Severn Trent Water Mirror Image Pension Scheme

Statement of Investment Principles

Date last amended: March 2021

1 Introduction

Scheme details

1.1 This document describes the principles governing decisions about investments made by the Trustee of the Severn Trent Water Mirror Image Pension Scheme (the Scheme).

1.2 The main objective of the Scheme is to provide relevant benefits (that is, broadly pensions, lump sums or similar benefits on retirement or death) for eligible employees and directors and for former employees and directors of the employing companies, each of which is a member of the Severn Trent Group. These benefits are calculated on a final salary basis and the Scheme Rules include a guarantee of pension increases in line with Orders made under the Pensions (Increase) Act. The liabilities of the Scheme are thus significantly influenced by the course of earnings and price inflation.

1.3 The Scheme is contracted-out of the State Second Pension. The Scheme is a registered pension scheme for the purposes of the Finance Act 2004.

1.4 Administration of the Scheme is vested in Severn Trent MIS Trustees Limited (the Scheme Trustee), which is responsible for the investment of the Scheme's assets.

Pensions Act

1.5 Under the Pensions Act 1995 (as updated by the Pensions Act 2004), trustees are required to prepare a statement of the principles governing investment decisions. This document fulfils that requirement.

1.6 The Scheme Trustee has consulted Severn Trent Water Limited on the content of this document and will consult Severn Trent Water Limited on any changes to the document. However, the ultimate authority and responsibility for deciding the investment policy of the Scheme lies solely with the Scheme Trustee.

1.7 In drawing up this document, the Scheme Trustee has sought advice from the Scheme's Actuary and Investment Adviser. The Scheme Trustee will review this document at least once a year. A copy of this statement will be provided, as updated from time to time, to the Investment Managers, who will be required to follow the principles which it sets out.

Financial Services and Markets Act 2000

1.8 In accordance with the Financial Services and Markets Act 2000, the Scheme Trustee will determine general investment policy, but will delegate day-to-day responsibility for selection of specific investments, and determining the proportion of the underlying funds that are invested in the various asset classes, to an appointed Investment Manager or Managers, which may include an insurance company or companies. The Investment Managers shall provide the skill and expertise necessary to manage the investments of the Scheme competently. The Investment Managers have been provided with a copy of this document.

Responsibilities

1.9 The Scheme Trustee is responsible for all of the investment decisions in respect of the Scheme including the responsibility for selecting and monitoring the Scheme's Investment Managers. The Scheme Trustee takes advice from the Scheme Actuary and the Investment Adviser.

1.10 Severn Trent Water Limited does not have the authority to place limits on the Scheme Trustee as to how it can invest the money.

1.11 The Scheme Trustee has set up an Investment Committee ("IC"). The responsibility of the Investment Committee is as follows:

- Develop the Scheme's long-term investment structures and strategies in line with the Trustee's Statement of Investment Principles ("SIP");
- Monitor and periodically review the Trustee's investment objectives and strategy to ensure they remain appropriate;
- Ensure that asset allocations, so far as reasonably practicable, remain in line with the Scheme's strategic long-term benchmark;
- Monitor the appropriateness of the investment management structure and the performance and suitability of individual investment managers;
- Monitor and periodically review the performance and continuing suitability of the Scheme's AVC providers;
- Monitor the management of the Scheme's assets including recommending amendments to the Scheme's SIP and index benchmarks, as appropriate;
- Periodically review the effectiveness of the Trustee's investment adviser;
- Provide general support and assistance to the Trustee in relation to all investment related matters including advising on developments in relevant legislation and economic or financial trends;

- Encourage dialogue between the Trustee and the Principal Employer and their respective advisers;
- To recommend changes to the manager or mandate where the change relates to 10% or more of the Scheme's assets;
- To recommend changes in the benchmark of a mandate where the mandate in question represents 10% or more of the Scheme's assets;
- To implement changes to the manager or mandate where the manager/mandate is less than 10% of Scheme assets;
- To implement changes to the benchmark of a mandate where the mandate in question represents less than 10% of Scheme assets, or the change in mandate represents less than 10% of Scheme assets;
- To monitor capital markets and make recommendations to the Scheme Trustee for a change to the investment strategy.

The Scheme Trustee shall remain responsible for all other investment activity.

1.12 The Scheme Trustee also takes advice from the Scheme Actuary and Investment Adviser.

2 Statement of Funding Principles

Statement of Funding Principles

2.1 The Pensions Act 2004 requires that the Scheme Trustee prepares a Statement of Funding Principles. The Scheme Trustee will prepare this document, after obtaining advice from the Scheme Actuary, in conjunction with each actuarial valuation.

2.2 The statement will cover the Scheme's statutory funding objective, the principles used in determining that objective, the policy for securing that it is met, and the process through which the Scheme Trustee and the Company reach agreement on the contents of the statement.

3 Long-term policy

Objectives

3.1 The long-term objectives of the Scheme Trustee are:

a. to maintain a portfolio of assets of appropriate liquidity which will generate sufficient income and capital growth to meet, together with contributions, the cost of benefits which the Scheme provides, as set out in the Trust Deed and Rules.

b. to maximise the likelihood that benefits will be paid to members as they fall due, both over the long-term and on a shorter-term basis

c. to minimise the long-term costs of the Scheme by maximising the return on the assets whilst having regard to the objective shown under 3.l.b above.

Within the context of these objectives, since March 2018 the Scheme Trustee is focused on the specific objective of a low risk investment strategy commensurate with full or partial settlement of the Scheme's liabilities. To the extent there is a solvency shortfall, the Trustee's investment strategy will be set to include an additional target return to make up the shortfall.

Policy

3.2 Having regard to:

- the Scheme's financial position, including its projected cashflow requirements
- the profile of its membership
- the nature of its liabilities
- the covenant of the Company
- the results of consultation with the Company

The Scheme Trustee's policy is to seek to achieve the objectives through investing in a suitable mixture of real and monetary assets. A mixture across asset classes should provide the level of returns required by the Scheme to meet its liabilities at an acceptable level of risk for the Scheme Trustee and an acceptable level of risk and cost to the Company.

3.3 In consultation with the Company, the Scheme has set a target asset allocation as set out below. Further detail of the strategy is provided in the Implementation Policy Document (IPD) Schedule A.

Asset Class	Weighting (%)	Benchmark Index
Senior Loans	8.0	LIBOR
Multi-asset credit	10.0	LIBOR
UK non-government bonds	30.0	iBoxx £ Non gilts index
Hedging portfolio	52.0	Composite [1]

[1] Cash within the hedging portfolio is benchmarked against the LIBID GBP 7-day index, while the levered and unlevered gilts and index-linked gilt holdings have a liability-specific composite benchmark.

Additional Voluntary Contributions (AVCs)

3.4 One member of the Scheme has AVC's invested in a "legacy" fund with Equitable Life Assurance Society. As the Scheme is closed no further contributions can be made.

4 Investment management arrangements

Investment management structure

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

4.2 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 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 Scheme.

4.3 Details of the current investment manager structure, alongside details of the performance objectives of each investment manager, can be found in Schedule B of the IPD.

Realisation of assets

4.4 The policy of the Scheme Trustee is that the realisation of individual holdings, whether to meet cashflow requirements or to reinvest the proceeds elsewhere, should be entirely at the discretion of each Investment Manager.

4.5 The policy of the Scheme Trustee is that there should be sufficient investments in liquid or readily realisable assets to meet cashflow requirements in the majority of foreseeable circumstances so that realisation of assets will not disrupt the Scheme's overall investment policy. The IC monitors the Scheme’s asset allocation on a quarterly basis and takes action to rebalance if deemed necessary.

Fees

4.6 Fees are currently paid to the Investment Managers based on the total value of assets under management for each manager. The exact method of calculation for each fee is set out in the written agreement with each Investment Manager. This type of fee structure has been chosen as it is the industry norm and is considered to be the best basis for the Scheme. Details of Investment Managers fees are set out in Schedule B of the IPD.

4.7 Fees are currently paid to the Scheme's Actuary and Investment Adviser on a fixed, time/cost or project basis.

Monitoring

4.8 The Scheme Trustee monitors its managers' performance, gross and net of fees, against their respective benchmarks or targets. Monitoring is carried out on a quarterly basis and the Scheme Trustee considers performance over different time periods including a long term time horizon. The Scheme Trustee seeks to understand the reason for any significant deviations away from benchmark or target.

Social, environmental and ethical issues, including climate change
Responsible Investment

4.9 The Scheme Trustee recognises that the consideration of financially material factors, including ESG factors, is relevant at different stages of the investment process. Within the context of the Scheme's shorter-term objective stated in section 3.1, the Scheme Trustee considers strategies that provide a greater probability of delivering sustainable and predictable returns as likely to be most suitable, and this is reflected in the Scheme Trustee's approach to Responsible Investment.

4.10 The strategic asset allocation for the Scheme has been determined using appropriate economic and financial assumptions for different asset classes. These assumptions apply at a broad market level and are considered to implicitly reflect all financially material factors. The Scheme Trustee recognises that climate change could pose systemic risks which could in turn affect the returns achieved from their investment strategy.

4.11 The Scheme Trustee has not at this stage made explicit allowance for climate change in framing the strategic asset allocation, although this will be reviewed periodically in the context of the Trustee's objectives. The Scheme Trustee believes good management of companies should lead to more sustainable and predictable returns.

Stewardship & Engagement

4.12 The Scheme Trustee supports the principles set out in the UK Stewardship Code.

4.13 The Scheme Trustee does not engage directly but believes it is appropriate for 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. The Trustee will review engagement activity undertaken by their investment managers as part of its broader monitoring activity.

4.14 Responsibility for the day-to-day investment decisions and their execution 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 Scheme 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.

4.15 The Scheme Trustee separately considers any conflicts of interest arising in the management of the Scheme and its investments and will ensure that each manager has an appropriate conflicts of interest policy in place.

Diversification

4.16 The choice of benchmark referred to in paragraph 3.3 is designed to ensure that the assets are adequately diversified. Within the portfolio for which each Investment Manager is responsible and within each asset category in that portfolio, the Investment Manager is responsible for appropriate diversification, subject to any limitation on investment contained in the relevant Investment Management Agreement.

Suitability

4.17 The Scheme Trustee has taken advice from the Scheme's Investment Adviser who has confirmed appropriate knowledge and experience of the management of and investment of trust schemes, to ensure that the benchmark specified is suitable, given the liability profile of the Scheme and the Scheme's financial position. Within the portfolio for which each Investment Manager is responsible, and within each asset category in that portfolio, the Investment Manager is responsible for the suitability of investments.

4.18 The Scheme Trustee recognises the long-term nature of its liability profile and appoints its collective managers to invest in a manner commensurate with generating 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 asset class in which they invest and the Scheme objective.

Duration

4.19 The duration of each mandate is determined by the Scheme Trustee at the inception of each mandate. For open-ended investments, the Scheme Trustee generally engages managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Scheme Trustee expects the minimum duration of the appointment will be three years, this being the minimum period over which the Scheme Trustee considers 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.

Portfolio Turnover

4.20 The Scheme Trustee has expectations of the level of turnover within each mandate, based on the Scheme Trustee’s knowledge of the manager, investment process and the nature of the portfolio. Whilst the Scheme Trustee expects performance to be delivered net of costs, including the costs of trading within the portfolio, The Scheme Trustee expects managers to report at least annually on the underlying assets held within the portfolio and details of any transactions over the period.

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

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

Investment restrictions

4.21 Restrictions have been agreed with each Investment Manager appropriate to its own portfolio and which the Scheme Trustee believes to be appropriate for the investment of the assets. The detailed restrictions are recorded in the Investment Management Agreements entered into between the Scheme Trustee and each Investment Manager.

5 Monitoring and implementation of investment policy

5.1 The Scheme Trustee has delegated responsibility for monitoring and implementation of the investment policy to the IC. The IC meets on a regular basis with the Investment Managers to review and discuss the operation of each Investment Manager's portfolio, including past and future policy decisions. The IC will thus monitor the competence with which the Investment Managers are carrying out the responsibilities delegated to them and their compliance with the Investment Management Agreements which are consistent with this statement.

5.2 The appointment of the Investment Managers will be reviewed by the Scheme Trustee from time to time, based on the results of the monitoring of performance and process.

Criteria for selection

5.3 The Scheme Trustee has identified the criteria by reference to which the Investment Managers should be selected (or dismissed). These include:

a. Past performance

b. Quality of the investment process

c. Role suitability

- Level of fees
- Reputation of the Investment Manager
- Familiarity with such mandates

d. Service

- Reporting
- Administration

e. Team proposed

- The quality of the individual investment managers working for the Scheme.

Criteria for dismissal

5.4 It will be the policy of the Scheme Trustee to replace an Investment Manager, without prejudice to the ability of the Scheme Trustee to dismiss an Investment Manager without notice and without giving reasons, if:

a. the Scheme Trustee believes that the Investment Manager is not capable of achieving these performance objectives in the future

b the Investment Manager fails to maintain satisfactory standards in respect of the other criteria listed in 5.1 and 5.3 above.

6 Risk management

6.1 The Scheme Trustee recognises a number of risks, including those described below, involved in the investment of the assets of the Scheme. Their policy for dealing with those risks is described below:

Solvency risk and mismatching risk

- are addressed through the asset allocation strategy (see section 3) and through ongoing triennial actuarial valuations
- are measured by assessing the progress of the actual growth of the liabilities relative to the selected investment policy.

Manager risk

- is addressed through the ongoing monitoring of the Investment Managers
- is measured by monitoring the actual deviation of each Investment Manager's returns relative to the objective (as set out in Schedule B of the IPD) and factors supporting each Investment Manager's investment process.
- The Scheme Trustee does not expect managers to take excess short-term risk and will regularly monitor the manager's performance against the benchmarks and objectives over the short, medium and long term.

Liquidity risk

- is managed by the Scheme Trustee who ensures that within the Scheme Trustee's bank account, sufficient cash balances are available to meet monthly outgoings
- is measured by the level of cashflow required by the Scheme over a specified period.

Inappropriate investments risk

- is addressed through constraints on the use of derivatives, gearing, specific asset limits and other restrictions

Currency Risk

- is managed by investing in funds which hedge the currency exposure (namely multi-asset credit and senior loans).
- is measured by the level of concentration in any one country/region leading to an adverse influence on investment values arising from unfavourable currency movements.

Political risk

- the risk of an adverse influence on investment values from political intervention is reduced by diversification of the assets across many countries
- is measured by the level of concentration of any one market leading to the risk of an adverse influence on investment values arising from political intervention
- is managed by regular reviews of the actual investments relative to policy and through regular assessment of the levels of diversification within the existing policy.

Counterparty risk

- is addressed through the agreed restrictions with respect to cash management.

Corporate governance risk

- is the risk that market values of companies are eroded due to corporate failure
- management is delegated to the Scheme's investment who will act in line with their corporate governance policies.

6.2 The IC continues to monitor these risks.

6.3 The Scheme Trustee accepts that some degree of risk is inevitable in the effective management of investments. The general principle is that the investments should be managed to maximise the return while containing the risk to a level which is consistent with the Scheme Trustee's long-term requirement to pay benefits as they fall due.