# *Statement of Investment Principles (SIP) for the Ahli United Bank (UK) Pension Fund (the "Fund")*



## 1. Introduction

This SIP sets out the policy of the Trustees of the Fund ("the Trustees") on various matters governing decisions about the investments of the Fund, which is a Defined Benefit ("DB") Scheme. This SIP replaces the SIP dated November 2018.

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).

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

The Trustees will review this SIP from time to time and, with the help of their advisers, amend it as appropriate. These reviews will take place as soon as practicable after any significant change in investment policy 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 Trustees, 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 Trustees' policy towards risk appetite, capacity, measurement and management.
- **Appendix 3** sets out the Fund's investment manager arrangements.

## 2. Investment objectives

The primary objective is to ensure that the Fund should be able to meet benefit payments as they fall due. The Trustees have the following additional objectives:

- that the expected asset return is maximised whilst maintaining investment risk at an appropriate level. What the Trustees determine 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 a gilts flat basis in the longer term. The Trustees are aware that there are various measures of funding, and have given due weight to those considered most relevant to the Fund.

- that the Fund has a long-term journey plan in place (which has been agreed with the employer) to achieve full funding on a gilts-flat basis by 2037. Progress will be reviewed on a regular basis.

## 3. Investment strategy

The Trustees, with the help of their advisers and in consultation with the employer, reviewed the investment strategy in November 2018, taking into account the objectives described in Section 2 above.

The result of the review was that the Trustees agreed that the Fund's investment strategy should de-risk gradually over time, as the Fund matures. The table below sets out how the strategic asset allocation is expected to evolve. This strategy will be subject to review at least every three years as part of the Actuarial Valuation.

| Asset Class | c.2019 | c. 2025 | c. 2032 | c. 2038 |
|---|---|---|---|---|
| Equities | 50% | 32% | 8% | 0% |
| Infrastructure | 10% | 10% | 10% | 10% |
| Property | 10% | 10% | 10% | 10% |
| Credit | 0% | 15% | 20% | 25% |
| Cash / insurance policies | 0% | 0% | 19% | 22% |
| Liability Driven Investment (LDI) | 30% | 33% | 33% | 33% |
| **Total** | **100%** | **100%** | **100%** | **100%** |

The Trustees have agreed to monitor the asset allocation annually. If material deviations from the strategic allocation occur the Trustees will consider with their advisers whether to rebalance the assets, taking into account factors such as market conditions, anticipated future cash flows and transaction costs.

## 4. Considerations in setting the investment arrangements

When deciding how to invest the Fund's assets, the Trustees consider a number of risks, including, those set out in Appendix 2. Some of these risks are more quantifiable than others, but the Trustees have tried to allow for their relative importance.

The Trustees considered a wide range of asset classes for investment, taking account of their expected returns, risks and risk mitigations. The key financial assumptions made by the Trustees in determining the investment arrangements are that the assets classes outperform gilts (p.a.) over the long term as follows:

- Equities: 5.0%;
- Infrastructure: 4.0%;
- Property: 3.2%;
- Credit: 1.0%; and

- LDI: 0%.

To meet the Fund's objectives, the Trustees took into account the following:

- the required return;
- the Fund's cash flow requirements;
- the best interests of all members and beneficiaries;
- the profile of the benefit cash flows, the funding level, and the strength of the employer;
- the risks, rewards and suitability of a number of possible asset classes;
- the need for appropriate diversification between assets;
- any other financially material considerations; and
- the Trustees' investment beliefs.

The Trustees' key investment beliefs, which influenced the setting of the investment arrangements, are as follows

- asset allocation is the primary driver of long-term returns;
- 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;
- 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; and
- costs have a significant impact on long-term performance and therefore obtaining value for money from the investments is important.

## 5. Implementation of the investment arrangements

Before investing in any manner, the Trustees obtain and consider proper written advice from their 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 Appendix 3.

The Trustees 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 Trustees have limited influence over managers' investment practices because all the Fund's assets are held in pooled funds, but they encourage their managers to improve their practices where appropriate.

The Trustees' 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 Trustees' responsibility to ensure that the managers' investment approaches are consistent with their 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 Trustees expect 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. They assess this when selecting and monitoring managers.

The Trustees evaluate 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 Trustees would be unlikely to terminate a mandate on short-term performance grounds alone.

The Trustees' policy is to evaluate each of their 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 Trustees recognise 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 Trustees expect their investment consultant to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Fund's investment mandates.

## 6. 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.

When appropriate, the Trustees, on the administrators' recommendation, decide on the amount of cash required for benefit payments and other outgoings and inform the investment managers of any liquidity requirements. The Trustees' preference is for investments that are readily realisable but recognise that achieving a well-diversified portfolio may mean holding some investments that are less liquid (eg property). In general, the Trustees' policy is to use cash flows to rebalance the Fund's assets towards the strategic asset allocation, and also receive income from some of the portfolios where appropriate.

## 7. Consideration of financially material and non-financial matters

The Trustees have 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 Trustees expect their investment managers to take account of financially material considerations (including climate change and other ESG considerations). The Trustees seek to appoint managers that have appropriate skills and process to do this, and from time to time review how their managers are taking account of these issues in practice.

The Trustees have limited influence over managers' investment practices where assets are held in pooled funds, but they encourage their managers to improve their practices where appropriate.

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

## 8. Voting and engagement

The Trustees recognise their responsibilities as owners of capital, and believe 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. The Trustees have delegated to their 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 Trustees do not monitor or engage directly with issuers or other holders of debt or equity. They expect 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 Trustees from time to time, considering the long-term financial interests of the beneficiaries. The Trustees have limited influence over managers' stewardship practices where assets are held in pooled funds, but they encourage their managers to improve their practices where appropriate.

**SIP signed for and on behalf of the Trustees of the Fund:**

**Signed:** AnnaEagles

Anna Eagles, Director for
The Law Debenture Pension Trust Corporation p.l.c.

30 SEPTEMBER 2019

# Investment governance, responsibilities, decision-making and fees



The Trustees have decided on the following division of responsibilities and decision-making for the Fund. This division is based upon the Trustees' 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 Trustees' investment powers are set out within the Fund's governing documentation.

## Trustees

Broadly, the Trustees are 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 asset class rebalancing;
- 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 (and, when necessary, 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;
- 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.

## Platform provider

The investment platform provider will be responsible for:

- providing access to a range of funds managed by various investment managers; and
- providing the Trustees with regular information concerning the management and performance of the assets.

## Investment managers

Broadly, 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 investment platform provider 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  are responsible for safe keeping of the assets and facilitating all transactions within the portfolios. The custodians are appointed by the investment managers. There is therefore no direct relationship between the custodian and the Trustees.

## Investment adviser

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

- advising on how material changes within the Scheme's benefits, membership, and funding position may affect the manner in which the assets should be invested and the asset allocation policy;
- 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 Trustees in reviews of this SIP.

## Fee structures

The Trustees recognise that the provision of investment management and advisory services to the Fund results in a range of charges to be met directly or indirectly.

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

The investment managers and platform provider receive fees calculated by reference to the market value of assets under management and also in some cases a performance related fee. The fee rates are believed to be consistent with the managers' general terms for institutional clients and are considered by the Trustees to be reasonable when compared with those of other similar providers.

The fee structure used in each case has been selected with regard to existing custom and practice, and the Trustees' current view as to the most appropriate arrangements for the Fund.

### Performance assessment

The Trustees are satisfied, taking into account the external expertise available, that there are sufficient resources to support their investment responsibilities. The Trustees believe that they have sufficient expertise and appropriate training to carry out their role effectively.

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

### Working with the Fund's employer

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

# Policy towards risk



## 1. Risk appetite and risk capacity

Risk appetite is a measure of how much risk the Trustees are willing to bear within the Fund to meet their investment objectives. Taking more risk is expected to mean that those objectives could 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 Trustees can tolerate deviation from their long term objectives before attainment of those objectives is seriously impaired. The Trustees aim to strike a balance between risk appetite and risk capacity.

When assessing the above, the Trustees considered the following:

- the strength of the employer's covenant and how this may change;
- 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 2019 investment strategy (as set out on page 2), it is estimated that the Fund's 3 year 90% Value at Risk will be £30m on a Technical Provisions basis (based on the value of the asset / liability position as at 28 November 2018).[1] This means that there is estimated to be a 1 in 10 chance that the Fund's funding position will worsen by £30m or more, compared to the expected position, over a three year period. When deciding on the investment strategy, the Trustees believed this level of risk to be appropriate given the Trustees' and employer's risk appetite and capacity, given the Fund's objectives. This was supported by advice from the Trustees' covenant specialist.

## 2. Approach to managing and monitoring investment risks

The Trustees consider that there are a number of different types of investment risk that are important to manage and monitor. These include:

### 2.1 Risk of inadequate returns

A key objective of the Trustees is that, over the long-term, the Fund should generate its target return so that it has adequate assets to meet its liabilities as

[1] More details, including the underlying assumptions, available on request.

they fall due. The Trustees therefore invest 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 taken into account in setting the investment strategy and is monitored by the Trustees on a regular basis.

### 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 Trustees believe that the Fund's assets are adequately diversified between different asset classes and within each asset class.

### 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 Trustees receive written advice from a suitably qualified individual, and will typically undertake an investment manager selection exercise. The Trustees monitor the investment managers on a regular basis to ensure they remain appropriate for their selected mandates.

### 2.4 Liquidity/marketability risk

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 to meet benefit payments. The Trustees are aware of the Fund's cash flow requirements and believe that this risk is managed by maintaining an appropriate degree of liquidity across the Fund's investments and by investing in income generating assets, where appropriate.

### 2.5 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 climate change, unsustainable business practices, and unsound corporate governance. The Trustees seek to appoint investment managers who will manage these risks appropriately on their behalf.

### 2.6 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 call for additional cash to be paid to the LDI portfolio to support a given level of leverage. Collateral adequacy risk is the risk that the Trustees when requested to do so will not be able to post cash to the LDI fund within the required timeframe. 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. To manage this risk, the Trustees ensure that the Fund has a sufficient allocation to liquid assets which can be readily realised, so that cash can be posted to the LDI manager at short notice.

### 2.7 Credit risk

This is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The Fund is subject to credit risk because it invests in bonds and interest rate and inflation swaps via the pooled LDI funds. Credit risk is reduced within the LDI funds through the use of a range of different counterparties to swap contracts. Counterparties must also meet minimum credit ratings. Increasingly the LDI manager is trading through a central exchange rather than directly with a single counterparty.

### 2.8 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, specifically within the overseas equity and infrastructure funds. The Trustees consider the overseas currency exposure in the context of the overall investment strategy, and believe that the currency exposure that exists diversifies the strategy and is appropriate.

The Trustees do not currently hedge any of the Fund's exposure to foreign currency back to GBP.

### 2.9 Interest rate and inflation risk

The assets are subject to interest rate and inflation risk because some of the Fund's assets are held in bonds and interest rate and inflation swaps via pooled funds. However, the interest rate and inflation exposure of the Fund's assets hedges part of the corresponding risks associated with the Fund's liabilities.

The Trustees consider interest rate and inflation risks to be unrewarded investment risks.

As a result, the Trustees aim to hedge around 80% of the Fund's exposure to interest rate risk and 80% of the Fund's exposure to inflation risk (on a Technical Provisions basis), by investing in leveraged LDI arrangements. The Trustees also have a plan in place to increase this level of hedging over time.

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

### 2.10 Other non-investment risks

The Trustees recognise 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 their assessment of the other aspects of the Fund's Integrated Risk Management framework.

Examples include:

- longevity risk (the risk that members live, on average, longer than expected); and
- sponsor covenant risk (the risk that, 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 Trustees regularly review 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 Trustees believe that they have appropriately addressed and are positioned to manage this general risk.

# *Investment manager arrangements*





Details of the investment managers, their objectives and investment guidelines are set out below.

## 1. Legal & General Investment Management ("LGIM") – Equities

The Trustees have selected LGIM as the investment manager for the Fund's passive equity investments, which are held in pooled unit-linked life policy funds.

| Asset class | Benchmark index |
|---|---|
| UK equities | FTSE All-Share Index |
| North America equities | FTSE North America Index |
| Europe (ex UK) equities | FTSE Developed Europe ex UK Index |
| Japan equities | FTSE Japan Index |
| Asia Pacific (ex Japan) equities | FTSE World Asia Pacific ex Japan Index |

LGIM's investment objective for each of these funds is to track the relevant benchmark index return to within a particular range for two years out of three:

- +/-0.25% pa for the UK fund;
- +/- 0.5% pa for the North American, European (ex UK) and Japanese funds; and
- +/-0.75% pa for the Asia Pacific (ex Japan) fund.

## 2. Legal & General Investment Management ("LGIM") – Bonds

The Trustees have selected LGIM as the investment manager for the Fund's passive long dated corporate bond investment, which is held in a pooled unit-linked life policy fund. The fund's investment objective is to track the performance of the Markit iBoxx £ Non-Gilts (ex-BBB) Over 15 Years Index to within +/-0.5% pa for two years out of three.

The Fund's investment in corporate bonds will be used to fund the proposed allocation to UK property.

## 3. Legal & General Investment Management ("LGIM") – LDI

The Trustees have selected LGIM as the investment manager for the Fund's LDI investment, which are held in pooled unit-linked life policy funds; the Matching Core fund range. The objective of these LDI funds is to provide leveraged exposure to interest rates and inflation. The funds can then be combined to hedge the Fund's liability exposure to interest rates and inflation.

## 4. JP Morgan Asset Management ("JP Morgan") - Infrastructure

The Trustees have selected JP Morgan as the investment manager for the Fund's infrastructure investment, which is held in a pooled fund. The objective of this fund is to deliver a total return of 8-12% after fees in local currency terms, with a 5-7% pa cash yield.

## 5. The home reversion portfolio

The Trustees have selected Home & Capital as the investment manager for the Fund's home reversion portfolio.

The Fund's home reversion portfolio is small and illiquid, and is currently in run-off.

## 6. Additional Voluntary Contributions ("AVCs")

The Trustees have full discretion as to the appropriate vehicles made available for members' AVCs. The Trustees have selected Santader UK and the Scottish Life Assurance Company as the Fund's AVC providers.

Only investment vehicles that are considered suitable for investment of AVCs are considered by the Trustees, having taken appropriate advice. The Trustees' policy is to review the investment vehicles over which they retain control and to obtain written advice about them from time to time. Nevertheless, members are expected to take independent financial advice when choosing a vehicle for the AVCs.