

# Statement of Investment Principles for the Wessex Water Pension Scheme (Defined Benefit Section)

## **1 INTRODUCTION**

### **1.1 Purpose of Statement**

This Statement sets out the principles governing decisions about the investment of the assets of the Wessex Water Pension Scheme (*the Scheme*). This Statement is issued by the Trustees to comply with Section 35 of the Pensions Act 1995 (as amended by Section 244 of the Pensions Act 2004) (the “Pensions Act”).

### **1.2 Advice**

The Trustees have obtained written advice on the content of this Statement from Hymans Robertson LLP (“Hymans”), the Scheme’s Investment Consultant.

### **1.3 Investment Powers**

The investment powers of the Trustees are set out in the Scheme’s Trust Deed and Rules. This Statement is consistent with those powers. Neither this Statement nor the Trust Deed and Rules restrict the Trustees’ investment powers by requiring the consent of the Employer.

### **1.4 Governance of the Scheme**

The ultimate power and obligation for deciding on the strategic investment policy lies solely with the Trustees. The main areas of investment responsibility include:

- Determination of strategic allocation;
- Determination of portfolio structure;
- Selection and appointment of external investment managers; and
- Ongoing monitoring and evaluation of the investment arrangements.

The Trustees have appointed Hymans Robertson LLP to provide strategic and implementation advice, and monitoring of the Scheme’s managers and overall performance.

### **1.5 Agreement to Statement**

The Trustees consulted the Principal Employer, who has been nominated by the participating employers, to comment on the context of this Statement.

## **2 SCHEME OBJECTIVES AND COMPLIANCE WITH THE SCHEME SPECIFIC FUNDING REQUIREMENT**

### **2.1 Scheme objective**

The Trustees’ primary objective is to ensure that they can meet their obligations to the beneficiaries both in the short and long term. In addition, the Trustees have the objective of:

- Achieving a return on assets of 2% above the growth in liabilities over the long term
- Meeting any regulatory solvency requirements arising from the Scheme Specific Funding Requirement

## 2.2 Scheme Specific Funding Requirement

As at 30 September 2019 the funding level of the Scheme on the technical provisions basis was 81%. The next formal valuation is expected to be as at 30 September 2022.

## 2.3 Annual Funding Review

The financial position of the Scheme will be considered each year, and if it changes significantly, the suitability of the investment strategy will be reviewed.

## **CHOOSING INVESTMENTS**

### 2.4 Process for choosing investments

The Trustees rely on professional fund managers for the day to day management of the majority of the Scheme's assets. However, the Trustees retain direct control over the strategic asset allocation, the choice of fund manager, manager mandates and the selection of the pooled funds in which the Scheme invests. The Trustees make the decisions about the investment vehicles offered to members for additional voluntary contributions (AVCs).

### 3.2 AVCs

The Trustees give members the opportunity to invest Additional Voluntary Contributions (AVCs) at the members' discretion. The Trustees have selected Aviva (Friends Life) and AEGON (Scottish Equitable) as the Scheme's AVC providers. The AVC arrangements and investment options available to members are regularly reviewed for suitability taking into account the asset type, charging structure, flexibility and the quality of administration.

For the Scheme's AVC arrangements the Trustees agreed to provide the following arrangements:

- Aviva will be offered as the only provider for new AVC members.
- The range of investment choices available to new members will be limited to a core range with Aviva.

Existing AVC members hold investments in a wide range of funds offered by Aviva and AEGON. For these members, there will be no requirement to move out of funds in which they are currently invested. However any new contributions can only be invested into the new core range of funds with Aviva. The funds are kept under regular review to ensure they provide value for members. The last detailed review was completed by the Trustees in 2019.

The new core fund range with Aviva is as follows:

Asset class	Management style	Friends Life Fund name
UK Equities	Index Tracking	FL BlackRock UK Equity Index Fund
Global Equities	Index Tracking	FL BlackRock World (ex-UK) Equity Index Fund
UK Equities	Active	FL BlackRock UK Equity Fund
Global Equities	Active	FL Global Equity Fund
Stewardship	Active	FL Stewardship Managed Fund
Balanced/Multi-Asset	Active	FL Managed Fund
Fixed Interest Gilts	Index Tracking	FL BlackRock Over 15 Year Gilt Index
Index-Linked Gilts	Index Tracking	FL BlackRock 5Y+ Index Linked Gilt Index
Pre-Retirement	Active	FL Pre-Retirement Fund
Property	Active	FL Property Fund
Cash	Active	FL Cash Fund
<b>The default fund will be the FL Managed Fund with a 5 year lifestyle programme.</b>		

The Trustees offer a lifestyle programme that gradually de-risks members' assets to ensure that members do not end up with a very significant proportion of their assets invested in equities at the point of their retirement (as would be the case if members' assets remained invested in the FL Managed Fund). The Trustees recognise that 100% cash at the point of retirement would be the most suitable option for members as they would expect many members to take their AVC benefits as cash. However, Aviva are currently unable to offer a lifestyle programme that de-risks to 100% cash. The Trustees have therefore chosen the 5 year lifestyle programme that still de-risks a member's assets over the 5 years to retirement, but into a target allocation at retirement of 25% FL Cash Fund and 75% FL Pre-Retirement Fund.

### 3.3 Investments directly controlled by the Trustees

The Trustees' policy is to review any investments over which they retain direct control and to obtain written advice about them annually. When deciding whether or not to make any new investments the Trustees will obtain written advice.

The written advice will consider the suitability of the investments, the need for diversification and the principles contained in this Statement. Hymans Robertson provides investment advice for the Scheme's AVC arrangements and will have the knowledge and experience required under Section 36(5) of the Pensions Act.

### 3.4 The Scheme's Investment Policy

The Trustees have set the long term investment policy with regard to the Scheme's liabilities and funding level. The Trustees invest in a range of assets in order to gain appropriate diversification and long-term growth above the expected growth of the liabilities.

The Scheme's overall strategic asset allocation is as follows:

<b>Discretionary Portfolio</b>	<b>26%</b>
Equities	16.5%
Enhanced Yielding Debt	9.5%
<b>Rebalancing Portfolio</b>	<b>55%</b>
Investment Grade, Sovereign Debt & Leveraged Gilt Funds	55%
<b>Notification Portfolio</b>	<b>19%</b>
Dynamic Asset Allocation Fund	10%
Secured Property	5%
Private Equity	4%

Further details of the investment strategy are shown in the Appendix

### 3.5 Review of Investment Policy

The Trustees reviewed the expected return requirements associated with the Scheme's investment policy as part of the 2019 valuation and it is also considered when changes to the strategic asset allocations are proposed (such as derisking). The Trustees will monitor the effectiveness of this policy on a quarterly basis, though in the absence of any major demographic or benefit changes in the Scheme, the Trustees expect that this policy will remain stable for a number of years.

### **3.6 Delegation of fund manager**

The Trustees have appointed fund managers, each of which is regulated by the Financial Conduct Authority (FCA), to implement their investment strategy. The Trustees have a signed agreement with each fund manager.

Where appropriate, and where commercial considerations permit, the terms of the mandate and the basis on which the manager is engaged will be defined specifically for the Scheme. Where such tailoring is not directly achievable, the Trustees will invest in pooled funds where the objectives of the fund and the policies of the investment manager will be evaluated by the Trustees to ensure that they are appropriate for the needs of the Scheme.

Remuneration for each mandate is determined at the inception of each mandate based on commercial considerations and typically set on an ad valorem basis. Where appropriate to the nature of the mandate, the term of the mandate and the role the mandate plays within the investment strategy, the Trustees may agree to a fee structure where the manager is incentivised to deliver outperformance relative to an agreed benchmark, typically in conjunction with a lower ad valorem fee. The Trustees periodically review the fees paid to all of its managers against industry standards, and may use an independent third party to carry out the benchmarking.

The Trustees review the nature of Scheme investments on a regular basis, with particular reference to suitability and diversification. The Trustees seek and consider written advice from a suitably qualified person when determining the appropriateness of each manager and mandate for the Scheme, particularly in relation to diversification, risk, expected return and liquidity. If, at any time, investment in a security or product not previously known to the Trustees is proposed, appropriate advice is sought and considered to ensure its suitability. The Trustees recognise the long-term nature of its liability profile and appoints its managers to invest in such a way that generates long term sustainable returns. The Trustees will carry out necessary due diligence on the underlying investment decision making process, to ensure the manager makes investment decisions over an appropriate time horizon aligned with the Scheme objective.

The duration of each mandate is determined by the Trustees at the inception of each mandate. For open-ended investments, the Trustees generally engage managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Trustees expect the minimum duration of the appointment will be three years, this being the period over which performance of the mandate can be appropriately evaluated although all mandates are subject to ongoing review against various financial and non-financial metrics in addition to their continued appropriateness within the investment strategy. For close-ended investments, the Trustees expect the term of the appointment to be the lifetime of the investment.

The Trustees monitor its managers performance against their respective benchmarks or targets on a quarterly basis over a long-term time horizon. Managers are expected to provide explanation for any significant deviations away from benchmark or target.

A summary of the Scheme's investment mandates and the respective benchmarks [and targets] is included in the Appendix .

### **3.7 Socially Responsible Investment and Corporate Governance**

#### *Sustainability and the evaluation of long-term risks*

The Trustees believe that financially material factors should take precedence over non-financial factors but recognise that Environmental, Social and Governance (ESG) factors, including climate change, can have a material impact on the returns achieved from investments.

The Trustees have framed their strategic asset allocation to deliver a return which is expected to be sufficient to meet their long-term objectives. The Trustees regularly review both the expectations for investment return from

their strategy and the level of uncertainty associated with this return. The expected risk/return profiles for different asset classes are based on appropriate economic and financial assumptions which apply at a broad market level and are considered to implicitly reflect all financially material factors. Given the inherent uncertainty, the Trustees have not made explicit allowance for the risks of climate change in setting their strategic benchmark. The Trustees believe this approach to be appropriate for determining the strategic allocation.

The Trustees recognise that market risk is not static and have decided that the allocation to Growth assets within the strategy should be actively managed. The Trustees believe that their investment managers have the ability to assess how long-term risks, including those which derive from ESG and climate change issues, could impact on the return from their investments. The Trustees also acknowledge that the price of an asset may serve to compensate for such risks and, providing such risks have been adequately evaluated by the manager, taking such risks may be acceptable.

The Trustees will evaluate an investment manager's approach to considering ESG factors within their investment process as part of their due diligence when appointing a new investment manager for the Scheme. Existing investment managers' capabilities will be monitored and managers will be questioned on these issues during periodic review meetings. The Trustees retain the power to terminate a manager's appointment if they do not believe that risks are being adequately managed.

#### *Non-financial considerations*

The Trustees do not currently have reason to believe that the membership as a whole have significant ethical concerns with regard to the Scheme's investments. The Trustees do not therefore reflect non-financial factors in their investment strategy. The investment choices made available for the investment of money purchase AVCs include an ethical investment fund.

#### *Stewardship of assets*

The Trustee recognises that stewardship encompasses the exercise of voting rights, engagement by and with investment managers and the monitoring of compliance with agreed policies.

The Trustees recognise that, as an asset owner, they have responsibility for framing their policy with regard to the exercise of rights attaching to investments. The Trustees also recognise that there are practical constraints which influence how such rights could be exercised.

The Trustees have chosen to invest primarily through pooled funds and accept that the managers' respective stewardship policies will apply to each of the funds in which they have invested. The Trustees will keep these policies under review as part of their ongoing engagement with the Scheme's managers.

Where appropriate, the Trustees will evaluate an investment manager's stewardship policy as part of their due diligence when appointing a new manager. The Trustees have delegated to Russell Investments responsibility for exercising the rights attaching to the Scheme's investments within the Russell mandate.

#### *Voting and engagement*

The Trustees have adopted a policy of delegating voting decisions on stocks to their investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. The managers are expected to exercise the voting rights attached to individual investments in accordance with their own house policy.

The Trustees will review the stewardship activity undertaken by their investment managers periodically and in particular the Trustees' request that the managers provide regular reports indicating the overall level of voting activity and detailing instances where they have not voted in line with their stated policy.

Where appropriate, the Trustees will engage with and may seek further information from their managers on how portfolios may be affected by a particular issue.

The Trustees do not engage directly but actively encourages its investment managers to engage with key stakeholders which may including corporate management, regulators and governance bodies, relating to their investments in order to consider the management of conflicts of interest and improve corporate behaviours, improve performance and mitigate financial risks. Where necessary, investment managers are expected to notify the Trustees of any issue on which it may be beneficial for the Trustees to undertake further engagement. The Trustees will review engagement activity undertaken by their investment managers as part of its broader monitoring activity.

Responsibility for investment decisions has been delegated to the investment managers which includes consideration of the capital structure of investments and the appropriateness of any investment made. Where managers are responsible for investing in new issuance, the Trustee expects the manager to engage with the issuer about the terms on which capital is issued and the potential impact on the rights of new and existing investors.

The Trustees separately consider any conflicts of interest arising in the management of the Scheme and its investments and has ensured that each manager has an appropriate conflicts of interest policy in place. Managers are required to disclose any potential or actual conflict of interest to the Trustee.

#### *Monitoring*

The Trustees monitor managers' general voting activity or with respect to particular companies if it is deemed necessary. Any issues of concern will (or through its Investment Consultant) be raised with their manager for further explanation.

Where appropriate, the Trustees meet with all their investment managers on a periodic basis and provide an agenda for discussion, including issues relating to fund performance and, where relevant, ESG issues. Managers are challenged both directly by the Trustees and by their Investment Consultant on the impact of any significant issues including ESG matters that may affect the prospects for return from the portfolio.

### **3.8 Performance objectives**

The Trustees have set each manager a performance objective relative to the defined benchmark of their respective mandates, which overall will align to deliver the broader Scheme investment strategy. The Trustees also monitor the performance of the Scheme's assets against the expected growth of the liabilities over the long term.

### **3.9 Expected return**

The Trustees have designed the total portfolio to produce an expected return over the long-term above the expected growth of the liabilities.

### **3.10 New investments**

Within the categories of investment permitted by the Trustees, the fund managers can purchase any new investments as long as they do not breach the provisions of the respective fund management agreement. The Investment Consultant will bring to the Trustees' attention any new category of investment which in their judgement has become suitable for the Scheme before investing in that category.

### **3.11 Realisation of investments**

The Investment Consultant will bring to the Trustees' attention any category of investment held by the Scheme which in their judgement has become unsuitable for the Scheme. The fund managers are not expected to bring to the Trustees' attention individual investments realised on purely investment grounds as part of the day-to-day management of the Scheme's assets.

The Trustees have delegated responsibility to Russell Investments to realise and invest assets in order to manage the Scheme's assets in line with the rebalancing ranges and instructions defined in the Appendix .

### **3.12 Portfolio Turnover**

The Trustees have an expectation of the level of turnover within each mandate which is determined at the inception of the mandate, based on the Trustees' knowledge of the manager, investment process and the nature of the portfolio. Whilst the Trustees expect performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustees expect managers to report on at least an annual basis on the underlying assets held within the portfolio and details of any transactions over the period.

The Trustees will challenge its managers if there is a sudden change in portfolio turnover or if the level of turnover seems excessive.

### **3.13 Custody**

The Trustees regard the safekeeping of the Scheme's assets as being of paramount importance. Northern Trust has been appointed to ensure safekeeping and efficient servicing of the Scheme's assets.

## **4. DIVERSIFICATION AND RISK CONTROLS**

The following measures have been implemented to reduce the risks associated with making investments.

### **4.1 Risks**

The Trustees will consider explicitly the risks inherent in both the assets and the liabilities, including (but not limited to) inflation and interest rate risk, equity and other capital market risks, currency risks, active management risks and ESG risks. The Trustees will consider how to manage each of these major categories of risk and will seek to strategically hedge those risks that have no expected reward, where it is cost-effective to do so.

### **4.2 Risk versus the liabilities**

In terms of magnitude, the Trustees consider that asset-liability mismatch risk is one of the most important measures to control. Therefore, following an actuarial valuation, the Trustees review and monitor the impact of asset allocation on expected future funding levels and the variability in outcomes using value at risk-based analysis. The Trustees also consider the Scheme's net exposures to interest rate and inflation risk.

### **4.3 Number and type of managers**

The process of risk management continues through to implementation. The decision whether to pursue active management is taken on an asset class by asset class basis, with regard to the potential reward within that asset class for taking on active risk.

The directly held gilts and pooled leverage gilt funds which are held within the Rebalancing Portfolio are managed on a passive basis while the corporate bonds are managed actively. The Discretionary and Notification Portfolios are managed on an active basis.



Furthermore, the Trustees recognise that no single manager can be best of class in all areas, and so they have decided to employ Russell Investments as a multi manager for the equity and enhanced yield mandates. As such, Russell outsources the day-to-day management of the Scheme's assets covered by their mandate to a broad range of high quality, external fund managers.

#### **4.4 Manager restrictions**

The Trustees' agreement with fund managers contain a series of restrictions on the way the portfolio is managed which may be amended from time to time. The purpose of the restrictions is to limit the risks from each individual investment and prevent unsuitable investment activity. The fund managers will comply with these restrictions. Frequent monitoring of portfolio characteristics such as excess returns and tracking error also aids in the ongoing risk management for the plan.

#### **4.5 Manager controls**

Powers of investment delegated to the fund managers must be exercised with a view to giving effect to the principles contained in this Statement so far as reasonably practicable. The fund managers will also ensure that suitable internal operating procedures are in place to control individuals making investments for the Scheme.

### **5. OTHER**

#### **5.1 Fees**

External fund manager fees are determined as a percentage of assets.

Hymans Robertson's investment consulting fees are based upon a retainer fee for all services.

From time to time the Scheme Actuary may be asked to give advice related to the investments to the Fund. These services are charged on a time-cost and materials basis.

#### **5.2 Professional advice**

The Trustees review from time to time the services provided by their advisers and other service providers as necessary to ensure that the services provided remain applicable to the Scheme and of satisfactory coverage and quality.

#### **5.3 Frequency of review**

In accordance with legislation (Occupational Pension Plan (Investment) Regulations 2005 (the "OPS IRegs 05"), the Trustees will review this Statement at least every three years, and without delay after any significant changes in investment policy.

The Trustees have a policy to review the content of this Statement annually or sooner if there is a significant change in policy on any of the areas covered by this Statement. The Trustees will consult with the Principal Employer and take written advice when revising this Statement.

#### **5.4 Performance measurement information**

The Trustees use the Investment Consultant to provide performance measurement and monitoring of the performance of the managers against the objective set on a regular basis.



**Signed on behalf of the Trustees**

**Signature** .....

**Name** .....

**Position** .....

**Effective Date** .....

• **1.1.1.APPENDIX – Investment Strategy Implementation**

The Scheme’s current managers are as follows:

Insight Investment has been appointed as the fund manager of the Rebalancing Portfolio. The Rebalancing Portfolio includes passively managed segregated UK gilts and gilt like securities, pooled leveraged gilt funds and actively managed corporate bonds (accessed via pooled funds). These assets are designed to match certain duration and inflation characteristics of the Scheme’s liabilities.

Russell Investments has been appointed as fund manager for the Discretionary Portfolio which invest across a diversified range of specialist external fund managers, selected by Russell. Their objective is to achieve a return (gross of fees) in excess of the composite benchmark, which will be used as a short-term performance measurement and attribution assessment tool. The long-term objective is to achieve a return greater than SONIA + 4% over the full investment cycle (5-7 years), with this period commencing on 1 February 2023.

Pantheon Ventures has been appointed to manage the Trustees’ private equity investments. Pantheon operates a number of pooled funds which invest across a diversified range of private equity funds, selected by Pantheon.

M&G have been appointed to manage a long-term lease property investment on behalf of the Trustees. M&G invest primarily in UK commercial real estate, with the objective to deliver a secure long-term income stream.

Pictet have been appointed to manage a dynamic asset allocation mandate on behalf of the Trustees to incorporate a greater element of dynamic or tactical asset allocation into the Scheme’s asset implementation framework. The investment is in the Pictet Dynamic Asset Allocation Fund.

Implementation of the overall investment strategy and the asset allocation of each Portfolio is shown in the tables below, along with agreed ranges for rebalancing which Russell monitors.

<b>ASSET CLASS</b>	<b>TOTAL SCHEME TARGET ALLOCATION</b>	<b>RUSSELL’S TARGET ALLOCATION</b>	<b>RUSSELL’S REBALANCING BOUNDS</b>
	<b>%</b>	<b>%</b>	<b>%</b>
<b>Discretionary Portfolio</b>	<b>26</b>	<b>43</b>	<b>See below</b>
<b>Rebalancing Portfolio</b>	<b>55</b>	<b>25</b>	
<b>Corporate credit (Insight Credit Sub-portfolio)</b>	15	25	22 - 28
<b>Gilts/Leveraged gilt funds (Insight Hedge Sub-portfolio)</b>	40	N/A	N/A
<b>Notification Portfolio</b>	<b>19</b>	<b>32</b>	
<b>Property secured income (M&amp;G)</b>	5	8	5 - 11
<b>Private equity (Pantheon)</b>	4	7	4 - 10
<b>Dynamic Asset Allocation (Pictet)</b>	10	17	14 - 20
<b>TOTAL</b>	<b>100</b>	<b>100</b>	

The Trustees have appointed Russell Investments to maintain the actual asset allocation of the Discretionary Portfolio and the Rebalancing Portfolio with the exception of the Insight Hedge Portfolio. As a result, the table above shows the separate target allocation which Russell monitors (i.e. excluding the Insight Hedge Sub-Portfolio) and the corresponding rebalancing bounds. The Insight Hedge Sub-Portfolio has been excluded from Russell’s rebalancing remit to avoid disrupting the Scheme hedging assets which aim to hedge 75%/60% of the Scheme’s interest rate/inflation sensitivity as measured on the latest Technical Provisions basis.

The Trustees set a target allocation of 40% for this Hedge Sub-portfolio, but due to market movements the actual allocation may differ from this amount.

The table below shows the specific target allocation and rebalancing ranges within the Discretionary Portfolio.

The asset allocation of the Notification Portfolio will be monitored by Russell Investments and periodically reported to the Trustees. Where any rebalancing action is required within the Notification Portfolio, the Trustees will liaise with their Investment Consultant. Due to the relative illiquidity of Private Equity and Long lease property, as well as the preferential fee rate offered by Pictet, these allocations are not rebalanced automatically.

**Discretionary Portfolio Allocation and Target Ranges**

ASSET CLASS	TARGET ALLOCATION %	BENCHMARKS (90% HEDGED TO GBP AT PORTFOLIO LEVEL)	TARGET RANGE %	CONSTRAINTS
Diversified Equities	65	MSCI ACWI (USD) – Net Returns <sup>1</sup>	45 - 85	Maximum 10% active position in any one of the following regions: North America, UK, Developed Europe ex UK, Japan, Asia Pacific ex Japan, Emerging Markets
Diversified Fixed Income	35	Fixed Income Composite Benchmark <sup>2</sup>	15 - 55	Maximum 20% of the total DAA portfolio Maximum 20% of the total DAA portfolio to EMD Hard and Local Currency combined Maximum 20% of the total DAA portfolio Maximum 20% of the total DAA portfolio
Government Bonds				
Corporate Bonds				
High Yield Bonds				
Emerging Market Debt (Hard)				
Emerging Market Debt (Local)				
Bank Loans				
Asset Backed Securities				
Real Assets	0			
Listed Real Estate				
Listed Infrastructure				
Commodities				
Cash	0	SONIA	0 - 20	
<b>TOTAL</b>	<b>100</b>	<b>Composite</b>		

<sup>1</sup> To achieve the required level of hedging at total portfolio level, the equity benchmark is approximated by 85% of the MSCI ACWI (USD) – Net Returns being hedged to GBP, with the remaining 15% held on an unhedged basis.

<sup>2</sup> Fixed Income Composite Benchmark comprises of 50% Bloomberg Global Aggregate GBP Hedged Index, 50% Bloomberg Global Aggregate Credit GBP Hedged Index.