Statement of Investment Principles

This is the Statement of Investment Principles made by "the Trustee" (Kelda Group Pension Trustees Limited) of the Kelda Group Pension Plan ("the Plan") in accordance with the Pensions Act 1995 (as amended) and the Occupational Pension Schemes (Investment) Regulations 2005. It is subject to review by the Trustee at least every three years and without delay after any significant change in investment policy.

In preparing this Statement, the Trustee has consulted with the Principal Employer to the Plan (Kelda Group Limited) and has taken written advice from the Investment Practice of Hymans Robertson LLP.

Details concerning the broad governance of the Plan and the nature of the mandates for investment management and other service providers are contained in the Plan's Myners Adherence document which should be read in conjunction with this Statement of Investment Principles.

The Trustee reviews the performance of Plan investments on a regular basis.

Defined Benefit Section

Plan Objective

The primary objective of the Plan is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependants, on a defined benefit basis.

The Trustee's over-riding funding principles for the Plan are to set the employer contribution at a level which is sufficient:

- to ensure that there are always sufficient assets of the Plan (at their realisable value) to meet 100% of accrued benefits as they fall due for payment to members; and
- to recover any shortfall in assets relative to the value placed on accrued liabilities over the longer term.

More specifically, the Trustee and the Principal Employer have the objective of having sufficient assets to cover 100% of the cost of providing benefits assessed using an assumed investment return based on the UK Government conventional gilt yield curve plus 0.50% p.a. (which represents a long term low risk target position for the Plan). As such, the assets are expected to give returns in excess of this assumed investment return and that, alongside contributions, will enable the Plan to close any deficit relative to Technical Provisions liabilities and meet the long term cost of providing benefits.

The value of liabilities is calculated on the basis agreed by the Trustee, after taking advice from the Scheme Actuary, and the Principal Employer. The funding position is monitored regularly by the Trustee and is formally reviewed at each triennial actuarial valuation, or more frequently as required by the Pensions Act 2004.

Investment Strategy

The Trustee has translated its objectives into a suitable strategic asset allocation benchmark for the Plan. All day to day investment decisions have been delegated to a number of authorised investment managers. The strategic benchmark has been translated into benchmarks for the individual managers which are consistent with the Plan's overall strategy. The Plan benchmark is consistent with the Trustee's views on the appropriate balance between seeking an enhanced long-term return on investments and accepting greater short-term volatility and risk.

The investment strategy takes due account of the maturity profile of the Plan (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit (relative to the objective of having sufficient assets to cover 100% of the cost of providing benefits assuming an investment return of 0.50% p.a. above conventional gilts).

As the Plan is now closed to new entrants, the Trustee has reduced the proportion of the Plan invested in return seeking assets with plans currently in place to further reduce investment risk over time, as the funding level of the Plan improves towards being fully funded on a gilts plus 0.5% p.a. basis. It is intended that this position will be reviewed regularly relative to the progress being made towards achieving the funding objective and reviewed more formally at least every three years following actuarial valuations of the Plan.

The Trustee monitors strategy relative to its agreed asset allocation benchmark. It is intended that the investment strategy will be reviewed at least every three years following actuarial valuations of the Plan, and will normally be reviewed annually.

Choosing Investments

The Trustee has appointed investment managers who are each authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Trustee has appointed each of its investment managers to deliver a specific benchmark (or performance target), which overall will align to deliver the broader Plan investment strategy. The Trustee ensures that all manager engagements have clearly defined benchmarks, objectives and management parameters.

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 Plan. Where such tailoring is not directly achievable, the Trustee will invest in pooled funds where the objectives of the fund and the policies of the investment manager will be evaluated by the Trustee to ensure that they are appropriate for the needs of the Plan.

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 Trustee 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 Trustee periodically reviews the fees paid to all of its managers against industry standards.

The Trustee reviews the nature of Plan investments on a quarterly basis, with particular reference to suitability and diversification. The Trustee seeks and considers written advice from a suitably qualified person when determining the appropriateness of each manager and mandate for the Plan, 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 Trustee is proposed, appropriate advice is sought and considered to ensure its suitability. The Trustee expects its investment adviser to notify it of any issue relating to an investment manager which could affect the suitability of the mandate.

The Trustee recognises 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 Trustee 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 Plan objective.

The duration of each mandate is determined by the Trustees at the inception of each mandate. For open-ended investments, the Trustee generally engages managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Trustee expects 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.

Kinds of investment to be held

The Plan may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds, cash, global credit markets, asset backed securities, property and pooled funds. The Plan also makes use of derivatives and contracts for difference for the purpose of efficient portfolio management. The Trustee considers all of these classes of investment to be suitable in the circumstances of the Plan.

Balance between different kinds of investments

The Plan's investment managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market, each manager will maintain a diversified portfolio of stocks through direct investment or pooled vehicles.

Risk

The Plan is exposed to a number of risks which pose a threat to the Plan meeting its objectives. The principal risks affecting the Plan are:

Funding risks

- Financial mismatch – The risk that Plan assets fail to grow in line with the developing cost of meeting the liabilities.

- Changing demographics –The risk that longevity improves and other demographic factors change, increasing the cost of the Plan benefits.

- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Plan's liabilities. Climate change is a particular systemic risk that has the potential to cause economic, financial and demographic impacts and is considered a long term financial risk to the Plan's outcomes.

The Trustee measures and manages financial mismatch in two ways. As indicated above, the Trustee has set a strategic asset allocation benchmark for the Plan. The Trustee assesses risk relative to that benchmark by monitoring the Plan's asset allocation and investment returns relative to the benchmark. The Trustee also assesses risk relative to liabilities by monitoring the delivery of returns relative to liabilities.

The Trustee keeps mortality and other demographic assumptions, which could influence the cost of benefits, under review. These assumptions are considered formally at triennial valuations and the Trustee may enter into insurance contracts (bulk annuities or longevity swaps) to reduce these demographic risks.

The Trustee seeks to mitigate systemic risks through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset risks

- Concentration - The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.

- Illiquidity - The risk that the Plan cannot meet its immediate liabilities because it has insufficient liquid assets.

- Currency risk – The risk that the currency of the Plan's assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.
- Environmental, Social and Governance (ESG) risks – the extent to which ESG issues are not reflected in asset prices and/or not considered in investment decision making leading to underperformance relative to expectations.
- Climate risk - The extent to which climate change causes a material deterioration in asset values as a consequence of factors including but not limited to policy change, physical impacts and the expected cost of transition to a low-carbon economy.

The Trustee manages asset risks as follows. The Trustee provides a practical constraint on Plan investments deviating greatly from the intended approach by investing in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrain risk within their expected parameters.

By investing across a range of assets, including quoted equities, bonds (and possibly in the future bulk annuity policies), the Trustee recognises the need to access funds in the short term to pay benefits. The risk of manager underperformance is mitigated by the inclusion of passive investment mandates within the investment portfolio.

In appointing several investment managers, the Trustee has considered the risk of underperformance by any single investment manager.

The Trustee does not expect managers to take excess short term risk and will regularly monitor the managers' performance against the benchmarks and objectives set on a short, medium and long term basis.

The Trustee's approach to the consideration of ESG risks and climate risk is set out in further detail later on in this document.

Other provider risk

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers.
- Custody risk - The risk of loss of Plan assets when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.

The Trustee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Plan, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). When carrying out significant transitions, the Trustee seeks professional advice.

Expected return on investments

The investment strategy aims to achieve a return on Plan assets, which taken in conjunction with, contributions is sufficient over time to match growth in the Plan's pension liabilities.

Realisation of investments

The majority of the Plan's investments may be realised quickly if required.

Portfolio turnover

The Trustee has expectations of the level of turnover within each mandate which is determined at the inception of the mandate, based on the Trustee's knowledge of the manager, investment process and the nature of the portfolio. Whilst the Trustee expects performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustee expects 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 Trustee will challenge its managers if there is a sudden change in portfolio turnover or if the level of turnover seems excessive.

The Trustee will request turnover costs incurred by the asset manager over the Plan reporting year.

Consideration of financially material factors in investment arrangements

The Trustee recognises that the consideration of financially material factors, including ESG factors, is relevant at different stages of the investment process.

Strategic Considerations

The strategic benchmark has been determined using appropriate long-term economic and financial assumptions from which expected risk/return profiles for different asset classes have been derived. These assumptions apply at a broad market level and are considered to implicitly reflect all financially material factors.

Given the inherent uncertainty, the Trustee has not made explicit allowance for the risks of climate change in setting their strategic benchmark.

Structural Considerations

Given the discretion afforded to the active Investment Managers, the Trustee expects that their Investment Managers will take account of all financially material factors including the potential impact of ESG factors in the implementation of their mandate.

Selecting investment managers

Within active mandates, the Trustee has delegated responsibility for the consideration of security specific issues to their individual Investment Managers. The Trustee is satisfied that the Investment Managers are following an approach which takes account of all financially material factors.

In passive mandates, the Trustee recognises that the choice of benchmark dictates the assets held by the investment manager and that the manager has minimal freedom to take account of factors that may be deemed to be financially material. The Trustee accepts that the role of the passive manager is to deliver returns in line with the benchmark and believe the choice of benchmarks will deliver appropriate risk adjusted returns. The Trustee will review the index benchmarks employed for the Plan on at least a triennial basis, as part of its wider review of investment strategy.

In selecting new investment managers for the Plan, where relevant to the investment mandate, the Trustee explicitly considers potential managers' approach to responsible investment and the extent to which managers integrate ESG issues in the investment process as a factor in their decision making.

Consideration of non-financially material factors in investment arrangements

Given the objectives of the Plan, the Trustee has not considered any non-financially material factors in the development and implementation of their investment strategy.

Stewardship

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.

Voting and engagement

The Trustee has 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 Trustee believes it is important for Investment Managers to exercise voting rights on shares held and are expected to exercise the voting rights attached to individual investments in accordance with their own house policy.

Where relevant, the Trustee will review the voting policies of their Investment Managers and determined that these policies are appropriate. Where appropriate, the Trustee will engage with and may seek further information from their Investment Managers on how portfolios may be affected by a particular issue. The Trustee 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 Trustee separately considers 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.

Monitoring

Investment Managers report on voting activity to the Trustee on a periodic basis. The Trustee will monitor Investment Managers voting activity and may periodically review managers voting patterns. The Trustee may also monitor Investment Managers' voting on particular companies or issues affecting more than one company.

Additional Voluntary Contributions (AVCs)

Some members of the Plan have defined contribution AVCs invested with Legal & General and Utmost Life and Pensions. Members can continue to contribute to AVC plans held with Legal & General, whereas the arrangement with Utmost Life and Pension is closed to future contributions.

With-profits policies held with Equitable Life were transferred to unit-linked policies with Utmost Life and Pensions in January 2020. Pending legal and regulatory approval, policies held with Legal & General are due to be transferred to ReAssure in September 2020.