# Shanks Group Pension Scheme

# Statement of Investment Principles

This document is the Statement of Investment Principles ("SIP") for the Shanks Group Pension Scheme required under the Pensions Act 2005. This SIP is produced to meet the requirements of the Pensions Acts 1995 and 2004, the Occupational Pension Funds (Investment) Regulations 2005 and to reflect the Government's Voluntary Code of Conduct for Institutional Investment in the UK.

This SIP has been adopted by the Trustees of the Shanks Group Pension Scheme ("the Scheme") to meet the requirements of the relevant legislation. The Trustee also complies with the requirements to maintain and take advice on the SIP and with the disclosure requirements.

This Statement of Investment Principles sets out to address specific aspects of the Scheme, in particular;

- Governance
- Investment Objectives
- Risk Measurement and Management
- Investment Implementation
- Responsible Investment.

**September 2020**

# GOVERNANCE

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

| **Trustees** |
|---|
| • Set structures and process for carrying out their role.<br>• Select and monitor planned asset allocation strategy.<br>• Select direct investments (see below).<br>• Select investment advisers and fund managers<br>• Decide on investment structures and their implementation.<br>• Monitor investment advisers and fund managers.<br>• Select structure for implementing investment strategy.<br>• Monitor direct investments.<br>• Make ongoing decisions relevant to the operational principles of the Scheme's investment strategy. |
| **Investment Adviser** |
| • Advise on all aspects of the investment of the Scheme's assets, including implementation.<br>• Advise on this statement.<br>• Available to provide investment training as required. |
| **Fiduciary Managers** |
| • Operate within the terms of their written contracts, which are consistent with the terms of this statement.<br>• Select individual asset classes and best in class investment managers with regard to their suitability and diversification.<br>• Manage the Scheme's investments with regard to the liabilities.<br>• Monitor funding position versus flightplan and implement as necessary.<br>• Monitor underlying fund manager performance and select and deselect as appropriate. |
| **Fund Managers** |
| • Operate within the terms of their written contracts, which are consistent with the terms of this statement.<br>• Select individual investments with regard to their suitability and diversification. |

The Pensions Act 1995 distinguishes between investments where the management is delegated to a fund manager with a written contract and those where a product is purchased without a contract, eg the purchase of an insurance policy or units in a pooled vehicle. The latter are known as **direct investments**, and include:

- The contracts with Equitable Life (closed to new contributions), Standard Life and Royal London (closed to new contributions) which are used for members additional voluntary contributions (AVCs).

The Trustees' policy is to review their direct investments and to obtain written advice about them at regular intervals (normally annually).

When deciding whether or not to make any new direct investments the Trustees will obtain written advice and consider whether future decisions about those investments should be delegated to the fund manager(s).

The written advice will consider the issues set out in the Occupational Pension Schemes (Investment) Regulations 2005 and the principles contained in this statement. The regulations require all investments to be considered by the Trustees (or, to the extent delegated, by the fund managers) against the following criteria:

- The best interests of the members and beneficiaries;
- Security;
- Quality;
- Liquidity;
- Profitability;
- Nature and duration of liabilities;
- Tradability on regulated markets;
- Diversification; and
- Use of derivatives.

The Trustees' investment adviser, Aon Solutions UK Limited, has the knowledge and experience required under the Pensions Act 1995.

The Trustees expect the fund and fiduciary managers to manage the assets delegated to them under the terms of their respective contracts and to give effect to the principles in this statement so far as is reasonably practicable.

The Trustees have delegated all day-to-day decisions about the investments that fall within each mandate to the relevant fund manager. When choosing investments, the Trustees and the fund managers (to the extent delegated) are required to have regard to the criteria for investment set out in the Occupational Pension Schemes (Investment) Regulations 2005 (regulation 4). The managers’ duties also include:

- Taking into account social, environmental or ethical considerations in the selection, retention and realisation of investments;
- Voting and corporate governance in relation to the Scheme's assets.

The Trustees will review this SIP at least every three years and immediately following any significant change in investment policy. The Trustees will take investment advice and consult with the Sponsoring Employer over any changes to the SIP.

# INVESTMENT ADVISER

Aon Solutions UK Limited has been selected as investment adviser to the Trustees. They operate under an agreement to provide a full service designed to ensure that the Scheme Trustees are fully briefed both to take the decisions they take themselves and to monitor those they delegate. They are paid for advice received on the basis of an agreed annual basis points fee linked to the value of the Scheme's assets, which covers all services needed on a regular basis, including quarterly monitoring of the performance of the Scheme's investments and its managers as well as attendance at Trustee meetings. For significant areas of advice that are agreed to be outside of the contract, the investment advisors will be paid according to the amount of time that is needed to advise the Trustees, although fixed fees may be negotiated for certain projects. This structure has been chosen to ensure that cost-effective, independent advice is received.

## Investment Objective

The Trustees aim to invest the assets of the Scheme prudently to ensure that the benefits promised to members are provided. In setting investment strategy, the Trustees considered a range of investment strategies. The asset allocation strategy they have selected is designed to achieve a higher return than the lowest risk strategy while maintaining a prudent approach to meeting the Scheme's liabilities.

The Trustees recognise that the key source of financial risk (in relation to meeting their objectives) arises from asset allocation.

They therefore retain overall responsibility for setting asset allocation, and take expert advice as required from their professional advisers. Additionally, the Trustees have appointed Aon Investments Limited ("AIL") Delegated Consulting Service ("DCS") to manage the majority of the Scheme's assets. Within both the Growth Component and Liability Hedging Component of DCS, the Trustees have delegated responsibility to set the asset allocation to AIL. This has been done to further aid the diversification of the Scheme's assets and to reduce the investment risk relative to the Scheme's liabilities. Further, AIL have been instructed to monitor the funding level of the Scheme against pre-determined triggers, designed to switch assets from the Growth Component to the Liability Hedging Component and manage the Scheme's investment risks (see Implementation).

The Trustees review their investment strategy following each formal actuarial valuation of the Scheme (or more frequently should the circumstances of the Scheme change in a material way). The Trustees take written advice from their professional advisers regarding an appropriate investment strategy for the Scheme.

The asset allocation set out in the Implementation section of this document was determined after considering written advice from the Scheme's advisers.

The Trustees' investment advisers modelled the Scheme's assets and liabilities for a range of alternative asset allocation strategies. A variety of different investment scenarios were modelled with the assumption that return-seeking assets would outperform bonds over a long time period, and that active fund management can be expected to add value. However, the Trustees recognise the potential volatility in return-seeking asset returns, particularly relative to the Scheme's liabilities, and the risk that the fund and fiduciary managers do not achieve the targets set. Certain alternative investments have characteristics that cannot be modelled. Therefore decisions about their inclusion will be addressed, if necessary, using qualitative judgements. The written advice received addressed the following:

- The need to consider a full range of asset classes.
- The risks and rewards of a range of alternative asset allocation strategies.
- The suitability of each asset class.
- The need for appropriate diversification.

# RISK MEASUREMENT AND MANAGEMENT

The Trustees recognise that the key risk to the Scheme is that it has insufficient assets to make provisions for 100% of its liabilities ("funding risk"). The Trustees have identified a number of risks which have the potential to cause a deterioration in the Scheme's funding level and therefore contribute to funding risk. These are as follows:

- The risk of a significant difference in the sensitivity of asset and liability values to changes in financial and demographic factors ("mismatching risk"). The Trustees and its advisers considered this mismatching risk when setting the investment strategy.
- The risk of a shortfall of liquid assets relative to the Scheme's immediate liabilities ("cash flow risk"). The Trustees and its advisers will manage the Scheme's cash flows taking into account the timing of future payments in order to minimise the probability that this occurs.
- The failure by the fund managers to achieve the rate of investment return assumed by the Trustees ("manager risk"). This includes not taking financially material risks, such as environmental (including climate change), social and governance considerations into account during the investment process. This risk is considered by the Trustees and its advisers both upon the initial appointment of the fund managers and on an ongoing basis thereafter.
- The failure to spread investment risk ("risk of lack of diversification"). The Trustees and its advisers considered this risk when setting the Scheme's investment strategy and have also mandated to each of the fund managers employed that a suitably diversified portfolio of assets should be maintained at all times.
- The possibility of failure of the Scheme's sponsoring employer[s] ("covenant risk"). The Trustees and its advisers considered this risk when setting investment strategy and consulted with the sponsoring employer as to the suitability of the proposed strategy.
- The risk of fraud, poor advice or acts of negligence ("operational risk"). The Trustees have sought to minimise such risk by ensuring that all advisers and third party service providers are suitably qualified and experienced and that suitable liability and compensation clauses are included in all contracts for professional services received.

Due to the complex and interrelated nature of these risks, the Trustees consider the majority of these risks in a qualitative rather than quantitative manner as part of each formal investment strategy review (normally triennially). Some of these risks may also be modelled explicitly during the course of such reviews.

Having set an investment objective which relates directly to the Scheme's liabilities and implemented it through AIL, the Trustees' policy is to monitor, where possible, these risks quarterly. The Trustees receive quarterly reports showing:

- Performance versus the Scheme investment objective.
- Performance of AIL versus its respective target.
- Any significant issues with AIL that may impact its ability to meet the performance targets set by the Trustees.

The Trustees have appointed Aon Solutions UK Limited to alert them on any matters of material significance that might affect the ability of AIL to achieve its objectives. The Trustees have appointed AIL to monitor the funding level of the Scheme on a daily basis against pre-defined triggers, designed to switch assets from the Growth Component to the Liability Hedging Component, thereby de-risking the asset allocation and increasing the liability hedge, as and when it becomes affordable to do so. These triggers are re-assessed on a regular basis.

# IMPLEMENTATION

Trustees have appointed AIL's DCS to manage the Scheme's assets. Within both the Growth Component and Liability Hedging Component of DCS, the Trustees have delegated responsibility to set the asset allocation to AIL. Further, AIL have been instructed to monitor the funding level of the Scheme against pre-determined triggers, designed to switch assets from the Growth Component to the Liability Hedging Component and manage the Scheme's investment risks.

The asset allocation between the Growth and Liability Hedging Components will be adjusted over time to take account of improvements in the Scheme's funding position and to reduce investment risk when it is affordable to do so; both by switching from growth to matching assets, and through increasing the liability hedge. The current funding level triggers can be found in Appendix II. The Trustees will review and update these on a regular basis.

If the funding level falls sufficiently, the Trustees may also consider, in consultation with the sponsor, increasing risk in the Scheme to target higher returns. This may involve switching holdings from the Liability Hedging Component to the Growth Component.

The DCS Growth Component invests in a range of asset classes and investment funds, with the target of achieving asset growth in excess of the growth of the Scheme's liabilities over the long term.

The DCS Liability Hedging aims to match a percentage of the Scheme's fixed interest and inflation linked liabilities through the use of bonds, interest rate swaps, and / or inflation swaps.

# ARRANGEMENTS WITH ASSET MANAGERS

In setting the Scheme's investment strategy, the Trustees' 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 Trustees have appointed AIL as their fiduciary manager, who they consider to be their asset manager. References in this policy to 'underlying asset managers' refers to those asset managers which AIL in turn appoints to manage investment on behalf of the Trustees.

The Trustees recognise that the arrangements with AIL, and correspondingly the underlying asset managers, are important to ensure that interests are aligned. In particular, the Trustees seek to ensure that AIL is incentivised to operate in a manner that generates the best long-term results for the Scheme and its beneficiaries.

The Trustees receive regular reports and verbal updates from AIL on various items including the investment strategy, performance, and longer-term positioning of the portfolio. The Trustees focus on longer-term performance when considering the ongoing suitability of the investment strategy in relation to the Scheme objectives, and assess AIL over 3-year periods.

The Trustees also receive annual stewardship reports on the monitoring and engagement activities carried out by AIL, which supports the Trustees in determining the extent to which the Scheme's engagement policy has been followed throughout the year.

The Trustees share the policies, as set out in this SIP, with AIL and request that they review and confirm whether its approach is in alignment with the Trustees' policies.

The Trustees delegate the ongoing monitoring of underlying asset managers to AIL. AIL monitors the Scheme's investments to consider the extent to which the investment strategy and decisions of the underlying asset managers are aligned with the investment objectives of the Scheme.

This includes monitoring the extent to which the underlying asset managers:

- make decisions based on assessments about medium- to long-term financial and non-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.

Before appointment of a new fiduciary manager, the Trustees review the governing documentation associated with the investment and will consider the extent to which it aligns with the Trustees' policies. Where possible, the Trustees will seek to amend that documentation or express their expectations (such as through side letters, in writing, or verbally at trustee meetings) so that there is more alignment.

The Trustees believe that having appropriate governing documentation, setting clear expectations to AIL, and regular monitoring of AIL's performance and investment strategy, is sufficient to incentivise AIL to make decisions that align with the Trustees' policies and are based on assessments of medium- and long-term financial and non-financial performance.

Where AIL is considered to make decisions that are not in line with the Trustees' policies, expectations, or the other considerations set out above, the Trustees will typically engage with AIL to understand the circumstances and materiality of the decisions made.

There is typically no set duration for arrangements with AIL, although the continued appointment will be reviewed periodically. Similarly, there are no set durations for arrangements with the underlying asset managers that AIL invests in, although this is regularly reviewed as part of the manager research and portfolio management processes in place.

The Trustees do not regularly monitor asset managers against non-financial criteria of the investments made on their behalf.

**Environmental, Social, and Governance ("ESG") considerations**

The Trustees consider investment risk to include ESG factors and climate change. These risks could negatively impact the Scheme's investments. The Trustees consider these risks by taking advice from its investment adviser.

As part of AIL's management of the Scheme's assets, the Trustees expect AIL to:

- Where relevant, assess the integration of ESG factors in the investment process of underlying managers;

- Use its influence to engage with underlying managers to ensure the Scheme's assets are not exposed to undue risk; and

- Report to the Trustees on its ESG activities as required.

**Stewardship – Voting and Engagement**

The Trustees recognise the importance of their role as a steward of capital and the need to ensure the highest standards of governance and promotion of corporate responsibility in the underlying companies and assets in which the Scheme invests, as ultimately this creates long-term financial value for the Scheme and its beneficiaries.

The Trustees annually review the stewardship activity of AIL to ensure the Scheme's stewardship policy is being appropriately implemented in practice. The Trustees receive annual reports on stewardship activity carried out by their fiduciary manager, these reports include detailed voting and engagement information from underlying asset managers.

As part of AIL's management of the Scheme’s assets, the Trustees expects the manager to:

- Ensure that (where appropriate) underlying asset managers exercise the Trustees’ voting rights in relation to the Scheme’s assets; and

- Report to the Trustees on stewardship activity by underlying asset managers as required.

The Trustees will engage with their fiduciary manager as necessary for more information, to ensure that robust active ownership behaviours, reflective of their active ownership policies, are being actioned. This will take the form of annual reporting which will be made available to Scheme members on request.

Where possible, the transparency for voting should include voting actions and rationale with relevance to the Scheme, in particular where: votes were cast against management; votes against management generally were significant; votes were abstained.

Where voting is concerned we would expect our underlying asset managers, to recall stock lending, as necessary, in order to carry out voting actions.

The Trustees may engage with their fiduciary manager, who in turn is able to engage with underlying asset managers, investee company or other stakeholders, on matters including the performance, strategy, risks, social and environmental impact, corporate governance, capital structure, and management of actual or potential conflicts of interest, of the underlying investments made. Where a significant concern is identified, the Trustees will consider, on a case by case basis, a range of methods by which they would monitor and engage so as to bring about the best long-term outcomes for the Scheme.

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

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

**Cost Monitoring**

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

The Trustees receive annual cost transparency reports from AIL. These reports present information in line with prevailing regulatory requirements for AIL. They clearly set out on an itemised basis:

- The total amount of investment costs incurred by the Scheme;

- The fees paid to the AIL;
- The fees paid to the underlying asset managers appointed by AIL;
- The amount of portfolio turnover costs (transaction costs) incurred by the underlying asset managers appointed by AIL;
    - The Trustees define portfolio turnover costs as the costs incurred in buying and selling underlying securities held within the funds of the underlying asset managers appointed by AIL;
- Any charges incurred through the use of pooled funds (custody, administration, and audit fees)
- The impact of costs on the investment return achieved by the Scheme.

The Trustees acknowledge that portfolio turnover costs are a necessary cost to generate investment returns and that the level of these costs varies across asset classes and manager. AIL monitors the level of portfolio turnover (defined broadly as the amount of purchases plus sales) of all the underlying asset managers appointed on behalf of the Trustees.

The Trustees benefit from the economies of scale provided by AIL in two key cost areas:

- The ability of AIL to negotiate reduced annual management charges with the appointed underlying asset managers;
- The ability of AIL to monitor ongoing investment costs (including additional fund expenses and portfolio turnover) incurred by the underlying asset managers and achieve efficiencies where possible;

**Evaluation of performance and remuneration:**

The Trustees assess the (net of all costs) performance of AIL on a rolling three-year basis against the Scheme's specific liability benchmark and investment objective. The remuneration paid to AIL and fees incurred by third parties appointed by AIL are provided annually by AIL to the Trustees. This cost information is set out alongside the performance of AIL to provide context. The Trustees monitor these costs and performance trends over time.

# Appendix I

This SIP was formally adopted by the Trustees on 10 September 2020 and has been signed in acknowledgement by the Chair of the Trustees.

Signatory

Chair of the Trustees

10 September 2020
Date

**The following table records changes to this document:**

| Version | Document Name | Nature of Change | Date |
|---|---|---|---|
| 2005 V1 | S:\CLIENT\SHANKS&M\151 SIP March 05.doc | Initial creation | Mar 2005 |
| 2006 V1 | S:\CLIENT\SHANKS&M\165 Shanks SIP March 2006.doc | Addition of policy on risk | Mar 2006 |
| 2007 V1 | S:\CLIENT\SHANKS&M\192 Shanks SIP Sept 2007.doc | Update to reflect move to Standard Life | Sep 2007 |
| 2007 V2 | S:\CLIENT\SHANKS&M\194 Shanks SIP Nov 2007.doc | Changes to investment strategy benchmark | Jul 2008 |
| 2008 V1 | S:\CLIENT\SHANKS&M\224 Shanks SIP December 2008.doc | Miscellaneous changes by Trustees | Dec 2008 |
| 2010 V1 | O:\CLIENTS\SHANKS&M\252 Shanks SIP 8 September 2010.doc | Changes to SL cash fund, Newton mandate and LGIM mandate | 8 September 2010 |
| 2012 V1 | S:\Clients\Shanks&M\325 Shanks FINAL SIP August 2012.doc | Flightpath, Newton RRF | August 2012 |
| 2012 V2 | S:\Clients\Shanks&M\349 Shanks Final SIP Feb 2013.doc | Aberdeen appointment, change to L&G and Newton mandates | February 2013 |
| 2015 V1 | O:\CLIENTS\SHANKS&M\SIPs\Shanks DRAFT SIP June 2015.doc | Appointment of AIL for DB Pension Scheme assets | June 2015 |
| 2015 V2 | O:\CLIENTS\SHANKS&M\SIPs\Shanks DRAFT SIP September 2015.doc | Revised DC section | September 2015 |
| 2017 V1 | O:\CLIENTS\SHANKS&M\SIPs\2017 update\Shanks DRAFT SIP June 17.doc | Update to reflect strategy changes | 7 June 2017 |
| 2019 V1 | O:\CLIENTS\SHANKS&M\SIPs\2019 Update - ESG\Shanks SIP September 2019 - Tracked Changes.doc | Update to meet new regulatory requirements regarding material non-financial matters, and to update for flight path changes | September 2019 |
| 2020 V1 | O:\CLIENTS\SHANKS&M\SIPs\2020 Update\Shanks SIP June 2020 - Tracked Changes.doc | Update to meet new regulatory requirements regarding arrangements with investment managers, cost monitoring and stewardship. Update name of Aon legal entities. Removed DC section. | September 2020 |

# Appendix II: Funding Level Triggers

The funding level triggers, for the Defined Benefit Section, as approved by the Trustees in March 2019, are shown below.

| Funding Level (Gilts + 0.5% basis) | | Initial Allocation (as at 31 March 2017 ) | 85% | 90% | 95% | 100% | 110% | 120% |
|---|---|---|---|---|---|---|---|---|
| Liability Hedge | Interest Rates | 80% | 100%* | 100%* | 100%* | 100%* | 100%* | 100%* |
| | Inflation | 80% | 100%* | 100%* | 100%* | 100%* | 100%* | 100%* |
| Asset Allocation | Target Growth Component | 65% | 58% | 50% | 43% | 35% | 30% | 25% |
| | Target Liability Hedging Component | 35% | 42% | 50% | 57% | 65% | 70% | 75% |
| Investment objective | Target return in excess of liability benchmark | 2.6% | 2.3% | 2.0% | 1.7% | 1.4% | 1.2% | 1.0% |

*Note: *hedging is capped at 100% of the liabilities, where the assets are greater than the liabilities*