1 Statement of Investment Principles

1 Introduction

The Trustees of Highlands and Islands Superannuation Scheme (the "Scheme") have drawn up this Statement of Investment Principles ("the Statement") to comply with the requirements of the Pensions Act 1995 ("the Act" as amended). As required under the Act the Trustees have consulted a suitably qualified person in obtaining written advice from Hymans Robertson LLP ("Hymans Robertson"). The Trustees in preparing this Statement have also consulted the Sponsoring Employer in particular on the Trustees' objectives.

The Sponsoring Employer is funded by the Scottish Government via Grant-in-Aid, the amount of which requires to be agreed by a Minister of the Crown, Grant-in-Aid is the source of funding for the Scheme. This fact is taken into account when preparing this Statement.

Overall investment policy falls into two parts. The strategic management of the assets is fundamentally the responsibility of the Trustees acting on expert advice and is driven by their investment objectives as set out in Section 2 below.

The remaining elements of policy are part of the day to day management of the assets which is delegated to professional investment management and described in Section 3.

2 Investment Objectives and Risk Management

2.1 Investment Objectives

To guide them in their strategic management of the assets and control of the various risks to which the Scheme is exposed, the Trustees have adopted the following objective:

- To reduce the long term cost of providing benefits by maximising the expected return, subject to adequate control of funding and solvency risk.

2.2 Risk Management Methodology

There are various risks to which any pension scheme is exposed. The Trustees have considered the following key risks:

- The risk of deterioration in the Scheme's on-going funding level
- The risk of a shortfall of assets relative to the liabilities as determined if the Scheme were to wind up

The Trustees consider these key risks at each investment strategy review. Following these reviews, the Trustees agree an overall mix of assets that they believe will manage the risks set out above, whilst delivering the required returns to meet the long term actuarial assumptions. This long term asset allocation is set out in Section 3, and is formulated in consultation with the Sponsoring Employer.

In addition further risks are also considered:

- The risk that an investment manager, in their day to day management of the assets will not achieve the rate of investment return expected by the Trustees – this risk is managed by the Trustees in their monitoring of their investment managers (see Section 3.5)
- The risk that individual investments will not be realised when required – this risk is managed by ensuring that the investment managers invest predominantly in assets that are quoted on appropriately regulated stock markets. The policy on realising investments is set out in Section 3.4 below.

These risks are monitored on a quarterly basis by assessing the impact of the investments on the funding position of the Scheme.

2.3 Investment Strategy

The Trustees have determined a benchmark mix of asset types and ranges within which the investment managers may operate with discretion; these guidelines are set out in Section 3. This benchmark was last reviewed in 2017.

The Trustees believe that the resulting mix is currently appropriate for controlling the risks identified in Section 2.2 above.

3 Day to day management of the assets

3.1 Main Assets

The Trustees invest the main assets of the Scheme in pooled fund arrangements operated by Legal & General Investment Management ("Legal & General"), Aberdeen Standard Investments ("Aberdeen Standard"), BlackRock Investment Management ("BlackRock"), Aviva Investors ("Aviva"), Dimensional Fund Advisors ("Dimensional"), M&G Investment Management Ltd ("M&G") and Oak Hill Advisors LLP ("Oak Hill"). The Trustee Investment Plan, which the Scheme has invested with Standard Life Aberdeen, is an insurance policy written by Standard Life Assurance Company. The day-to-day investment management and administration of this policy is undertaken by Aberdeen Standard Investments Limited, a wholly owned subsidiary of Standard Life Aberdeen Assurance Company. Similarly, the Legal & General World Equity Index Fund is technically written as a long-term insurance contract with Legal & General Assurance (Pensions Management) Limited.

The Trustees employ more than one manager, and a mix of actively and passively managed mandates, to add value at the total fund level whilst reducing the risk to the Scheme as a whole should one manager underperform.

The target split of assets between the investment managers is 29% with Legal & General, 15% with Aberdeen Standard, 10% with BlackRock, 10% with Aviva, 6% with Dimensional, 15% with M&G and 15% with Oak Hill. The Trustees will review the balance of assets between the seven managers from time to time and seek to maintain the balance by directing positive cashflow to, or disinvestment from, the appropriate manager.

The investment managers have discretion subject to guidelines set out below.

Investment Performance Benchmarks

The performance of the Total Fund is compared against the following benchmark:

Asset Class	Asset Allocation	
	Benchmark (%)	Ranges (%)
Equities	**28.5**	**+/-7**
Global Equities (Sterling Hedged)	21.5	+/-5
Emerging Market Equities	7	+/-5
Bonds	**10**	**+/-7**
UK Index-Linked Gilts	5	+/-5
Levered UK Index-Linked Gilts	7.5	+/-5
Absolute Return	10	+/-5
Absolute Return/Hedging	10	+/-5
Property	10	+/-5

Asset Class	Asset Allocation	
	Benchmark (%)	Ranges (%)
Multi-asset credit	30	+/-5
Cash	-	+5
Total	**100**	

In addition to the strategic benchmark above, the Trustees have agreed target hedge levels for the management of the Scheme's interest rate and inflation exposure. The aim is to build the Scheme's hedge to c.45% across interest rates and inflation as measured on a Technical Provision basis of the Scheme's liabilities by 2019.

Hedging levels are increased by c.2.5% per quarter, however, if market levels are attractive the Trustees will accelerate the pace of hedging increases. The Trustees monitor the following interest rate and real yield triggers on a quarterly basis to consider whether the Scheme should accelerate the implementation of the increase in hedging:

Scheme Hedging	Interest rate – 10 year spot yield	Real rate – 10 year spot yield
Minimum 35%	2.0%	-1.0%
45%	2.5%	-0.5%

3.2 Socially Responsible Investment and Corporate Governance

The Trustees consider that it is appropriate for investment managers to take account of social, environmental and ethical considerations insofar as they believe such considerations will benefit from performance or reduce risk. The Trustees therefore encourage the investment managers to discharge their responsibilities in respect of investee companies in accordance with the principles underlying the UK Stewardship Code drawn up by the Financial Reporting Council (FRC) in July 2010.

As the assets of the Scheme are managed in a pooled arrangement the Trustees accept that the assets are subject to the Investment Managers' own policies in these areas.

The Trustees have reviewed the Investment Managers' policies in these areas and are satisfied they broadly meet with the Trustees' views. The Trustees will continue to monitor them on a regular basis.

3.3 Additional Assets

Additional assets held in respect of any member's additional voluntary contributions are mainly invested in line with the strategy of the main Scheme assets.

3.4 Realisation of Investments

In general the Scheme's investment managers have discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments.

3.5 Monitoring of Investment Managers

Performance of the investment managers is reviewed by the Trustees as part of each quarterly meeting. Hymans Robertson also provides additional reporting on each of the managers each quarter. Hymans Robertson are retained as investment consultants to assist the Trustees in fulfilling their responsibility for monitoring the investment managers. The Trustees have also adopted a "traffic light" governance framework approach to signal when a meeting with a manager is required and if steps should be taken to remove the manager.

The key criteria which would trigger the Trustees to consider inviting a manager for a face-to-face meeting would be based on factors including:

- Performance issues;
- Business issues such as the departure of key personnel highlighted by Hymans Robertson; and
- A weakening of the Hymans Robertson Rating on the manager's likelihood of delivering outperformance in the future.

4 Compliance with this statement

The Trustees will monitor compliance with this Statement annually. In particular they will obtain written confirmation from the investment managers that they have complied with this Statement as supplied to them and the Trustees undertake to advise the investment managers promptly and in writing of any material change to this Statement.

5 Review of this statement

The Trustees will review this Statement in response to any material changes to any aspects of the Scheme, its liabilities, finances and attitudes to risk of the Trustees and the Sponsoring Employer which they judge to have a bearing on the stated Investment Policy. Any such review will take place at least every three years, and will again be based on written expert advice and will be in consultation with the Employer.

Dates of Amendments

First Amendment:	December 1999
Second Amendment:	June 2000
Third Amendment:	June 2003
Fourth Amendment:	August 2005
Fifth Amendment:	April 2006
Sixth Amendment:	August 2008
Seventh Amendment:	June 2010
Eighth Amendment:	November 2010
Ninth Amendment:	October 2012
Tenth Amendment:	February 2015
Eleventh Amendment:	June 2017
Twelfth Amendment:	June 2018

Appendix – Managers' investment mandates

Legal & General

Performance Benchmark

- The Scheme has three separate portfolios with Legal & General.

Global equity portfolio

Asset Class	Benchmark allocation (%)	Benchmark Index
Global Equities (Sterling Hedged)	100	FTSE AW-World Index on a currency hedged basis against sterling (with the exception of Advanced Emerging Markets)
Total	**100**	

Legal & General's objective for the global equity portfolio is to track the total return of the benchmark to within +/- 0.5 p.a. for two years in three.

Sterling Liquidity Fund

Asset Class	Benchmark allocation (%)	Benchmark Index
Cash	100	UK 7 Day LIBID
Total	**100**	

The Scheme invests in Legal & General's Sterling Liquidity Fund with the objective to provide capital stability, liquidity and diversification.

Matching Plus portfolio

The Scheme gains interest rate and inflation exposure via Legal & General's Matching Plus suite of leveraged gilt and index-linked gilt funds. The Scheme's investment in the underlying Matching Plus funds are held collectively in the Scheme's Matching Plus portfolio. The Matching Plus portfolio does not have a specific benchmark. The underlying funds held within the portfolio have been chosen with reference to the duration of the Scheme's liabilities in order that the combined Matching Plus portfolio provides the appropriate interest rate and inflation exposure.

Investment Management Charges

Global equity portfolio:

For the first £5 million:	0.223%
For the next £10 million:	0.198%
For the next £35 million:	0.173%
For the balance over £50 million:	0.148%

Sterling Liquidity Fund:

0.125% per annum

Matching Plus portfolio:

0.245% per annum for the first £25m, plus 0.170% per annum of the balance above £25m. The fee rate applicable is calculated using the aggregated value of the Scheme's holdings across all Matching Plus funds.

Aberdeen Standard Investments

Performance Benchmark

The Scheme has two separate portfolios with Aberdeen Standard. The first (shown in the table below) relates to the index-linked gilt mandate, whilst the second relates to the Scheme's investment in the Aberdeen Standard Liability Aware Absolute Return III ("LA AR III") Fund.

Asset Class	Bond Portfolio	
	Benchmark allocation (%)	Benchmark Index
UK Index-Linked Gilts	100.0	FTSE Over 5 Year Index-Linked Gilts Index
Total	**100.0**	

Aberdeen Standard's bond mandate objective is to exceed the benchmark by 0.7% p.a. net of fees over rolling three year periods.

In addition, Aberdeen Standard LA AR III is part of the manager's Integrated Liability Plus Solutions (ILPS) fund range. The ILPS fund range has been designed to allow UK defined benefit pension schemes to access growth assets alongside interest rate and inflation hedging (also known as "liability hedging") in a single pooled investment solution. The fund has two objectives:

1 Hedging – aiming to provide protection (i.e. a hedge) against changes in the value of liabilities arising from movements in interest rate and inflation movements; and

2 Growth – at the same time, seek a return in excess of cash on the amount invested in the fund.

The Hedging element of the fund aims to match the return of the proxy liability profile defined by the manager.

The Growth element of the fund targets a return of cash (UK 6 month LIBOR) plus 5% p.a. gross of fees over rolling three year periods.

Investment Management Charges

Bond Fund

0.30% per annum

LA AR III Fund

0.75% per annum (introductory fee until the end of 2018, reverting to 0.90% per annum thereafter)

Tracking Errors

Index-Linked Gilt Fund: Under normal circumstances the Fund's tracking error is expected to be within 0.75% and 1.5% per annum.

LA AR III Fund: The tracking error of the LA AR III fund is considered in three components:

1 Strategic positions in hedging instruments

2 Mismatches between the sensitivity of the fund's target liability profile and asset portfolio to changes in interest rates at different maturity points of the yield curve

3 Investment in assets targeting capital growth.

The first component is not managed on a tracking error basis because there is no limit on strategic positions in hedging instruments.

The manager monitors the second and third components in isolation and the annualised observed aggregate tracking error calculated relative to and as a function of the discounted present value of the target liability profile is expected to be below 10% per annum in the normal course of events.

Under normal circumstances the Growth fund's tracking error is expected to be within 4.0% and 8.0% per annum.

BlackRock

Performance Benchmark

Asset Class	Benchmark allocation (%)	Benchmark Index
Absolute Return	100	UK 3 month LIBOR
Total	**100**	

BlackRock's objective is to outperform the cash benchmark by 3.0% p.a. net of fees on a rolling three year basis.

Investment Management Charges

The annual management fee on this fund is 0.65% per annum.

Aviva

Performance Benchmark

Asset Class	Benchmark allocation (%)	Benchmark Index
HLV Property	100	50% FTSE 5-15 Year Gilts/50% +15 Year Gilts
Total	**100**	

Aviva's objective is to outperform the benchmark by 1.5% p.a. over the medium to long term.

Investment Management Charges

The annual management fee on this fund is 0.40% per annum.

Dimensional

Performance Benchmark

Asset Class	Benchmark allocation (%)	Benchmark Index
Emerging Market Equities	100	MSCI Emerging Markets Index (net div)
Total	**100**	

Dimensional's objective is to outperform the benchmark by 1-2% p.a. over rolling three year periods.

Investment Management Charges

The annual management fee on this fund is 0.55% per annum

Tracking Error

Expected tracking error is 2-4% p.a. over rolling three year periods.

M&G

Performance Benchmark

Asset Class	Benchmark allocation (%)	Benchmark Index
Multi-asset credit	100	LIBOR (6 month)
Total	**100**	

M&G's objective is to outperform the benchmark by 3-5% p.a. over rolling three year periods.

Investment Management Charges

The annual management fee on this fund is 0.35% per annum. Further to this, M&G levy a fee of 0.15% p.a. for expenses such as administration and custody. The total Fund charge is therefore 0.50% p.a.

Oak Hill

Performance Benchmark

Asset Class	Benchmark allocation (%)	Benchmark Index
Multi-asset credit	100	LIBOR (6 month)
Total	**100**	

Oak Hill's objective is to deliver a return of between 6%-9% net per annum across a credit cycle.

Investment Management Charges

The annual management fee on this fund is 0.65% per annum, plus a performance fee of 15% over LIBOR + 4% capped at 0.35%. The maximum fee is therefore 1%.