

# **Volvo Penta UK Retirement Benefits Scheme (the "Scheme")**

## **Statement of Investment Principles – October 2021**

### **1. Introduction**

PSGS Trust Corporation Limited, the Trustee of the Volvo Penta UK Retirement Benefits Scheme (the "Scheme") has drawn up this Statement of Investment Principles (the "Statement") to comply with the requirements of the Pensions Act 1995 (the "Act") and associated legislation including the Occupational Pension Schemes (Investment) Regulations 2005 (as amended). The Statement is intended to affirm the investment principles that govern decisions about the Scheme's investments. The Trustee investment responsibilities are governed by the Scheme's Trust Deed and Rules, of which this Statement takes full regard.

In preparing this Statement, the Trustee has consulted a suitably qualified person by obtaining written advice from Mercer Limited ("Mercer"). In addition, consultation has been undertaken with Volvo Group UK Limited (the "Sponsor") to ascertain whether there are any material issues of which the Trustee should be aware in agreeing the Scheme's investment arrangements and, in particular on the Trustee's objectives.

The Scheme's investment arrangements, based on the principles set out in this Statement, are detailed in the Investment Policy Implementation Document ("IPID") which is available to Scheme members on request.

### **2. Scheme Governance**

The Trustee has appointed a firm of professional consultants (the "Investment Consultant") to provide relevant advice to the Trustee. The Trustee also takes advice as appropriate from the Scheme Actuary and other professional advisors.

The Trustee has decided to implement a delegated Cashflow Driven Financing ("CDF") strategy, whereby the Scheme invests in such a way that expected cashflows should broadly match a proportion of the Scheme's expected liability cash-flow profile, whilst still targeting a return in excess of gilts (noting that the intention is to match as high a proportion as possible, subject to the level of expected return required).

Particularly, the Trustee has appointed Mercer to act as discretionary investment manager to implement the Trustee's strategy. In this capacity, and subject to agreed restrictions, the Scheme's assets are invested in multi-client collective investment schemes ("Mercer Funds") managed by a management company (Mercer Global Investments Management Limited ("MGIM")). MGIM has appointed Mercer Global Investments Europe Limited ("MGIE") as investment manager of the Mercer Funds. In practice, MGIE delegates the discretionary investment management for the Mercer Funds to third party investment managers based in countries such as Ireland, UK and USA and those sub-investment managers will manage either a sub-fund or certain segments of a sub-fund. Mercer has expertise in identifying, selecting and combining highly rated fund managers who are best placed and resourced to manage the Scheme's assets on a day to day basis.

Under this framework, the Trustee retains control of the most important strategic decisions, whilst many of the day-to-day actions are delegated to Mercer.

In considering appropriate investments for the Scheme, the Trustee has obtained and considered the written advice of Mercer, whom the Trustee believes to be suitably qualified to provide such advice. The advice received and arrangements implemented are, in the

Trustee's opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended).

### **3. Investment Objectives**

The Trustee's primary investment objective is to invest the Scheme's assets in such a manner as to ensure that members' benefit entitlements can be paid as and when they fall due.

Within this context, the Trustee's main objectives with regard to investment policy are:

- to ensure that the long term return expectations for the investment strategy are consistent with the funding strategy;
- to ensure that sufficient liquid assets are available to meet benefit payments as they fall due; and
- to consider the interests of the Company in relation to the size and volatility of the Company's contribution requirements.

### **4. Risk Management and Measurement**

There are various risks to which any pension scheme is exposed. The Trustee's policy on risk management over the Scheme's anticipated lifetime is as follows:

- The primary risk upon which the Trustee focusses is that arising through a mismatch between the Scheme's assets and its liabilities and the Sponsor's ability to support this mismatch risk.
- The Trustee recognises that whilst increasing risk increases potential returns over a long period, it also increases the risk of a shortfall in returns relative to that required to cover the Scheme's liabilities as well as producing more volatility in the Scheme's funding position.
- To control the risk outlined above, the Trustee, having taking advice, sets the initial asset allocation so that the expected return on the overall portfolio is expected to be sufficient to meet the objectives outlined in section 3.
- The Trustee recognises that even if the Scheme's assets are invested in matching assets there may still be a mismatch between the interest rate and inflation sensitivity of the Scheme's assets and the Scheme's liabilities due to the mismatch in duration between matching assets and actuarial liabilities.
- The Trustee recognises the risks that may arise from the lack of diversification of investments. To control this risk the Trustee has agreed upon a suitably diversified asset allocation policy. Mercer aims to ensure the asset allocation policy in place results in an adequately diversified portfolio. Investment exposure is obtained via pooled vehicles.
- To help the Trustee ensure the continuing suitability of the current investments, Mercer provides the Trustee with regular reports regarding the performance of the underlying asset managers appointed within the relevant Mercer Funds to enable the monitoring of differences between the expected and experienced levels of risk and return.
- There is a risk that the day-to-day management of the assets will not achieve the rate of investment return expected by the Trustee. The Trustee recognises that the use of active investment managers involves such a risk. However, for specific asset classes it believes that this risk is outweighed by the potential gains from successful active

management. Likewise, passive management will be used for one of a number of reasons, namely to diversify and reduce risk and when investing in certain asset classes where, due to relatively efficient markets, the scope for achieving added value is more limited.

- To help diversify manager-specific risk, the Trustee expects that the Scheme's assets are managed by appropriate underlying asset managers.
- By investing in the Mercer Funds, the Trustee does not make investments in securities that are not traded on regulated markets. However, should the Trustee Scheme's assets be invested in such securities, in recognition of the associated risks (in particular liquidity and counterparty exposure), such investments would normally only be made with the purpose of reducing the Scheme's mismatch risk relative to its liabilities or to facilitate efficient portfolio management. In any event, the Trustee would ensure that the assets of the Scheme are predominantly invested on regulated markets.
- The Trustee recognises the risks inherent in holding illiquid assets. The Trustee has carefully considered the Scheme's liquidity requirements and time horizon when setting the investment strategy and liquidity risk is managed by ensuring illiquid asset classes represent an appropriate proportion of the overall investment strategy.
- The Scheme is subject to currency risk because some of the investment vehicles in which the Scheme invests are denominated or priced in a foreign currency. Within the context of the Mercer Funds used by the Scheme's Portfolios, to limit currency risk, a target non-sterling currency exposure is set and the level of non sterling exposure is managed using currency hedging derivatives such as forwards and swaps.
- The Trustee recognises that environmental, social and corporate governance concerns, including climate change, have a financially material impact on return. Section 9 sets out how these risks are managed.
- Responsibility for the safe custody of the Scheme's assets is delegated to Mercer who has appointed State Street Custodial Services (Ireland) Limited ("State Street") as custodian of the assets invested in their vehicles. Mercer is responsible for keeping the suitability of State Street under ongoing review.

Should there be a material change in the Scheme's circumstances, the Trustee will advise Mercer, who will review whether and to what extent the investment arrangements should be altered; in particular whether the current strategy remains appropriate.

## **5. Investment Strategy**

The Trustee, with advice from the Scheme's Investment Consultant and Scheme Actuary, reviewed the Scheme's investment strategy in 2020. As part of the discussions around the Scheme's 2019 Actuarial Valuation, the Trustee engaged with Mercer to design and implement a "Growth plus CDF" strategy.

The "Growth plus CDF" framework featured a long-term investment portfolio that sought to deliver investment returns such that the Scheme's funding position improved and the funding deficit was eliminated on the Technical Provisions ("TP") basis. Furthermore, the strategy was designed to target a funding position in excess of 100% on the TP liabilities basis.

Upon reaching a suitably funded position, the Trustee further reviewed the investment strategy and determined that it was affordable to adopt a CDF strategy.

The CDF strategy aims to:

- Match a high proportion of the Scheme's expected liability cashflows over the next c.10 years by investing in predominantly income-generating asset classes such that expected asset cashflows should broadly match the Scheme's expected liability cashflow profile.
- Support an initial discount rate of gilts+0.75% p.a.

With this in mind, the Trustee has agreed that the Scheme's investment portfolio should be constructed so that it provides a broad liability hedge through a range of diversified investments managed by Mercer rather than accumulate exposure in any single part of the interest rate or inflation curve (i.e. to avoid "curve" risk). The Trustee has delegated the responsibility for constructing, managing and monitoring the Scheme's liability hedging arrangements and further information on target hedge ratios for interest rate and inflation hedging is included in the IPID.

The result is expected to be better cashflow management, lower expected transaction costs over the lifecycle of the Scheme, a more stable long-term funding position, and an investment strategy which helps facilitate a smoother path to the Trustee's endgame objective.

## **6. Expected Return**

The Trustee has adopted a long-term investment strategy to meet their primary objective of achieving an investment return that is consistent with the discount rate used to value the liabilities.

## **7. Realisation of Investments**

The Trustee on behalf of the Scheme holds shares in the Mercer Funds. In its capacity as investment manager to the Mercer Funds, MGIE, and the underlying third party asset managers appointed by MGIE, within parameters stipulated in the relevant appointment documentation, have discretion in the timing of the realisation of investments and in considerations relating to the liquidity of those investments.

## **8. Cash flow and cash flow management**

Mercer has delegated responsibility to select investments and/or disinvestments to maintain the dual objectives of maintaining the liability hedging and expected return capabilities of the strategy.

## **9. ESG, Stewardship, and Climate Change**

The Trustee believes that environmental, social, and corporate governance ("ESG") factors may have a material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration.

As noted above, the Trustee has appointed Mercer to act as discretionary investment manager in respect of the Scheme's assets and such assets are invested in a range of Mercer Funds managed by MGIE. Asset managers appointed to manage the Mercer Funds are expected to evaluate ESG factors, including climate change considerations, and exercise voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code.

The Trustee considers how ESG, climate change and stewardship is integrated within Mercer's, and MGIE's, investment processes and those of the underlying managers in the monitoring process. Mercer, and MGIE, is expected to provide reporting on a regular basis, at least annually, on ESG integration progress, stewardship monitoring results, and climate-related metrics such as carbon foot printing for equities and/or climate scenario analysis for diversified portfolios.

### **Member views**

Member views are not taken into account in the selection, retention and realisation of investments given the difficulty in determining members' views and applying these to the Scheme's investment strategy. However, this position may be reviewed over time.

### **Investment Restrictions**

The Trustee has not set any investment restrictions in relation to particular Mercer Funds.

## **10. Trustee's Policies with Respect to Arrangements with, and Evaluation of the Performance and Remuneration of, Asset Managers and Portfolio Turnover Costs**

When engaging Mercer as discretionary investment manager to implement the Trustee's investment strategy outlined in section 5, the Trustee is concerned that, as appropriate and to the extent applicable, Mercer is incentivised to align its strategy and decisions with the profile and duration of the liabilities of the Scheme, in particular, long-term liabilities.

As Mercer manages the Scheme's assets by way of investment in Mercer Funds, which are multi-client collective investment schemes, the Trustee accepts that it does not have the ability to determine the risk profile and return targets of specific Mercer Funds but the Trustee expects Mercer to manage the assets in a manner that is consistent with the Trustee's overall investment strategy as outlined in section 5. The Trustee has taken steps to satisfy itself that Mercer has the appropriate knowledge and experience to do so and keeps Mercer's performance under ongoing review.

Should Mercer fail to align its investment strategies and decisions with the Trustee's policies, it is open to the Trustee to disinvest some or all of the assets invested managed by Mercer, to seek to renegotiate commercial terms or to terminate Mercer's appointment.

To evaluate performance, the Trustee receives, and considers, investment performance reports produced on a quarterly basis, which presents performance information and commentary in respect of the Scheme's funding level and the Mercer Funds in which the Trustee is invested. Such reports have information covering fund performance for the previous three months, one-year, three years and since inception. The Trustee reviews the absolute performance and relative performance against a portfolio's and underlying investment manager's benchmark (over the relevant time period) on a net of fees basis. The Trustee's focus is on the medium to long-term financial and non-financial performance of Mercer and the Mercer Funds.

Neither Mercer or MGIE make investment decisions based on their assessment about the performance of an issuer of debt or equity. Instead, assessments of the medium to long-term financial and non-financial performance of an issuer are made by the underlying third party asset managers appointed by MGIE to manage assets within the Mercer Funds. Those managers are in a position to engage directly with such issuers in order to improve their performance in the medium to long term. The Trustee is, however, able to consider Mercer's and MGIE's assessment of how each underlying third party asset manager embeds ESG into their investment process and how the manager's responsible investment philosophy aligns

with the Trustee's own responsible investment policy. This includes the asset managers' policies on voting and engagement.

Section 9 provides further details of the steps taken, and information available, to review the decisions made by managers, including voting history and the engagement activities of managers to identify decisions that appear out of line with a Mercer Fund's investment objectives or the objectives/policies of the Scheme.

The asset managers are incentivised as they will be aware that their continued appointment by MGIE will be based on their success in meeting MGIE's expectations. If MGIE is dissatisfied then it will, where appropriate, seek to replace the manager.

The Trustee is a long-term investor and is not looking to change its investment arrangements on an unduly frequent basis. However, the Trustee does keep those arrangements under review, including the continued engagement of Mercer using, among other things, the reporting described above.

The Trustee monitors, and evaluates, the fees it pays for asset management services on an ongoing basis taking into account the progress made in achieving its investment strategy objectives as outlined in section 5. Mercer's, and MGIE's, fees are based on a percentage of the value of the Scheme's assets under management which covers the design and annual review of the investment strategy, and investment management of the assets. In addition, the underlying third party asset managers of the Mercer Funds also charge fees based on a percentage of the value of the assets under management. In some instances, some of the underlying managers may also be entitled to charge fees based on their performance.

MGIE reviews the fees payable to third party asset managers managing assets invested in the Mercer Funds on a regular basis with any negotiated fee savings passed directly to the Scheme. Mercer's, MGIE's, and the third party asset managers', fees are outlined in a quarterly investment strategy report prepared for the Trustee, excluding performance-related fees and other expenses involved in the Mercer Funds not directly related with the management fee.

Details of all costs and expenses are included in the Mercer Funds' Supplements, the Report & Accounts and within the Scheme's annualized, MiFID II compliant Personalised Cost & Charges statement. The Scheme's Personalised Cost & Charges statement also include details of the transaction costs associated with investment in the Mercer Funds.

The Trustee does not have an explicit targeted portfolio turnover range but rebalancing ranges have been designed to avoid unnecessary transaction costs being incurred by unduly frequent rebalancing. Performance is reviewed net of portfolio turnover costs, with the review of portfolio turnover of the underlying investment managers undertaken by MGIE.

## **11. Additional Voluntary Contributions ("AVCs")**

Under the terms of the Trust Deed the Trustee is responsible for the investment of AVCs paid by members. The Trustee reviews the investment performance of the chosen providers on a regular basis and takes advice as to the providers' continued suitability.

## **12. Employer Related Investments**

The Trustee's policy is not to hold any employer-related investments as defined in the Pensions Act 1995 and the Occupational Pension Scheme (Investment) Regulations 2005, except where the Scheme invests in pooled vehicles that may hold employer-related investments, in which case the total exposure to employer-related investments will not exceed 5% of the Scheme's value.

### **13. Review of this Statement**

The Trustee will review this Statement at least once every three years and without delay after any significant change in investment policy. Any change to this Statement will only be made after having obtained and considered the written advice of someone who the Trustee reasonably believes to be qualified by their ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of pension scheme investments.

Date 1 November 2021

**For and on behalf of PSGS Trust Corporation Limited as Trustee of the  
Volvo Penta UK Retirement Benefits Scheme**