

# *Statement of Investment Principles for the Skanska Pension Fund*

## **Effective from November 2023**

### **1. Introduction**

This Statement of Investment Principles (“SIP”) sets out the Trustee’s policy on various matters governing decisions about the investments of the Skanska Pension Fund (“the Fund”), a pension scheme with Defined Benefit (“DB”) and legacy Defined Contribution (“DC”) sections. This SIP replaces the previous SIP dated September 2022.

The SIP is designed to meet the requirements of Section 35 (as amended) of the Pensions Act 1995 (“the Act”), the Occupational Pension Schemes (Investment) Regulations 2005 (as amended) and the Pension Regulator’s guidance for defined benefit pension schemes (March 2017) and the Occupational Pension Schemes (Charges and Governance) Regulations 2015.

This SIP has been prepared after obtaining and considering written professional advice from LCP, the Fund’s investment adviser, whom the Trustee believes to be suitably qualified and experienced to provide such advice. The advice considers the suitability of investments including the need for diversification given the circumstances of the Fund and the principles contained in this SIP. The Trustee has consulted with the relevant employer in producing this SIP.

The Trustee will review this SIP from time to time and, with the help of its advisers, will amend it as appropriate. These reviews will take place as soon as practicable after any significant change in investment policy or in the demographic profile of the relevant members in respect of the DC Section and at least once every three years.

- **Appendix 1** sets out details of the Fund’s investment governance structure, including the key responsibilities of the Trustee, investment advisers and investment managers. It also contains a description of the basis of remuneration of the investment adviser and the investment managers.
- **Appendix 2** sets out the Trustee’s policy towards risk appetite, capacity, measurement and management.

A separate document, the Statement of Investment Arrangements (“SIA”), provides further information on the details of the investment of the assets in the DB Section of the Fund.

### **2. Investment objectives**

The primary objective for the DB Section is to ensure that the Fund should be able to meet benefit payments as they fall due. In addition to this primary objective, the Trustee has additional objectives. These are as follows:

- that the expected return on the Fund’s assets is maximised whilst managing and maintaining investment risk at an appropriate level. What the Trustee determines to be an appropriate level of risk is set out in Appendix 2.
- that the Fund should be fully funded on a technical provisions basis (ie the asset value should be at least that of its liabilities on this basis, with a secondary objective of being fully funded on an estimated buyout basis in the longer term. The Trustee is aware that there are various

measures of funding and has given due weight to those considered most relevant to the Fund, together with an integrated risk management approach.

- that the Fund has a long-term journey plan in place which is designed to help it achieve full funding on the agreed basis.

The Trustee's primary objectives for the DC Section are to provide members with access to:

- an appropriate range of investment options, reflecting the membership profile of the DC Section and the variety of ways that members can draw their benefits in retirement; and
- a default investment option that the Trustee believes to be reasonable for those members that do not wish to make their own investment decisions. The objective of the default option is to generate returns significantly above inflation whilst members are some distance from retirement, but then to switch automatically and gradually to lower risk investments as members near retirement.

### **3. DB investment strategy**

The Trustee, with the help of its advisers and in consultation with the Employer, undertakes reviews of the Fund's investment strategy from time to time, taking into account the objectives described in Section 2.

The last actuarial valuation completed by the Scheme Actuary is dated 31 March 2021.

The Trustee has agreed that the long-term investment strategy for the Fund should be based on the following broad asset mix:

- An LDI Portfolio designed to provide some protection against the Fund's interest rate and inflation risk.
- A Collateral Pool, which consists of assets seeking to provide a return in excess of government bonds and which are available to be used to provide additional collateral should the LDI Portfolio require it.
- An Illiquid Portfolio, which consists of assets where it would take longer than six months to a year to liquidate in normal circumstances and therefore represent "buy-and-hold" investments.

As the Fund matures over time, the Trustee intends to de-risk the investment strategy to reflect the change in the liability profile (ie switching from growth to matching assets). The Trustee has put in place a mechanism to de-risk the investment strategy following improvements in the funding position. The objective of this mechanism is to lock in gains following better than expected investment experience. The Trustee reviews the de-risking mechanism on a regular basis.

The main investment restrictions for each of the three pools of assets are set out below. Further details are included in the Fund's SIA.

#### **3.1. The LDI Portfolio**

The LDI Portfolio has been designed to provide a hedge against adverse movements in long-term interest rates and inflation expectations on a portion of the Fund's liabilities.

The target leverage ratio of the LDI Portfolio is broadly around 2:1. The Trustee aims to maintain the leverage within the LDI Portfolio between 1:1 and 3:1.

This hedging policy will be reviewed from time to time. The Fund's LDI benchmark was last updated in February 2023 to reflect the 2021 actuarial valuation liability cashflow information. The Fund's target interest rate and inflation hedging (on a gilts+0.4% pa basis) is around 95%.

### 3.2. The Collateral Pool

The assets held in the Collateral Pool will be invested in the asset classes set out in the table below. The table also shows the maximum and minimum amount (expressed as a proportion of the assets in the Collateral Pool) to be allocated to each of these asset classes. The ISC will allocate the assets in Collateral Pool within these boundaries.

Asset Class	Minimum allocation (%)	Maximum allocation (%)
Developed equities	0	30
Diversified growth funds	0	40
Absolute return bonds	0	30
Corporate bonds	0	90
Cash	0	60

The ISC has established a protocol for moving assets between the LDI Portfolio and the Collateral Pool so as to maintain the desired level of leverage within the LDI Portfolio. This protocol, along with further details of the management of these assets, is set out in the SIA.

### 3.3. The Illiquid Portfolio

The Illiquid Portfolio consists partly of a directly held property asset, Bentley Works, as well as assets held in alternative credit and private equity portfolios. For more details on these portfolios please refer to the SIA.

The Illiquid Portfolio is expected to broadly be in the range of 0% to 20% of the total Fund assets and is expected to reduce over time as the illiquid investments mature.

The Trustee has entered into an agreement with Columbia Threadneedle Management Limited (formerly BMO Asset Management Limited) to invest the assets of the Fund's DB Section (where possible) via its LDI Private Sub-Fund, a bespoke pooled fund solely for the Fund.

## 4. DC benefits

In respect of each member who has benefits on a DC basis the Employer paid contributions at agreed rates up to 31 March 2018, when contributions ceased.

The Trustee considered the long-term provision of DC benefits and decided that members' interests would be best served by transferring the majority of the DC assets to the Aegon Master Trust. This took place on 15 October 2018, leaving a small number of members remaining with Guaranteed

Minimum Pensions (GMPs) who could not be transferred. Where members have a GMP, it is not possible to transfer these members’ benefits into a master trust without individual consent.

**4.1. Investment strategy and selection of the investment manager**

The Trustee has had regard to the long term performance characteristics of various asset classes, in terms of their expected returns and the variability of those returns, in deciding on the range of investment vehicles to make available to members.

The Trustee provides a range of investment vehicles that it considers suitable for the investment of members’ Investment Accounts and it is for each member to decide which vehicle(s) he/she is notionally invested in at any time.

The Trustee will review the range of investment vehicles offered to DC members annually or, if advised by the Fund’s investment consultants, at other times.

The Trustee has entered into an agreement with Legal & General Assurance (Pensions Management) Limited (“L&G”) to invest the assets of the Fund’s AVC Sections via L&G’s investment platform. Trafalgar House has been appointed as the Fund’s third party administrator.

The Trustee offers members a range of funds managed by Legal & General Investment Management (“LGIM”) and a diversified growth fund, which comprises 50% of Standard Life’s Global Absolute Returns Strategies (“GARS”) fund and 50% of Newton’s Real Return fund, and a Shariah fund managed by HSBC.

The Trustee has made the decision to “White Label” the funds offered to DC members of the Fund. This process allows bespoke generic funds to be set up, without the necessity of specifying the underlying fund manager or fund(s) being used. The following table shows the funds that the Trustee has chosen as suitable vehicles for members who have DC benefits and their corresponding underlying fund:

White label name	Underlying Fund
UK Equity Fund	LGIM UK Equity Index Fund
Global Equity Fund	LGIM Global Equity Fixed Weights (60:40) Index Fund
Overseas (non UK) Equity Fund	LGIM World (ex UK) Equity Index Fund
Ethical Global Equity Fund	LGIM Ethical Global Equity Index Fund
UK Government Bonds Fund <sup>1</sup>	LGIM Over 15 Year Gilts Index Fund
UK Index-Linked Bonds Fund	LGIM Over 5 Year Index Linked Gilts Index Fund
Cash Fund	LGIM Cash Fund
Diversified Fund	50% Standard Life Global Absolute Return Strategies and 50% Newton Real Return Fund
Property Fund	LGIM Property Fund
Shariah Fund	HSBC Life Islamic Global Equity Index Fund
Corporate Bonds Fund	LGIM AAA-AA-A Corporate Bond Over 15 Year Index Fund

<sup>1</sup> The UK Government Bonds Fund invests in conventional (ie fixed interest) gilts only – in contrast to the UK Index-Linked Bonds Fund.

Each member is responsible for specifying one or more of these funds as the nominal investment vehicle of his/her account, having regard to the risks involved.

The Trustee has also implemented three lifestyle strategies effective June 2015, under which individual members' funds are invested in proportions defined by lifestyle matrices. The lifestyles are called the Drawdown Lifestyle Strategy, the Cash Lifestyle Strategy and the Annuity Lifestyle Strategy.

The Drawdown Lifestyle Strategy is the default option for members that do not make an investment choice.

#### **4.2. Lifestyle strategies**

Each Lifestyle Strategy has two different phases based on the time until a member's selected retirement age.

From the period when a member joins to 15 years from their selected retirement age, the aim of each Lifestyle Strategy is to achieve good long term growth in excess of inflation. This is called the "growth phase" and is the same for all three Lifestyle Strategies.

During the "growth phase" assets will be divided in a 50:50 split between the DGF and equities up to 15 years before retirement, and then assets start to be switched into less risky assets.

Over the remaining 15 years before the members' selected retirement date, the allocation of investments within each of the three lifestyle strategies is tailored to target different income options on retirement. This is called the "switching phase".

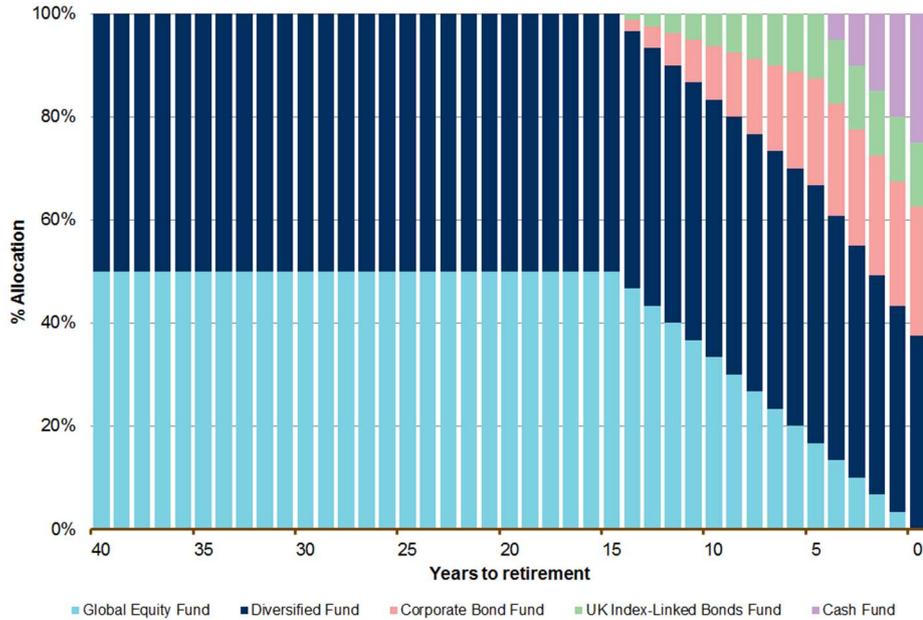
Each Lifestyle Strategy uses an appropriate combination of the funds listed in Section 4.1. The allocations of the Lifestyle Strategies are outlined in the sections below.

##### **4.2.1. The Drawdown Lifestyle Strategy**

The Drawdown Lifestyle Strategy is designed to meet the objectives of members who want to drawdown income at retirement. The aim of this lifestyle in the Switching Phase is to provide more stability than the Growth Phase whilst still aiming to generate returns in excess of inflation.

Over the 15 years to 5 year period before retirement, a proportion of the assets will be gradually switched into corporate bonds and index-linked gilts.

In the final 5 years to retirement, assets will be completely switched out of equities and an allocation will be introduced to cash.



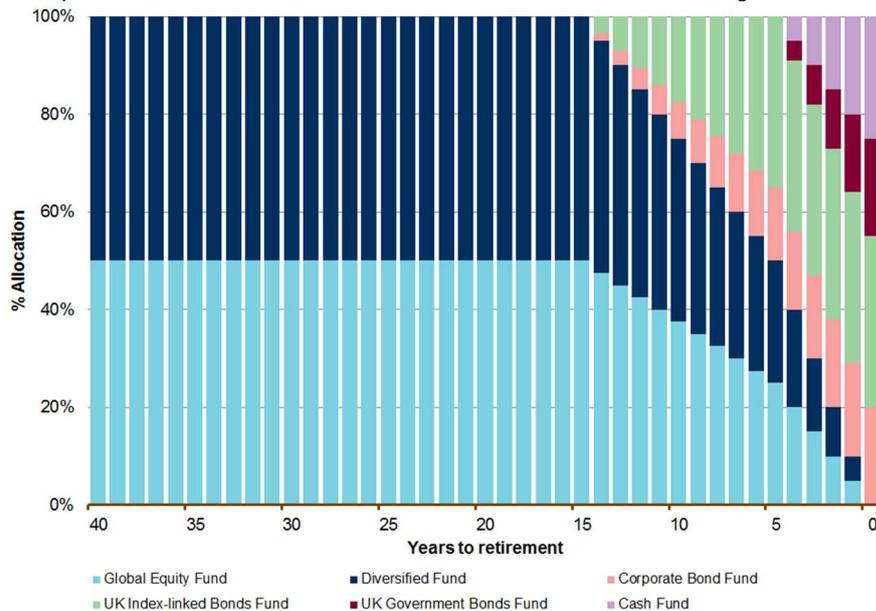
**4.2.2. The Annuity Lifestyle Strategy**

The Annuity Lifestyle Strategy is designed to meet the objectives of members who wish to buy an annuity (or pension) at retirement. The aim of this lifestyle is to better match the cost of an annuity by investing in a greater proportion of bonds, whose prices are expected to move broadly in line with long term interest rates, as the member approaches retirement.

Prior to June 2015, this lifestyle was the default strategy for the DC Schemes.

Over the 15 years to 5 year period before retirement, a proportion of the assets will be gradually switched into corporate bonds and index-linked gilts.

In the final 5 years to retirement, assets will be completely switched out of the DGF and equities and an allocation will be introduced to both fixed interest gilts and cash.

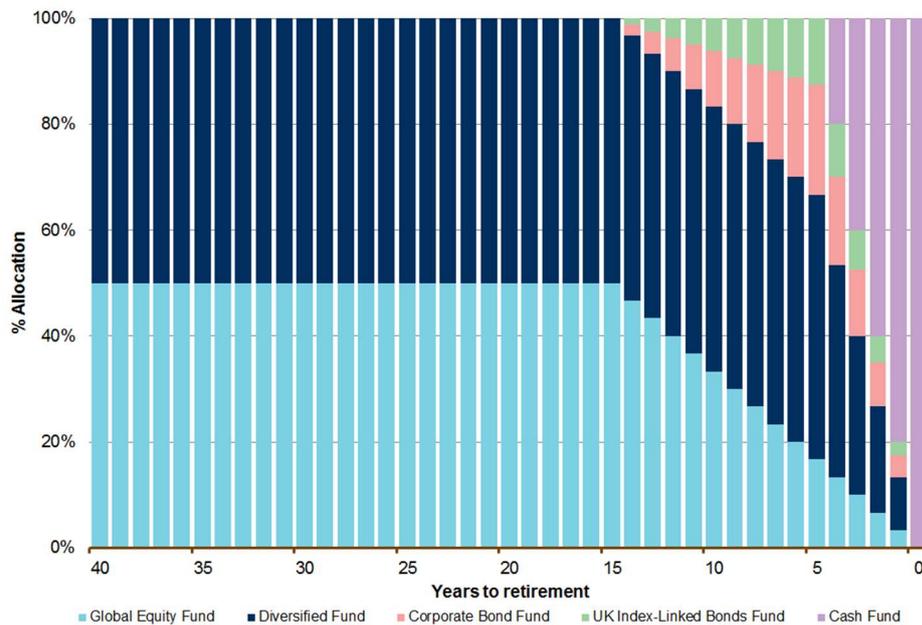


### 4.2.3. The Cash Lifestyle Strategy

The Cash Lifestyle Strategy is designed to meet the objectives of members who wish to take their whole account as cash on retirement. The aim of this lifestyle is to reduce investment risk and increase the certainty of the amount of cash available at retirement.

Over the 15 years to 5 year period before retirement, a proportion of the assets will be gradually switched into corporate bonds and index-linked gilts.

In the final 5 years to retirement, assets will be switched so that 100% of the assets are invested in cash at retirement.



### 4.3. Fees

If the investment management charges together with other charges levied on, for example, transfers or platform fees are excessive, then the value of a member’s notional account will be reduced unnecessarily. The Trustee has, therefore, closely regarded the terms and conditions of its arrangements.

## 5. Considerations in setting the investment arrangements

When deciding how to invest the Fund’s assets, the Trustee considers several risks, including, but not limited to, those set out in Appendix 2. Some of these risks are more quantifiable than others, but the Trustee has tried to allow for the relative importance and magnitude of each risk.

The Trustee considered a wide range of asset classes for investment, taking account of the expected returns and key individual risks associated with those asset classes as well as how these risks can be mitigated where appropriate.

The Trustee is aware of the long-term performance characteristics of various asset classes in terms of their expected returns and the variability of those returns, and in particular is aware of the risk that equities and other alternative investments may underperform bonds (as a proxy for the funding

target). When comparing alternative investment strategies, the Trustee, on advice from the investment consultant, allows for median investment returns on equities of 3.4% pa in excess of government bond returns (based on assumptions as at 30 June 2023).

The other financial assumptions made by the Trustee in determining the investment arrangements are detailed in the Fund's SIA.

In setting the strategy for the DB Section the Trustee considered:

- the Fund's investment objectives, including the target return required to meet the Trustee's investment objectives;
- the Fund's cash flow requirements in order to meet benefit payments in the near to medium term;
- the best interests of all members and beneficiaries;
- the circumstances of the Fund, including the profile of the benefit cash flows (and the ability to meet these in the near to medium term), the funding level, and the strength of the employer covenant;
- the risks, rewards and suitability of a number of possible asset classes and investment strategies and whether the return expected for taking any given investment risk is considered sufficient given the risk being taken;
- the need for appropriate diversification between different asset classes to ensure that both the Fund's overall level of investment risk and the balance of individual asset risks are appropriate;
- any other considerations which the Trustee considers financially material over the time horizon that the Trustee considers is needed for the funding of future benefits by the investments of the Fund; and
- the Trustee's investment beliefs about how investment markets work, and which factors are most likely to impact investment outcomes.

In determining the investment arrangements for the DC Section the Trustee took into account:

- the best interests of all members and beneficiaries;
- the profile of the membership and what this is likely to mean for the choices members might make upon reaching retirement;
- the risks, rewards and suitability of a number of possible asset classes and lifestyle strategies and whether the return expected for taking any given investment risk is considered sufficient given the risk being taken;
- the need for appropriate diversification within the default strategy and other lifestyle options to ensure that, for each such option, both the overall level of investment risk and the balance of individual asset risks are appropriate;
- the need for appropriate diversification within the other investment options offered to members;
- any other considerations which the Trustee considers financially material over the periods until members' retirement, or any other timeframe which the Trustee believes to be appropriate; and

- the Trustee's investment beliefs about how investment markets work and which factors are most likely to impact investment outcomes.

The Trustee's key investment beliefs, which influenced the setting of the investment arrangements, are as follows:

- asset allocation is the primary driver of long-term returns;
- costs may have a significant impact on long-term performance and therefore obtaining value for money from the investments is important.
- investment managers who can consistently spot and profitably exploit market opportunities are difficult to find and therefore passive management, where available, is usually better value;
- risk-taking is necessary to achieve return, but not all risks are rewarded. Equity, credit and illiquidity are the primary rewarded risks. Risks that do not have an expected reward should generally be avoided, hedged or diversified;
- environmental, social and governance (ESG) factors are likely to be one area of market inefficiency and so managers may be able to improve risk-adjusted returns by taking account of ESG factors;
- climate change is a financially material systemic issue that presents risks and opportunities for the Fund over the short, medium and long term;
- aligning assets with net zero greenhouse gas emissions by 2050 where practicable is expected to help reduce the risks to the Fund from climate change; and
- voting and engagement are important and can create long term value which is in the best interest of Fund members and therefore the Trustee encourages managers to improve their voting and engagement practices;
- collaborative investor action can help address systemic risks, for example the Trustee believes net zero alignment, if implemented well, could be an effective approach to addressing climate risk.

The Trustee's key investment beliefs and understanding of the Fund's membership are reflected in the design of the default and other lifestyle options, and in the range of other funds made available to members.

## **6. Implementation of the investment arrangements**

Before investing in any manner, the Trustee obtains and considers proper written advice from its investment adviser on the question of whether the investment is satisfactory, having regard to the need for suitable and appropriately diversified investments.

Details of the investment managers are set out in the SIA.

The Trustee has signed agreements with two investment managers (in respect of the DB Section), and a platform provider (in respect of the DC Section) setting out in detail the terms on which the portfolios are to be managed. The investment managers' primary role is the day-to-day investment management of the Fund's investments.

The Trustee and investment managers to whom discretion has been delegated exercise their powers to give effect to the principles in this Statement of Investment Principles, so far as is reasonably practicable.

The Trustee has limited influence over managers' investment practices because the majority of the Fund's assets are held in pooled funds, but it encourages its managers to improve their practices where appropriate.

The Trustee's view is that the fees paid to the investment managers, and the possibility of their mandate being terminated, ensure they are incentivised to provide a high quality service that meets the stated objectives, guidelines and restrictions of the fund. However, in practice managers cannot fully align their strategy and decisions to the (potentially conflicting) policies of all their pooled fund investors in relation to strategy, long-term performance of debt/equity issuers, engagement and portfolio turnover.

It is the Trustee's responsibility to ensure that the managers' investment approaches are consistent with its policies before any new appointment, and to monitor and to consider terminating any existing arrangements that appear to be investing contrary to those policies. The Trustee expects investment managers, where appropriate, to make decisions based on assessments of the longer term financial and non-financial performance of debt/equity issuers, and to engage with issuers to improve their performance. It assesses this when selecting and monitoring managers.

The Trustee evaluates investment manager performance by considering performance over both shorter and longer-term periods as available. Except in closed-ended funds where the duration of the investment is determined by the fund's terms, the duration of a manager's appointment will depend on strategic considerations and the outlook for future performance. Generally, the Trustee would be unlikely to terminate a mandate on short-term performance grounds alone.

The Trustee's policy is to evaluate each of its investment managers by reference to the manager's individual performance as well the role it plays in helping the Fund meet its overall long-term objectives, taking account of risk, the need for diversification and liquidity. Each manager's remuneration, and the value for money it provides, is assessed in light of these considerations.

The Trustee recognises that portfolio turnover and associated transaction costs are a necessary part of investment management and that the impact of portfolio turnover costs is reflected in performance figures provided by the investment managers. The Trustee expects its investment consultant to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Fund's investment mandates.

## **7. Realisation of investments**

The investment managers have discretion over the timing of realisation of investments of the Fund within the portfolios that they manage, and in considerations relating to the liquidity of investments.

For the DB Section, when appropriate, the Trustee, on the administrators' recommendation, decides on the amount of cash required for benefit payments and other outgoings and informs Columbia Threadneedle of any liquidity requirements. The Trustee's preference is for investments that are readily realisable, but recognises that achieving a well-diversified portfolio may mean holding some investments that are less liquid (eg alternative credit, private equity and property). In

general, with regards to the Collateral Pool, the Trustee's policy is to use cash flows to rebalance the Fund's assets towards the strategic asset allocation.

For the DC Section, the Trustee's policy is to invest in funds that offer daily dealing to enable members to readily realise and change their investments.

## **8. Financially material considerations and non-financial matters**

The Trustee has considered how environmental, social, governance ("ESG") and ethical factors should be taken into account in the selection, retention and realisation of investments, given the time horizon of the Fund and its members.

The Trustee expects its investment managers to take account of financially material considerations (including climate change and other ESG considerations). The Trustee seeks to appoint managers that have appropriate skills and processes to do this, and from time to time reviews how their managers are taking account of these issues in practice.

The Trustee has limited influence over managers' investment practices where assets are held in pooled funds, but it encourages its managers to improve their practices where appropriate.

The Trustee's ambition is to align its assets with net zero greenhouse gas emissions by 2050 through selecting managers, and investing in funds, with credible net zero targets.

The Trustee does not take into account any non-financial matters (ie matters relating to the ethical and other views of members and beneficiaries, rather than considerations of financial risk and return) in the selection, retention and realisation of investments.

The Trustee offers the Ethical Global Equity Index Fund to members with AVC investments. This fund is aimed at members who wish to take account of ethical, environmental or social principles.

## **9. Voting and engagement**

The Trustee recognises its responsibilities as owners of capital, and believes that good stewardship practices, including monitoring and engaging with investee companies, and exercising voting rights attaching to investments, protect and enhance the long-term value of investments and is in the best interests of its members.

The Trustee has delegated to its investment managers the exercise of rights attaching to investments, including voting rights, and engagement with issuers of debt and equity and other relevant persons about relevant matters such as performance, strategy, capital structure, management of actual or potential conflicts of interest, risks and ESG considerations.

The Trustee does not monitor or engage directly with issuers or other holders of debt or equity. It expects the investment managers to exercise ownership rights and undertake monitoring and engagement in line with the managers' general policies on stewardship, as provided to the Trustee from time to time, taking into account the long-term financial interests of the beneficiaries. The Trustee seeks to appoint managers that have strong stewardship policies and processes, reflecting where relevant the recommendations of the UK Stewardship Code issued by the Financial

Reporting Council, and from time to time the Trustee reviews how these are implemented in practice.

The Trustee monitors managers' activities in relation to ESG factors, voting and engagement on a regular basis. The Trustee seeks to understand how they are implementing their stewardship policies in practice to check that their stewardship is effective and aligned with its expectations.

The Trustee has selected some priority ESG themes to provide a focus for its monitoring of investment managers' voting and engagement activities. The Trustee reviews the themes regularly and updates them if appropriate. The Trustee communicates these stewardship priorities to its managers.

If the Trustee's monitoring identifies areas of concern, the Trustee will engage with the relevant manager to encourage improvements.

## *Investment governance, responsibilities, decision-making and fees*

The Trustee has decided on the following division of responsibilities and decision-making for the Fund. This division is based upon the Trustee's understanding of the various legal requirements placed upon them, and their view that the division of responsibility allows for efficient operation and governance of the Fund overall. The Trustee's investment powers are set out within the Fund's governing documentation.

### **1. Trustee**

In broad terms, the Trustee is responsible in respect of investment matters for:

- developing a mutual understanding of investment and risk issues with the employer;
- setting the investment strategy, in consultation with the employer;
- formulating a policy in relation to financially material considerations, such as those relating to ESG considerations (including but not limited to climate change);
- setting the policy for rebalancing between asset classes;
- setting a policy on the exercise of rights (including voting rights) and undertaking engagement activities in respect of the investments;
- putting effective governance arrangements in place and documenting these arrangements in a suitable form;
- appointing, monitoring, reviewing and, dismissing investment managers, investment advisers, actuary and other service providers;
- monitoring the exercise of the investment powers that they have delegated to the investment managers and monitoring compliance with Section 36 of the Act;
- communicating with members as appropriate on investment matters, such as the Trustee's assessment of its effectiveness as a decision-making body, the policies regarding responsible ownership and how such responsibilities have been discharged;
- reviewing the investment policy as part of any review of the investment strategy;
- reviewing the content of this SIP from time to time and modifying it if deemed appropriate; and
- consulting with the employer when reviewing the SIP.

The Trustee has delegated consideration of certain investment matters to an investment sub-committee ("ISC"). Full details are included in the ISC's terms of reference.

### **2. Investment managers**

In broad terms, the investment managers will be responsible for:

- managing the portfolios of assets according to their stated objectives, and within the guidelines and restrictions set out in their respective investment manager agreements and/or other relevant governing documentation;

- taking account of financially material considerations (including climate change and other ESG considerations) as appropriate when managing the portfolios of assets;
- exercising rights (including voting rights) attaching to investments and undertaking engagement activities in respect of investments;
- providing the Trustee with regular information concerning the management and performance of their respective portfolios; and
- having regard to the provisions of Section 36 of the Act insofar as it is necessary to do so.

The custodians of the portfolios (whether there is a direct relationship between the custodian and the Trustee or not) are responsible for safe keeping of the assets and facilitating all transactions within the portfolios.

### **3. Investment adviser**

In broad terms, the investment adviser will be responsible, in respect of investment matters, as requested by the Trustees, for:

- advising on how material changes within the Fund's benefits, membership, and funding position may affect the manner in which the assets should be invested and the asset allocation policy;
- advising on a suitable fund range and default strategy for the Fund, and how material changes to legislation or within the Fund's benefits and membership may impact this;
- advising on the selection, and review, of the investment managers, incorporating its assessment of the nature and effectiveness of the managers' approaches to financially material considerations (including climate change and other ESG considerations); and
- participating with the Trustee in reviews of this SIP.

### **4. Fee structures**

The Trustee recognises that the provision of investment management and advisory services to the Fund results in a range of charges to be met, directly or indirectly, by deduction from the Fund's assets.

The Trustee has agreed Terms of Business with LCP, the Fund's investment advisers, under which work undertaken is charged for by an agreed fixed fee or on a "time-cost" basis.

Details of the investment providers' fee structures are set out in the SIA. The fee structure used in each case has been selected with regard to existing custom and practice, and the Trustee's view as to the most appropriate arrangements for the Fund. However, the Trustee will consider revising any given structure if and when it is considered appropriate to do so.

The Trustee, having discussed the options available, has decided to remunerate the role of pensioner member nominated trustee in recognition of duties fulfilled in that role.

## **5. Performance assessment**

The Trustee is satisfied, taking into account the external expertise available, that there are sufficient resources to support their investment responsibilities. The Trustee believes that it has sufficient expertise and appropriate training to carry out its role effectively.

It is the Trustee's policy to assess the performance of the Fund's investments, investment providers and professional advisers from time to time. See Section 3 of the SIP. The Trustee will also periodically assess the effectiveness of its decision-making and investment governance processes and will decide how this may then be reported to members.

## **6. Working with the Fund's employer**

When reviewing matters regarding the Fund's investment arrangements, such as the SIP, the Trustee seeks to give due consideration to the employer's perspective. While the requirement to consult does not mean that the Trustee needs to reach agreement with the employer, the Trustee believes that better outcomes will generally be achieved if the Trustee and employer work together collaboratively.

## 1. Risk appetite and risk capacity

Risk appetite is a measure of how much risk the Trustee is willing to bear within the Fund in order to meet its investment objectives. Taking more risk is expected to mean that those objectives can be achieved more quickly, but it also means that there is a greater likelihood that the objectives are missed, in the absence of remedial action. Risk capacity is a measure of the extent to which the Trustee can tolerate deviation from its long term objectives before attainment of those objectives is seriously impaired. The Trustee aims to strike the right balance between risk appetite and risk capacity.

When assessing the risk appetite and risk capacity, the Trustee considered a range of qualitative and quantitative factors, including:

- the strength of the employer's covenant and how this may change in the near/medium future;
- the agreed journey plan and employer contributions;
- the Fund's long-term and shorter-term funding targets;
- the Fund's liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged;
- the Fund's cash flow and target return requirements; and
- the level of expected return and expected level of risk (as measured by Value at Risk ("VaR")), now and as the strategy evolves.

Following implementation of the Fund's current investment strategy, as at 30 June 2023, the Fund's 1 year 95% Value at Risk was estimated to be around £50m<sup>2</sup> on the Technical Provisions basis. This means that there is estimated to be a 1 in 20 chance that the Fund's funding position will worsen by £50m or more, compared to the expected position, over a one year period. When deciding on the current investment strategy, the Trustee believed this level of risk to be appropriate given the Trustee's and employer's risk appetite and capacity, given the Fund's objectives.

## 2. Approach to managing and monitoring investment risks

The Trustee considers that there are several different types of investment risk that are important to manage and monitor. These include, but are not limited to:

### 2.1. Risk of inadequate returns

For the DB Section a key objective of the Trustee is that, over the long-term, the Fund should generate its target return so that it has adequate assets to meet its liabilities as they fall due. The Trustee therefore invests the assets of the Fund to produce a sufficient long-term return in excess of the liabilities. There is also a risk that the performance of the Fund's assets and liabilities diverges in certain financial and economic conditions in the short term. This risk has been considered in setting the investment strategy and is monitored by the Trustee on a regular basis.

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<sup>2</sup> More details, including the underlying assumptions, available on request.

In the DC Section, as members' benefits are dependent on the investment returns achieved, it is important that investment options are available which can be expected to produce adequate real returns over the longer term. Accordingly, equity and equity-based funds, which are expected to provide positive returns above inflation over the long term, have been made available to members and feature in the growth phase of the default strategy. To reduce the chance of a sharp deterioration in members' benefits close to retirement, the Trustee has made the default option a "lifestyle" strategy.

## **2.2. Risk from lack of diversification**

This is the risk that failure of a particular investment, or the general poor performance of a given investment type, could materially adversely affect the Fund's assets. The Trustee believes that the Fund's DB assets and DC default strategy are adequately diversified between different asset classes and within each asset class and the DC options provide a suitably diversified range for members to choose from. This was a key consideration when determining the Fund's investment arrangements and is monitored by the Trustee on a regular basis.

## **2.3. Investment manager risk**

This is the risk that an investment manager fails to meet its investment objectives. Prior to appointing an investment manager, the Trustee receives written advice from a suitably qualified individual and will typically undertake an investment manager selection exercise. The Trustee monitors the investment managers on a regular basis to ensure they remain appropriate for their selected mandates.

## **2.4. Counterparty Risk**

This is the risk that one party to a contract (such as a derivative instrument) causes a financial loss to the other party by failing to discharge a contractual obligation. This risk applies in particular for those contracts that are traded directly between parties, rather than traded on a central exchange.

In particular, Columbia Threadneedle makes use within the Fund's LDI portfolio of derivative and gilt repos contracts and this portfolio is used by the Trustee to match efficiently a portion of the Fund's liabilities. Counterparty risk is managed within the portfolio through careful initial selection and ongoing monitoring of trading counterparties, counterparty diversification and a robust process of daily collateralisation of each contract, to ensure that counterparty risk is limited, as far as possible, to one day's market movements.

## **2.5. Illiquidity/marketability risk**

For the DB Section, this is the risk that the Fund is unable to realise assets to meet benefit cash flows as they fall due, or that the Fund will become a forced seller of assets in order to meet benefit payments. The Trustee is aware of the Fund's cash flow requirements and believes that this risk is managed by maintaining an appropriate degree of liquidity across the Fund's investments.

For the DC Section, this is the risk that core financial transactions, such as investing members' contributions, are not processed promptly due to lack of liquidity in the

investments. The Trustee manages this risk by only using pooled funds with daily dealing within the default strategy and diversifying the strategy across different types of investment.

#### **2.6. Environmental, social and governance (ESG) risks**

Environmental, social and corporate governance (ESG) factors are sources of risk to the Fund's investments, some of which could be financially material, over both the short and longer term. These potentially include risks relating to factors such as climate change, unsustainable business practices, and unsound corporate governance. The Trustee seeks to appoint investment managers who will manage these risks appropriately on their behalf and from time to time reviews how these risks are being managed in practice.

#### **2.7. Climate-related risks**

Climate change is a source of risk, which could be financially material over both the short and longer term. This risk relates to the transition to a low carbon economy, and the physical risks associated with climate change (eg extreme weather). The Trustee seeks to appoint investment managers who will manage this risk appropriately, and the Trustee monitors how this risk is being managed in practice. The Trustee encourages its managers (where practical) to set credible net zero targets for the funds in which the Trustee invests and to align their investments with net zero greenhouse gas emissions by 2050 to help drive real world emissions reduction and reduce systemic risks relating to climate change. The Trustee monitors and engages with its managers on their progress towards net zero alignment.

#### **2.8. Collateral adequacy risk**

The Fund is invested in leveraged Liability Driven Investment ("LDI") arrangements to provide protection ("hedging") against adverse changes in interest rates and inflation expectations. The LDI manager may from time to time require additional cash to be paid to the LDI portfolio in order to support the target level of leverage. Collateral adequacy risk is the risk that the Fund when requested to do so will not be able to post additional cash to the LDI portfolio. A potential consequence of this risk is that the Fund's interest rate and inflation hedging could be reduced and that the Fund's funding level could suffer subsequently as a result. In order to manage this risk, the Trustee ensures that the Fund has a sufficient allocation to cash and other highly liquid assets which can be readily realised, so that cash can be posted to the LDI portfolio at short notice.

#### **2.9. Risk from excessive charges**

Within the DC Section, if the investment management charges together with other charges levied on, for example, transfers or early retirement are excessive, then the value of a member's account will be reduced unnecessarily. The Trustee is comfortable that the charges applicable to the Fund are in line with market practice and assess regularly whether these represent good value for members.

#### **2.10. Credit risk**

This is the risk that a borrower will cause a financial loss for the other party by failing to meet required payments for a contractual obligation.

The Fund is subject to credit risk because it invests in bonds via pooled funds. The managers of these pooled funds manage credit risk by having a suitably diversified exposure to bond issuers, conducting thorough research on the probability of default of those issuers, and by typically having only a limited exposure to bonds rated below investment grade.

#### **2.11. Equity risk**

Equity represents (part) ownership of a company. Equity risk is the risk that the value of this holding falls in value.

The Trustee believes that equity risk is a rewarded investment risk, over the long term.

The Trustee considers exposure to equity risk in the context of the Fund's overall investment strategy and believes that the level of exposure to this risk is appropriate.

#### **2.12. Currency risk**

Whilst the majority of the currency exposure of the Fund's assets is to Sterling, the Fund is subject to currency risk because some of the Fund's investments are held in overseas markets. The Trustee considers the overseas currency exposure in the context of the overall investment strategy, and believes that the currency exposure that exists diversifies the strategy and is appropriate.

#### **2.13. Interest rate and inflation risk**

Some of the Fund's DB section assets are subject to interest rate risk. However, the overall interest rate exposure of the Fund's DB section assets hedges part of the corresponding risks associated with the Fund's DB section liabilities.

The Trustee considers interest rate and inflation risks to be generally unrewarded investment risks. As a result, the Trustee aims to hedge around 95% of the Fund's exposure to interest rate risk and inflation risk (on a gilts + 0.4% pa basis), by investing in a leveraged LDI arrangement managed by Columbia Threadneedle.

The net effect of the Trustee's approach to interest rate and inflation risk will be to reduce the volatility of the funding level, and so the Trustee believes that it is appropriate to manage exposures to these risks in this manner and to review them on a regular basis.

#### **2.14. Valuation risk**

Some of the Fund's assets such as listed equities and absolute return bonds can be valued regularly based upon observable market prices. For other Fund assets (such as private credit and private equity), prices may only be estimated relatively infrequently using one or more of a range of approximate methods – eg mathematical models or recent sales prices achieved for equivalents.

At times of market stress, there is a risk for all assets that the valuations provided by investment managers do not reflect the actual sale proceeds which could be achieved if the assets were liquidated at short notice.

The Trustee considers exposure to valuation risk in the context of the Fund's overall investment strategy and believes that the level of exposure to this risk is appropriate.

**2.15. Other non-investment risks**

The Trustee recognises that there are other, non-investment, risks faced by the Fund, and takes these into consideration as far as practical in setting the Fund's investment arrangements as part of its assessment of the other aspects of the Fund's Integrated Risk Management framework.

Examples for the DB Section include:

- longevity risk (the risk that members live, on average, longer than expected); and
- sponsor covenant risk (the risk that, for whatever reason, the sponsoring employer is unable to support the Fund as anticipated).

Together, the investment and non-investment risks give rise generally to funding risk. This is the risk that the Fund's funding position falls below what is considered an appropriate level. The Trustee regularly reviews progress towards the Fund's funding target, both in the longer-term as well as against short-term milestones, comparing the actual versus the expected funding level.

By understanding, considering and monitoring the key risks that contribute to funding risk, the Trustee believes that it has appropriately addressed and is positioned to manage this general risk.

## *Monitoring and engaging with managers on voting and engagement*

### **1. Stewardship policies**

The Trustee has selected some priority themes to provide a focus for its monitoring of investment managers' voting and engagement activities. The Trustee will review them regularly and update them if appropriate. The Trustee's current priorities are Climate Change, Diversity, Equity and Inclusion and Human Rights.

The Trustee chose these priorities because the Trustee believes Climate Change ranks as one of the most important global risks. Diversity, Equity and Inclusion and Human Rights were also important to the Trustee as these align with the values of the sponsoring employer. Therefore the Trustee believes it is in its members' best interests that its managers adopt strong practices in these areas.

The Trustee will write to its investment managers regularly to notify them of its stewardship priorities, and remind them of its expectations of them in relation to responsible investment – ie ESG considerations, climate change, voting and engagement.

### **2. Manager selection**

The Trustee aims to appoint investment managers that have strong responsible investment skills and processes and has a preference for managers and funds with net zero targets and credible plans to meet them. The Trustee may favour investment managers who are signatories to the Principles for Responsible Investment, the UK Stewardship Code, as well as the Net Zero Asset Managers Initiative.

When selecting new managers, the Trustee considers its investment consultant's assessment of potential managers' capabilities in this area.

### **3. Manager monitoring**

The Trustee reviews LCP's responsible investment (RI) scores for the Fund's existing managers as part of the Fund's quarterly performance monitoring report. These scores cover the manager's approach to ESG factors, voting and engagement and are most recently based on LCP's Responsible Investment Survey. The Trustee also considers individual fund RI scores and assessments which are based on LCP's ongoing manager research programme, and it is these that directly affect LCP's manager and fund recommendations.

### **4. Implementation statement including most significant votes**

Following the end of each Fund year, the Trustee prepares a statement which explains how it has implemented its Statement of Investment Principles during the year. The Trustee publishes it online for its members to read.