# Statement of Investment Principles

**Introduction**

This Statement of Investment Principles (SIP) has been prepared by the Directors of the Plumbing & Mechanical Services (UK) Industry Pension Scheme ("the Scheme") to comply with the requirements of the Pensions Act 1995, as amended, and the Occupational Pension Schemes (Investment) Regulations 2005.

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**Effective Date**

This SIP is effective from July 2020.

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## 1. Strategy

**Investment objectives**

The Directors assess the Scheme's investment strategy with reference to the Scheme's liabilities and the covenant. When considering the Scheme's liabilities, these are done so on several different bases by the Directors. The Directors' main focus is on the self-sufficiency basis.

The Directors' strategic objectives are:

- To target, over the long term, a return on the investments which is greater than the rate assumed by the Scheme Actuary.

  The investment strategy agreed by the Directors is targeted to deliver an expected return of gilts +0.75% per annum.

  As the Directors considered different investment strategies, it agreed that it wanted to reduce risk as much as practically possible, whilst targeting this level of return. The Directors thought about risk using a metric called Value at Risk (VaR). The agreed investment strategy had a 1-year VaR of c. £53m when calculated as at 30 September 2018. This is the minimum expected increase in deficit versus the expected position, over a 1-year period at a 5% confidence level (i.e. 1 in 20 event).

- To invest the assets of the Scheme prudently to ensure that the benefits promised to members are provided.

In seeking to achieve the objectives above, the Directors are looking to reduce the chance that contributions will have to be increased and to employ an investment strategy that is low risk and has a high probability of paying member benefits.

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**Allocation of Assets**

The investment strategy is currently comprised of a Main Portfolio and a bulk annuity.

The Main Portfolio comprises equities, property, infrastructure, credit, inflation protection and Liability Driven Investment ("LDI") assets. Its role is to provide an investment return that is sufficient to meet the Scheme's objectives outlined above in a risk controlled manner.

The bulk annuity ("buy-in") is a policy between the Scheme and Legal & General Assurance Society Limited ("LGAS"). Under the terms of the buy-in policy, the insurer will pay the Scheme the retirement benefits due to all pensioner members and their dependents, included in the terms of the policy at the time the policy was purchased. The Scheme may then use this income to pay the retired members their benefits. As such, the assets are invested in a manner appropriate to the nature and duration of the expected future retirement benefits payable under the Scheme.

Over the second half of 2019 the Directors made significant progress in the implementation of the new strategy, and the table below shows the Scheme's latest agreed strategic target allocation excluding the buy-in.

It is worth noting that the allocation to "Property", "Illiquid assets" and "Inflation protection illiquid assets" will take some time to reorganise due to the nature of these assets.

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**Main Portfolio**

| **Asset Class** | **Target weighting (%)** |
|---|---|
| Equities | 4 |
| Property | 3 |
| Illiquid assets | 3 |
| Credit | 20 |
| Liability Driven Investment | 65 |
| Inflation protecting illiquid assets | 5 |
| **Total** | **100** |

**Risks**

The Scheme is exposed to a number of different risks. These include risks relating to:

- Funding – the risk that there are insufficient assets to cover 100% of the accrued liabilities
- Interest rate – the risk that the market value of a financial instrument will fluctuate or that the future cash flows from that instrument will change because of changes in market interest rates
- Inflation – the risk that the market value of an investment will fluctuate or that the future cash flows from that instrument will change because of changes in realised or expected inflation
- Mismatching – a difference in the sensitivity of asset and liability values to financial and demographic factors
- Longevity – related to the increasing life expectancy of pensioners and those entitled to benefits. This can result in higher than expected payout
- Cash flows – a shortfall of liquid assets to pay benefits
- Credit – the risk that one party to a financial instrument will cause a financial loss for the other party by failing to meet a contractual obligation
- Currency – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates
- Political and regulatory – this is the risk of an adverse influence on investment values arising from political intervention
- Investment managers – a failure to meet target returns

- Diversification – inadequate spread of investments
- Covenant – the Scheme is a multi-employer scheme with over 400 participating employers, and so is exposed (to varying degrees) to the covenant of each employer
- Operational risk – fraud, poor advice or negligence
- Insurer insolvency – risk that the insurer, LGAS, becomes insolvent or is unable to honour its obligation to the Scheme.

The Directors reduce these risks by careful structuring of its funding and investment management arrangements and by contracts with the fund managers. The Directors' policy is to monitor, where possible, the majority of these risks quarterly. The Directors receive quarterly reports showing information on funding, cashflows and investment managers (including performance at the manager and Scheme level).

The Directors received appropriate advice associated with insurer related risk at the time of the purchase of the buy-in policy, including training on the topic and the risk of insurer insolvency.

Mismatching is reviewed as part of the triennial actuarial valuation process and is somewhat mitigated with the help of the formal LDI portfolio. The gilts assets held in the LDI portfolio are designed to closely match the Scheme's liability cashflows. The LDI portfolio implementation was completed in the second half of 2019.

Operational risk is reduced as far as possible by due diligence on the appointment and review of managers and advisers, and by contracts of engagement.

## 2. Implementation

**Main Portfolio**

This Portfolio comprises assets which collectively are designed to provide a stable, diversified return above the Scheme's liabilities over the long term. The portfolio comprises assets which aim to provide a growth in excess of the Scheme's liabilities and assets which are expected to move in a similar direction and magnitude to the Scheme's liabilities.

**Equities**

The Scheme employs Baillie Gifford & Co and Legal & General Assurance (Pensions Management) to manage the Scheme's equities.

Baillie Gifford & Co manage a run-off portfolio of unlisted securities whilst Legal & General Assurance (Pensions Management) manages equities on a passive, alternative indexation basis, more specifically:

- a global minimum volatility fund; and
- a fund aiming to provide the return from an index of global equities weighted using a range of measurers of each company's size.

**Infrastructure/ Illiquids**

An infrastructure allocation managed by Macquarie Infrastructure and Real Assets (Europe).

**UK Commercial Property**

UK Commercial property, with DTZ Investment Management appointed to establish and manage a portfolio of directly invested and, where appropriate indirect, property assets. The Manager and the Board of Directors are working together to reduce the size of the mandate.

**Credit**

The Scheme invests with Pacific Investment Management Company ("PIMCO"), LLC to manage a portfolio of credit assets and Insight Investments to manage a portfolio of asset backed securities.

**Liability Driven Investment (LDI)**

The Scheme employs Legal & General Assurance (Pensions Management) to implement a bespoke pooled LDI solution with an intention to better manage the movement if the Scheme's liabilities.

**Inflation protecting illiquids**

Furthermore, the Scheme is invested in a pooled fund managed by CBRE Global Investors which invests in property assets where a significant proportion of the return is expected to be derived from income linked to inflation.

**Bulk annuity**

The bulk annuity policy is held with LGAS and was purchased in June 2017.

**Choosing investments**

In general, individual investment managers have discretion in the timing of the purchase and sale of investments and in considerations relating to the liquidity of those investments. Additional realisations may be required to ensure that the Scheme's benefit outgo and other expenditure can be made.

Investment managers will use the criteria set out in the Occupational Pension Schemes (Investment) Regulations 2005, when selecting investments on behalf of the Scheme.

## 3. General

**Direct investments**

Assets directly held by the Directors, e.g. policies of assurance, will be regularly reviewed to ensure that they continue to be appropriate, and written advice will be obtained from advisers. This includes the investment vehicles provided for Additional Voluntary Contributions (AVCs).

The Directors will use the factors set out in the Occupational Pension Schemes (Investment) Regulations 2005 when selecting direct investments.

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**Socially Responsible Investment and Corporate Governance**

In setting the Scheme's investment strategy, the Directors' primary concern is to act in the best financial interests of the Scheme and its beneficiaries, seeking the best return that is consistent with a prudent and appropriate level of risk. The Directors believe that in order to fulfil this commitment and to protect and enhance the value of the Scheme's investments, it must act as a responsible steward of the assets in which the Scheme invests.

**Environmental, Social, and Governance considerations**

The Directors further acknowledge that an understanding of financially material considerations including environmental, social and corporate governance ("ESG") factors (such as climate change) and risks related to these factors can contribute to the identification of investment opportunities and financially material risks.

As part of their delegated responsibilities, the Directors expect the Scheme's investment managers to take into account corporate governance, social, and environmental considerations (including long-term risks posed by sustainability concerns including climate change risks) in the selection, retention and realisation of investments. Any decision should not apply personal ethical or moral judgments to these issues but should consider the sustainability of business models that are influenced by them.

The Directors are taking the following steps to monitor and assess ESG related risks and opportunities:

- The Directors will have periodic training on Responsible Investment to understand how ESG factors, including climate change, could impact the Scheme's assets and liabilities.
- As part of ongoing monitoring of the Scheme's investment managers, the Directors will use ESG ratings information provided by Aon, where relevant and available, to monitor the level of the Scheme's investment managers' integration of ESG on a quarterly basis.
- Regarding the risk that ESG factors including climate change negatively impact the value of investments held if not understood and evaluated properly; the Directors considers this risk by taking advice from their investment adviser when setting the Scheme's asset allocation, when selecting managers and when monitoring their performance.

**Stewardship – Voting and Engagement**

The Directors recognise the importance of their role as a steward of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which its investments reside. The Directors recognise that ultimately this protects the financial interests of the Scheme and its beneficiaries and can create long-term financial value.

It is the expectation of the Directors that the Scheme's investment managers will prioritise and actively monitor for these risks within the investment, providing transparency on engagement with respect to mitigating these risks as appropriate. The transparency offered for engagements should include objectives and relevance to the Scheme.

The Directors regularly review the suitability of the Scheme's investment managers and take advice from the Investment Adviser regarding any changes. Where applicable, this advice includes consideration of broader stewardship matters and the exercise of voting rights by the appointed managers. If an incumbent manager is found to be falling short of the standards the Directors expect, the Directors undertake to engage with the manager and seek a more sustainable position but may look to replace the manager.

The Directors review the stewardship activities of their investment managers on an annual basis, covering both engagement and voting actions. The Directors will review the alignment of the Directors' policies to those of the Scheme's investment managers and ensure the managers, or other third parties, use their influence as major institutional investors to carry out the Directors' rights and duties as a responsible shareholder and asset owner. This will include voting, along with – where relevant and appropriate – engaging with underlying investee companies to promote good corporate governance, accountability, and positive change.

The Directors will engage with the investment managers as necessary for more information, to ensure that robust active ownership behaviours, reflective of their active ownership policies, are being actioned.

The Directors may engage on matters concerning an issuer of debt or equity, including their performance, strategy, risks, social and environmental impact and corporate governance, the capital structure, and management of actual or potential conflicts of interest. Where such a concern is identified, the Directors will engage with the Investment Adviser to consider the methods by which, and the circumstances under which, they would monitor and engage an investment manager and other stakeholders.

**Members' Views and Non-Financial Factors**

In setting and implementing the Scheme's investment strategy, the Trustee Directors do not explicitly take into account the views of members and beneficiaries, in relation to ethical views, social and environmental impact matters and present and future quality of life matters (defined as "non-financial factors").

**Arrangements with investment managers**

The Directors monitor the Scheme's investments to consider the extent to which the investment strategy and decisions of the investment managers are aligned with the Directors' policies.

Where the Scheme invests in funds that are regularly reviewed by the Directors' Investment Adviser, the Directors use conclusions drawn from this assessment on a quarterly basis to determine whether the fund and investment manager remain suitable.

The above monitoring includes the extent to which investment managers:

- make decisions based on assessments about medium- to long-term financial performance of an issuer of debt or equity; and
- engage with issuers of debt or equity in order to improve their performance in the medium- to long-term.

The Directors receives at least quarterly reports and verbal updates from the Investment Adviser on various items including the investment strategy, performance, and longer-term positioning of the portfolio. The Directors focus on longer-term performance when considering the ongoing suitability of the investment strategy in relation to the Scheme's objectives, and assess the investment managers over the long-term.

In line with the required actions from the Pensions Regulator, on an annual basis the Trustee Directors will produce an Engagement Policy Implementation Statement ("EPIS") which will also be included in the annual reports and accounts.

The Directors shares the policies, as set out in this SIP, with the Scheme's investment managers, and requests that the investment managers review and confirm whether their approach is in alignment with the Board's policies.

Before appointment of a new investment manager, the Board reviews the governing documentation associated with the investment and will consider the extent to which it aligns with the Board's policies. Where possible, the Directors will seek to amend that documentation so that there is more alignment. Where it is not possible to make changes to the governing documentation, for example if the Scheme invests in a collective vehicle, then the Board will express their expectations to the investment managers by other means (such as through a side letter, in writing or verbally at Board meetings).

The Board believes that having appropriate governing documentation, setting clear expectations to the investment managers (where possible), and regular monitoring of investment managers' performance and investment strategy, is sufficient to incentivise the investment managers to make decisions that align with the Directors' policies and are based on assessments of medium- and long-term financial performance.

Where investment managers are considered to make decisions that are not in line with the Board's policies, expectations, or the other considerations set out above, the Directors will typically first engage with the manager but could ultimately replace the investment manager where this is deemed necessary.

There is typically no set duration for arrangements with investment managers, although the continued appointment for all investment managers will be reviewed periodically, and at least every three years. Where the Scheme holds closed ended vehicles, the duration may be defined by the nature of the underlying investments.

**Cost monitoring**

The Directors are aware of the importance of monitoring their investment managers' total costs and the impact these costs can have on the overall value of the Scheme's assets. The Directors recognise that in addition to annual management charges, there are a number of other costs incurred by the investment managers that can increase the overall cost incurred by their investments.

Collation of cost information

The Directors collect annual cost transparency reports covering all underlying investments and ask that the investment managers provide this data in line with the appropriate Cost Transparency Initiative ("CTI") template for each asset class. This allows the Board to understand exactly what it is paying investment managers. The Directors work with the Investment Adviser and investment managers to understand these costs in more detail where required.

The Directors are aware of the portfolio turnover costs (portfolio turnover costs are defined as the costs incurred as a result of the buying, selling, lending or borrowing of investments) associated to their underlying investments through the information provided by the investment managers. The monitoring of the target portfolio turnover and turnover range is monitored annually with the assistance of the Scheme's Investment Adviser.

The Directors accept that transaction costs will be incurred to drive investment returns and that the level of these costs varies across different types of investment mandates. A high level of transaction costs is acceptable if consistent with the type of investment mandate and historic trends. Where the Directors' monitoring identifies a lack of consistency, the mandate will be reviewed.

The Directors are supported in cost transparency monitoring activity by the Investment Adviser.

Evaluation of performance and remuneration:

The Directors assess the performance of their investment managers on a quarterly basis and the remuneration of their investment managers on at least an annual basis via collecting cost data in line with the CTI templates.

Ongoing reporting:

The Directors will provide reporting on the implementation of the Scheme's cost transparency policy to the Scheme's members via the EPIS.

**Governance**

The Directors are responsible for the investment of the Scheme's assets. The Directors take some decisions themselves and delegate others. When deciding which decisions to take themselves and which to delegate, the Directors have taken into account whether they have the appropriate training and expert advice in order to take an informed decision.

The Directors have delegated all day-to-day decisions about the investments that fall within each mandate to the relevant fund manager through a written contract.

For pooled investments with Legal & General Assurance (Pensions Management), CBRE Global Investors, Insight and Macquarie the investments are classified as direct investments and the investment managers select the individual assets.

**Custody & Accounting**

The Directors have appointed JP Morgan as the Scheme's custodian and independent performance measurer. The custodian provides safekeeping for a portion of the Scheme's equity assets and is expected to do so for part of the credit assets. It performs the administrative duties attached to segregated assets, such as the collection of interest and dividends and dealing with corporate actions. Title to UK commercial property is by means of the electronic register at the Land Registry, and other documents relating to property will be held by the Scheme's legal advisers. The custodial duties for pooled investments, such as the Scheme's policy with Legal & General Assurance (Pensions Management), LGAS, CBRE Global Investors, Insight and Macquarie are performed by a separate entity independent to the Scheme's custodian JP Morgan.

**Investment Adviser**

Aon Solutions UK Limited ("Aon") has been appointed as Investment Adviser. It has the knowledge and experience required under the Pensions Act 1995. Aon is paid an agreed annual fee which includes all services needed on a regular basis. Aon is paid on a variable fee basis for all the work they undertake for the Scheme outside of the annual fee, although fixed fees may be negotiated by the Directors for certain projects.

**Review of SIP**

The Directors will monitor compliance with this SIP on a regular basis. Following the aforementioned implementation of the Scheme's agreed investment strategy, the SIP can be updated and finalised. The fund managers will notify the Directors promptly of any breach of their investment management responsibilities as set out in their Investment Management Agreement and in this SIP.

This SIP will be reviewed at least every three years or immediately following a change of investment policy. The Directors will take investment advice and consult with sponsoring companies over any changes to the SIP.