

Heart of England Co-operative Society Pension Scheme

Statement of Investment Principles

September 2020

Statement of Investment Principles

The Trustees of the Heart of England Co-operative Society Pension Scheme (“the Scheme”) have prepared this Statement of Investment Principles (“the SIP”) in accordance with the Pensions Act 1995¹ (“the Act”) as amended and the Occupational Pension Scheme (Investment) Regulations 2005 as well as the principles recommended by the Myners Code.

It supersedes any previous SIP and reflects the investment policy agreed by the Trustees in respect of assets covering Defined Benefit liabilities.

This SIP will be reviewed at least every three years or immediately after any significant change in investment policy.

Before preparing this SIP the Trustees have:

- Obtained and considered the written advice from the Scheme’s Investment Consultant, XPS Investment (part of the XPS Pensions Group), who is suitably qualified through ability and experience and has appropriate knowledge.
- Consulted the principal employer.

Choosing investments

The Trustees set the investment strategy and investment policies for the Scheme.

The Trustees have considered the Scheme’s liabilities and strength of Employer covenant when setting the investment strategy and policies.

The Trustees rely on Investment Managers for the day-to-day management of the Scheme’s assets but retains control over all decisions made about the investments in which the Scheme invests.

Where Investment Managers are delegated discretion under Section 34 of the Act, the Investment Manager will exercise their investment powers in accordance with the Act, relevant and subsequent regulations, and this SIP.

The Trustees rely on the Investment Managers to appoint appropriate Custodians for pooled funds who are responsible for the safekeeping of the assets of the Scheme.

The Trustees rely on the Investment Managers to appoint appropriate Administrators or Registrars for pooled funds who are responsible for keeping records of the Scheme’s entitlement within the pooled funds.

¹ As amended 30th November 2018

Investment objective and strategy

Investment objective

The Trustees of the Scheme have set the following objectives:

- To achieve a fully funded position on a Technical Provisions basis. In particular, the discount rate used in calculating the value of assets required underpinning that target is a nominal value and is defined in more detail in the Statement of Funding Principles.
- To implement an investment strategy targeting a best estimate return of 2.0% pa in excess of gilts.
- To acquire suitable assets to achieve the above objective whilst controlling volatility and the long term costs of the Scheme.
- To hedge interest rate risk and inflation risk, as a proportion of the Scheme's total liabilities, through the Schemes matching assets.
- To adhere to the provisions contained within this SIP.

Investment strategy

The Trustees intend to meet the investment objective by investing in a diversified portfolio of return-seeking and liability-matching assets.

The Trustees can utilise a wide range of passively and actively managed investments, including (but not limited to):

- Assets or funds primarily utilised to match liability risk (typically movements in long term interest rates and inflation) including gilts, swaps and repos and the use of derivatives and leverage.
- Assets or funds primarily used to outperform the liabilities over the long term including equity, private markets, hedge funds, commodities, currency, bonds and other forms of credit, property, infrastructure and insurance including the use of derivatives and leverage. Illiquid assets can be used where a higher return or lower risk is expected.
- Assets or funds primarily used to provide immediate liquidity such as cash or cash instruments.
- Assets or funds that combine liability outperformance, liability hedging or liquidity characteristics including the use of derivatives and leverage.
- Annuity or insurance policies designed to match the specific characteristics of the Scheme's liabilities or membership.

The strategy the Trustees have adopted for the Scheme, including the allocation to different assets, and expected returns is set out in the Appendix.

Investment restrictions

The Trustees intend to adhere to the following restrictions:

- No more than 5% of Scheme assets can be held in investments related to the Employer.
- Whilst borrowing on a temporary basis is permitted, this option will only be utilised where absolutely necessary or where it is expected to reduce overall risk (e.g. for very short time periods during an asset transfer).
- Investment in derivative instruments may only be made where they contribute to risk reduction or facilitate efficient portfolio management.
- Stock lending is permitted at the discretion of the Scheme's Investment Managers in line with their overall investment objectives, policies and procedures.

Investment risk

The Trustees have identified a number of risks including (but not limited to):

- Employer covenant risk
- Liability risks: Interest rate risk, Inflation risk, Longevity risk
- Asset risks: Equity risk, Property risk, Currency risk, Credit risk, Interest rate risk, Inflation risk, credit default risk
- Strategy risks: Asset allocation risk, Liquidity risk (including collateral risk), Growth asset risk (including currency risk)
- Implementation risks: Investment manager risk, Counterparty risk, Operational risk

These risks are measured and managed by the Trustees as follows:

- The Trustees have set an investment strategy that adheres to the contents of this SIP.
- The Trustees receive strategic investment advice from the Investment Consultant that may include risk modelling and quantification (e.g. Value at Risk) whenever strategic changes are considered.
- The Trustees undertake regular monitoring of the Scheme's investments supplemented by information provided by both the Investment Managers and Investment Consultant, as well as advice from the latter.
- The Trustees periodically assess the strength of the principal employer covenant and uses external expertise where appropriate.
- The Trustees delegate the day-to-day management of some of these risks to the appointed Investment Managers.
- The Trustees consider the Investment Managers' role and approach to managing risk is considered when selecting appropriate Investment Managers.
- The Trustees utilise custodian relationships to ensure Scheme assets are held securely.
- The Trustees assess whether appropriate controls are put in place by themselves, the Investment Consultant, Investment Managers and Custodians (where there is a direct relationship).

Realising investments

The Trustees recognise that assets may need to be realised to meet Scheme obligations at any time.

The Trustees will ensure that an appropriate amount of readily realisable assets are held at all times, and this will be part of the assessment for including new investments within the strategy.

The Trustees will from time to time agree a policy for sourcing cash from the investments as required. Further details are set out in the Appendix.

Range of assets

Based on the allocation set out in the Appendix, the Trustees consider the arrangements with the Investment Managers to be aligned with the Scheme's overall strategic objectives. Details of each specific mandate are set out in agreements and pooled fund documentation with each Investment Manager. The amounts allocated to any individual category or security will be influenced by the overall benchmark and objectives, varied through the Investment Managers' tactical asset allocation preferences at any time, within any scope given to them through asset allocation parameters set by the Trustees or governing the pooled funds in which the Scheme is to be invested.

The Trustees will ensure that the Scheme's assets are invested in regulated markets to maximise their security. Investment Managers are incentivised to perform in line with expectations for their specific mandate as their continued involvement as Investment Managers as part of the Scheme's investment strategy – and hence the fees they receive – are dependent upon them doing so. They are therefore subject to performance monitoring and reviews based on a number of factors linked to the Trustees' expectations.

The Trustees encourage Investment Managers to make decisions in the long-term interests of the Scheme. The Trustees expect engagement with management of the underlying issuers of debt or equity and the exercising of voting rights. This expectation is based on the belief that such engagement can be expected to help Investment Managers to mitigate risk and improve long term returns. The Trustees also require the Investment Managers to take ESG factors and climate change risks into consideration within their decision-making as the Trustees believe these factors could have a material financial impact in the long-term. The Trustees therefore make decisions about the retention of Investment Managers, accordingly.

Investment Manager Arrangements

Review process

Appointments of Investment Managers are expected to be long-term, but the Trustees will review the appointment of the Investment Managers in accordance with their responsibilities.

The Trustees receive quarterly performance monitoring reports from the Investment Consultant which consider performance over the quarter, one and three year periods. In addition, any significant changes relating to the criteria below that the Investment Consultant is aware of will be highlighted, which may lead to a change in the Investment Consultant's rating for a particular mandate. These ratings help to determine an Investment Manager's ongoing role in implementing the investment strategy. If there are concerns, the Trustees may carry out a more in-depth review of a particular Investment Manager. Investment Managers will also attend Trustees meetings as requested.

Fund manager remuneration is considered as part of the manager selection process. It is also monitored regularly with the help of the Investment Consultant to ensure it is in line with the Trustees' policies and with fee levels deemed by the Investment Consultant to be appropriate for the particular asset class and fund type.

Portfolio turnover

The Trustees require the Investment Managers to report on actual portfolio turnover at least annually, including details of the costs associated with turnover, how turnover compares with the range that the Investment Manager expects and the reasons for any divergence.

Responsible investment

The Trustees have considered their approach to environmental, social and corporate governance (“ESG”) factors for the long term time horizon of the Scheme and believe there can be financially material risks relating to them. The Trustees have delegated the ongoing monitoring and management of ESG risks and those related to climate change to the Scheme’s Investment Managers. The Trustees require the Scheme’s Investment Managers to take ESG and climate change risks into consideration within their decision-making, in relation to the selection, retention or realisation of investments, recognising that how they do this will be dependent on factors including the characteristics of the asset classes in which they invest.

The Trustees will seek advice from the Investment Consultant on the extent to which their views on ESG and climate change risks may be taken into account in any future Investment Manager selection exercises.

Furthermore, the Trustees, with the assistance of the Investment Consultant, will monitor the processes and operational behaviour of the Investment Managers from time to time, to ensure they remain appropriate and in line with the Trustees’ requirements as set out in this Statement.

As the Scheme invests in pooled funds, the Trustees acknowledge that they cannot directly influence the policies and practices of the companies in which the pooled funds invest. They have therefore delegated responsibility for the exercise of rights (including voting rights) attached to the Scheme’s investments to the Investment Managers. The Trustees encourage them to engage with investee companies and vote whenever it is practical to do so on financially material matters such as strategy, capital structure, conflicts of interest policies, risks, social and environmental impact and corporate governance as part of their decision-making processes. The Trustees require the Investment Managers to report on significant votes made on behalf of the Trustees.

If the Trustees become aware of an Investment Manager engaging with the underlying issuers of debt or equity in ways that they deem inadequate or that the results of such engagement are mis-aligned with the Trustees’ expectation then the Trustees may consider terminating the relationship with that Investment Manager.

When considering the selection, retention or realisation of investments, the Trustees have a fiduciary responsibility to act in the best interests of the beneficiaries of the Scheme, although they have neither sought, nor taken into account, the beneficiaries’ views on matters including (but not limited to) ethical issues and social and environmental impact. The Trustees will review this policy if any beneficiary views are raised in future.

Section 35

The enclosed SIP has been prepared by the Trustees in accordance with S35 of the Pensions Act 1995 and will be reviewed at least every three years or immediately after any significant changes in investment policy. The Trustees have consulted with XPS Investment, acting in its capacity as the Scheme's Investment Consultant, and have acted upon written advice when deciding the suitability of the enclosed strategy.

Adopted by the Trustees of Heart of England Co-operative Society Pension Scheme on 30 September 2020.

This SIP is the responsibility of the Trustees. You must not use, copy or repeat any part of the SIP for commercial purposes without obtaining permission to do so in writing to us. We use material from third parties in preparing the SIP and although we try to ensure that all of the information is correct we do not give any express or implied warranty as to the accuracy of the material in the SIP and are not responsible, and do not accept and liability, for any error, omission or inaccuracy. We are not liable for any damages (including, without limitation, damages for loss of business or loss of profits) arising in contract, tort or otherwise from the use of or inability to use this SIP, or any material contained in it, or from any action or from any action or decision taken as a result of using it.

Appendix - Investment strategy

Overall strategy

The investment strategy of the Scheme is summarised in the table below, although the investment strategy has not yet been fully implemented.

Asset class	Long-Term Strategic Allocation	Expected return (above gilts pa)	Manager and fund	Manager Objective	OCF (pa)
Multi Asset	30%	3.6%	Legal & General Dynamic Diversified Fund	Achieve a return in excess of the Bank of England Base Rate + 4.5% pa over a full market cycle.	0.39%
Buy & Maintain	15%	1.3%	BlackRock Buy & Maintain Credit Fund	Seeks to maximize total risk adjusted return through a combination of income and capital appreciation over the longer cycle.	0.15%
Secure Income	25%	3.0%	BlackRock Strategic Alternative Income Fund	To generate income on Investments whilst preserving capital over the long term.	0.80%
LDI	30%	-0.1%	BlackRock LDI Pooled Fund Range	Seeks to accurately match the Scheme's liability characteristics by constructing a hedge based on BlackRock's Liability matching fund range and the Scheme's liability cash flows.	0.21%
Credit	The Fund will be used as a collateral vehicle, alongside the DDF	1.3%	BlackRock Sterling Short Duration Credit Fund	Aims to deliver total return of LIBOR +1.5% per annum (gross of fees) over a three year rolling basis.	0.15%
100%		2.0%			0.40%

*Exact allocation to BlackRock LDI and Buy and Maintain will be determined following the hedge design process

**The LGIM Dynamic Diversified Fund and BlackRock Sterling Short Duration Credit fund will be used as drawdown vehicles to fund the SAIF investment as capital is called.

***Expected return and OCF is quoted on the long-term strategic target.

Return expectations quoted above are best estimates for long-term returns.

Liability hedging

This strategy is not designed to achieve a specific level of liability hedging, but the matching assets cover:

- Interest rate risk protection, as a proportion of the Scheme's total liabilities.
- Inflation risk, as a proportion of the Scheme's total liabilities.

Rebalancing investments

The Scheme does not have any formal rebalancing arrangements in place. The Trustees will review the allocation quarterly and if required will instruct the Investment Managers to rebalance the Scheme's asset allocation.

Realising investments

The Trustees are aware of their responsibility to meet members' benefits as they fall due. This may involve the disinvestment of assets from time to time.

Where assets need to be realised, the Trustees will consult with the Investment Consultant regarding the source and timing of disinvestments. The liquidity and trading costs of such disinvestments will also be taken into account. It is envisaged that disinvestments will be sourced from the cash held in the Trustees' bank account, with any further monies to be taken from return-seeking assets held in the LGIM Dynamic Diversified Fund.



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