.

Additional Voluntary Contributions (AVCs)

The Fund provides an in-house AVC arrangement through Prudential. Monitoring the arrangement and investment activity of Prudential is carried out by Fund Officers. Access to information on increasing your pension for North East Scotland Pension Fund members can be found on our website https://www.nespf.org.uk/active-member/your-pension/increasing-your-pension/

Compliance with CIPFA Myners Principles

The Fund complies with the six CIPFA principles of investment practice. Details of the principles and the Fund's compliance are described separate to this document in the Compliance with the 6 Myners Principles Statement available on our website https://www.nespf.org.uk/about/policies-and-statements/

Responsibilities

Day to day responsibility for the implementation of this policy sits with the Chief Officer-Finance and the dedicated staff within the Pensions Team.

The Pensions Committee is at all times responsible for the Fund's investments, including oversight of this policy and its implementation.

The Statement of Investment Principles is reviewed on an annual basis by the Pensions Committee and following any change to the investment strategies of the Pension Fund.

Any questions or feedback on this document should be forwarded to the **Governance Team**:

NESPF
Level 1, 2 MSq
Marischal Square
Broad Street
Aberdeen
AB10 1LP

Email: governance@nespf.org.uk
Web: www.nespf.org.uk

APPENDIX I

North East Scotland Pension Fund Structure

Passive

All of the Funds' passive holdings are held with a single fund manager. The total of these assets combined should not exceed a 35% threshold. The Pensions Committee raised the limit under regulation 14(3) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended) from 30% to 35%.

Active

The remainder of the total Funds' assets (65% or above) are managed on an active basis.

Fund Manager Fee Structure

Fund Manager	Mandate	Fee Basis
Abrdn	Active – UK Property	Market Value
Aviva	Active – UK Infrastructure	Market Value
Baillie Gifford	Active – Global Equity	Performance
Blackrock	Active – Global Equity	Performance
Insight	Active – Global Buy & Maintain Credit	Market Value
Russell	Active – Global Multi Asset Credit	Market Value
SSGA	Passive – Global Equity	Market Value
SSGA	Passive – UK Index Linked Bond	Market Value

Private Markets – Debt & Equity

Fund Manager	Mandate	Fee Basis
Abrdn	Active – UK Residential	Performance
Alcentra	Active – European Private Debt	Performance
Allianz	Active – UK Home Equity	Market Value
Blackrock	Active – Global Infrastructure	Performance
Federated Hermes	Active – European Infrastructure	Performance
HarbourVest	Active – Global Private Equity	Performance
Hayfin	Active – Global Private Debt	Performance
IFM	Active – Global Infrastructure	Performance
Maven Capital	Active – UK Private Debt	Performance
Partners Group	Active – Global Property & Infrastructure	Performance
Unigestion	Active – Global Private Equity	Performance

APPENDIX II

LGPS Regulations – Disclosure Requirements

Use of Headroom Limits

The Fund's investment activities are subject to the provisions of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended) "the Regulations".

Regulation 14 imposes certain limits on the types of investment which may be held. Regulation 14 also allows an administering authority to increase investments beyond the normal limits up to increased 'headroom' limits as set out in Schedule 1 to the regulations. To do this it must comply with certain requirements including disclosure of the use of the increased limits within its Statement of Investment Principles.

The Pensions Committee has agreed 4 instances when the headroom limits should be used.

In accordance with regulation 14(3) and item 11 of Part 1 of Schedule 1 of the regulations, an increased limit of 35% (of the total Fund) invested with the Passive Manager SSGA under the terms of:-

> *'All investments in units or other shares of the investments subject to the trusts of unit trust schemes and all investments in open-ended investment companies where the unit trust schemes and the collective investment schemes constituted by those companies are managed by any one body'*

Along with increasing the headroom in accordance with regulation 14(3) and item 13 of Part 1 of Schedule 1 of the regulations, an increase to 35% (of the total Fund) within the Funds Stock Lending program, under the terms of:-

> *'All securities transferred (or agreed to be transferred by the administering authority under stock lending arrangements'*

Most recently, the decision was taken to increase headroom in accordance with regulation 14(3) and item 3 of Part 1 of Schedule 1 of the regulations to 30% (of the total Fund) under the terms of:-

> *'All contributions to partnerships'*

The decision was taken to reduce overall risk within the Fund by providing diversification across the Fund's equity investments and increase the flexibility/opportunities around the investment legal structures which could be accessed.

The above decision is subject to review as part of the Fund's triennial review of investment strategy.