

# UK Power Networks Group of the ESPS Statement of Investment Principles

September 2023



# Contents

<b>Introduction.....</b>	<b>1</b>
<b>1. Overview of the arrangements.....</b>	<b>2</b>
<b>2. Governance .....</b>	<b>2</b>
<b>3. Objectives .....</b>	<b>2</b>
<b>4. Investment Strategy .....</b>	<b>3</b>
<b>5. Range of Investments .....</b>	<b>3</b>
<b>6. Risk Management .....</b>	<b>4</b>
<b>7. Responsible Investing .....</b>	<b>4</b>
<b>8. Stewardship Policy .....</b>	<b>5</b>
<b>9. Arrangements with asset managers.....</b>	<b>6</b>
<b>10. Additional Voluntary Contributions .....</b>	<b>7</b>
<b>11. Monitoring.....</b>	<b>7</b>
<b>Appendix A – Investment Beliefs.....</b>	<b>9</b>
<b>Appendix B – Risks .....</b>	<b>10</b>

## Introduction

The Statement of Investment Principles (“SIP”) is a written statement governing decisions about investments for the purposes of an occupational pension scheme. It is a requirement of most occupational schemes that trustees must prepare, maintain and periodically revise the SIP. The SIP must be prepared in accordance with the relevant Pensions Act and Occupational Pension Schemes Regulations and must be updated to reflect any regulatory changes.

The SIP must cover at least the following:

- The policy for securing compliance with their statutory duty to choose investments (under section 36 of the Pensions Act 1995, as amended by the Pensions Act 2004);
- Policies relating to:
  - the kinds of investments to be held;
  - the balance between different kinds of investments;
  - risks – including identification and management;
  - the expected return on investments;
  - the realisation of investments;
  - the extent to which the trustees consider social, environmental and ethical factors in selecting, retaining and realising investments;
  - Stewardship policy; and
  - arrangements with asset managers

UK Power Networks Group (Trustee) Limited (“the Group Trustee”) prepared this SIP as trustee of the UK Power Networks Group of the Electricity Supply Pension Scheme (the “Group”) to govern the investment decisions of the Group in order to meet its investment objective.

The Group operates for the sole purpose of providing retirement benefits and death benefits to eligible participants and beneficiaries. It is a defined benefit pension scheme which is closed to new members.

In preparing the SIP the Group Trustee has obtained and considered appropriate written advice from BlackRock (the “Fiduciary Manager”) and will obtain and consider such advice before revising the SIP in the future.

The Group Trustee has consulted UK Power Networks (the “Sponsor”), on the content of this SIP. Any future changes will be subject to a new consultation.

It is the Group Trustee’s policy to review the SIP every three years, and also after any significant change in investment policy. The Group Trustee will notify the Fiduciary Manager of any material changes to the Group’s circumstances, including any material changes to the circumstances of the Sponsor which may impact its ability to continue supporting the Group. This will trigger a review of the investment strategy and SIP.

The SIP has been prepared in accordance with Section 35 of the Pensions Act 1995, as amended by the Pensions Act 2004, and the Occupational Pension Schemes (Investment) Regulations 2005.

This version of the SIP was approved on 7 September 2023.

## 1. Overview of the arrangements

The Group Trustee has ultimate responsibility for the management of its investment arrangements. It has delegated a number of decisions and responsibilities to specialist providers. As part of the process of delegating these decisions and responsibilities, the Group Trustee has established clear investment objectives informed by their Investment Beliefs. These investment objectives are explained later in the SIP, and the Investment Beliefs are included in Appendix A of this SIP.

There are a number of parties involved in the Group's investment arrangements including:

- Group Trustee
- EPTL – Electricity Pensions Trustee Limited, the Scheme Trustee
- Group Actuary
- The Fiduciary Manager
- Investment managers
- Providers of direct investments
- Custodian
- Fiduciary Manager Oversight

The Group Trustee confirms that all parties to whom it delegates responsibility have the appropriate knowledge and experience required to take on this role. The Group Trustee expects each party to carry out the duties delegated to it while taking into account the principles contained in the SIP, so far as is reasonably practicable.

## 2. Governance

The Group Trustee is responsible for setting the general investment policy. It is responsible for ensuring that it is consistent with the Group's funding objectives and its assessment of the strength of the employer covenant as part of its Integrated Risk Management framework.

The Group Trustee has appointed the Fiduciary Manager to manage the Group's assets in line with the Fiduciary Investment Management Agreement between the Group Trustee and the Fiduciary Manager (the "FMA"). The degree of delegation and parameters within which the Fiduciary Manager must operate are set out in the FMA. For example, the Fiduciary Manager is responsible for the selection of investments, including ensuring investments are appropriately diversified and suitable for the Group.

The Fiduciary Manager will also be responsible for advising the Group Trustee during reviews of this SIP in consultation with the Sponsor.

## 3. Objectives

The long-term objective is to be able to pay the benefits as they fall due without reliance on the Sponsor for additional contributions.

Specifically, the Group's investment objective is to invest the Group's assets to aim to achieve full funding on a low-risk basis by March 2026. The long-term funding objective is to maintain this full funding status beyond March 2026 without additional contributions from the Sponsor.

## 4. Investment Strategy

The Group Trustee has reflected its investment objective and investment strategy for the Fiduciary Manager in the parameters of the FMA. The Fiduciary Manager determines an appropriate asset allocation, within certain permitted ranges, which seeks to achieve this objective. In doing so the Fiduciary Manager takes into account the parameters and restrictions contained within the FMA. The FMA is subject to change as the strategy evolves.

### Investment Strategy

- To invest in a portfolio of low risk, bond-like assets which aims to hedge a proportion of the interest rate and inflation risk inherent within the Group's pension liabilities (the "Matching Portfolio");
- To invest in a diversified portfolio of assets to achieve an efficient risk / reward trade off and aim to generate sufficient returns above the pension liabilities to close the Group's funding gap (the "Growth Portfolio"); and
- To evolve the strategy over time as the funding level changes, in line with a Journey Plan.

### Journey Plan

- The Group has designed the Journey Plan in collaboration with the Sponsor, the Fiduciary Manager, Group Actuary and Covenant Adviser. The Journey Plan incorporates a Secondary Funding Target, which allows the Group to use any funding level gains ahead of plan to reduce investment risk.
- The Fiduciary Manager will monitor the agreed Journey Plan which defines how the investment strategy will evolve over time to aim to achieve the investment objective. These obligations are set out in the FMA with the Fiduciary Manager.
- As part of this process the Fiduciary Manager will rely on certain assumptions to determine the expected return across the portfolio of assets relative to the Group's liabilities. These assumptions will be reviewed from time to time and updates will be factored in where appropriate.

### Risk Management

Investment risk is necessary to earn the investment returns required by the Group. Investment risks will be managed by the Fiduciary Manager on behalf of the Group Trustee. The Group Trustee has set risk constraints in the FMA that the Fiduciary Manager must adhere to. This ensures the risks taken are appropriate, acceptable and consistent with the Group's funding and Sponsor covenant risks. The Fiduciary Manager reports on investment risk to the Group Trustee at least quarterly.

## 5. Range of Investments

The Group Trustee considers risk holistically across the Group's portfolio. This means the Group's assets are invested across a diverse range of investments. Asset classes and instruments that pension schemes may use as part of their investment strategy include, but are not limited to, the following:

- **Equities** – these are stocks and shares in companies. Equity shares give the holder a share of a company's profits. They are higher risk but usually higher reward investments;
- **Bonds** – these are loans to companies or governments that pay the holder interest. They are less risky than equities, but usually offer lower returns;

- **Alternatives** – these are equities, bonds or other assets that are sourced privately, rather than through public investment markets. This means they are less 'liquid' than public assets, meaning it is usually harder to sell them for cash if you need to before the specified maturity date. However, these assets usually offer higher returns to reward investors for accepting this lower liquidity. They also usually offer diversification benefits versus public assets. The Fiduciary Manager will seek approval from the Group Trustee prior to investing in this asset class;
- **Derivatives** – the Fiduciary Manager may transact forwards and futures instruments. These are financial contracts between two counterparties that exchange one set of future payments for another. They are used to transfer investment risk from one party to the other. An example would be to reduce currency risk associated with an investment in an overseas asset.

## **Realisation of assets**

Assets can be held in pooled funds or segregated accounts. The Group's ability to disinvest assets for cash is subject to the redemption terms of the asset, which can range from daily to quarterly or sometimes less frequently. Any allocation of the Group assets to strategies with particularly long redemption timelines will be considered with the Group's overall cashflow requirements in mind. Investment in such assets requires prior Group Trustee approval.

The Group Trustee recognises that the Fiduciary Manager, subject to the constraints in the investment management agreement, has authority and discretion to sell the Group's assets to meet collateral requirements.

## **6. Risk Management**

The Group Trustee recognises that a number of risks are involved in the investment of the Group's assets. The Group Trustee recognises that the key risk is that it has insufficient assets pay the benefits as they fall due. This is often called "funding risk".

The Group Trustee has identified a number of risks which have the potential to cause the Group's funding level to decrease and therefore contribute to funding risk. These are detailed in Appendix B of this SIP.

The Group Trustee manages these risks in a variety of ways, including but not limited to the use of diversification, setting parameters and constraints for the Fiduciary Manager in the FMA and its broader risk management framework.

## **7. Responsible Investing**

The Group Trustee recognises that Environmental, Social and Governance (ESG) risks could impact the ability of the Group to meet its investment objectives. The Group Trustee has therefore considered how to evaluate and manage these risks when setting its investment strategy. The Group Trustee shall detail its policies with regards to ESG, stewardship and engagement in the ESG Policy, however a summary of these policies are provided in the paragraphs below and in Section 8.

The Group Trustee will ensure that the Group's Fiduciary Manager shall, alongside other investment risks, integrate consideration of ESG risks throughout its investment decision making processes.

The Group Trustee requires that the Fiduciary Manager:

- Assesses the approach of all the Group's investment managers in integrating ESG risks considerations into the selection, retention and realisation of investments as part of their due diligence process. This will take place before appointing any underlying investment manager.
- Assesses the managers' integration of ESG into the investment process as part of the Investment Due Diligence process.

- Reviews the adherence of the Group's investment managers to their ESG principles as part of its ongoing monitoring. They will report on key ESG metrics for the Group's investment managers and aggregate these to portfolio level where appropriate. This will take place at least quarterly.
- Reports on its execution of voting and engagement responsibilities set by the Group Trustee as part of its ongoing quarterly monitoring. Where the Group invests in pooled funds, the Group Trustee recognises that the investment manager of the pooled funds is responsible for exercising voting rights and reporting on how they have exercised those rights.
- Where UK-domiciled investment managers are not signatories to the FRC's UK Stewardship Code, the Fiduciary Manager shall consider the investment manager's rationale for this position and, where appropriate, report back its findings to the Group Trustee.

The Group Trustee does not take into account non-financial matters when selecting, retaining and realising investments. Non-financial matters are defined as the views of members and beneficiaries, including (but not limited to) their ethical views, and their views relating to social and environmental impact and quality of life. It is not possible to reflect individual member views as the assets are typically held in pooled arrangements.

However, the Group Trustee believes that by being a responsible investor, it is managing investment risk with the aim of enhancing long term portfolio returns, which is in the best interests of the members and beneficiaries of the Group.

In order to better assess climate-related risks and opportunities, the Group Trustee produces a Taskforce on Climate-Related Financial Disclosures (TCFD) report on an annual basis. The intention is that the report helps the Group Trustee better assess the Group's exposures to climate-related risks and ultimately increase the likelihood of meeting the Group's investment objective.

## 8. Stewardship

The Group Trustee understands that stewardship can enhance value over the long term and recognises that it has a responsibility to act as a good steward and protect and grow the long-term value for the benefit of the members.

The Group Trustee recognises the importance of good stewardship and it expects that the Fiduciary Manager is a signatory of the UN Principles for Responsible Investment (UN PRI) and the FRC UK Stewardship Code. The Fiduciary Manager has confirmed that it is a signatory of the UN PRI and the UK Stewardship Code. In order to be a good steward, the Group Trustee has set a policy which states that the Group's respective stakeholders should undertake activities in relation to issues that have a material impact on the long-term value of the Scheme's investments.

The Group Trustee acknowledges that it retains ultimate responsibility for the way in which each appointed manager acts as a steward of the Group's assets, though Group Trustee expects the Fiduciary Manager ensures that the stewardship policy is appropriately implemented as far as is reasonably practicable. The policy includes ensuring to the extent possible that the underlying or external managers exercise on the Group Trustee's behalf rights and duties as an investor. This should include, where appropriate, voting and engaging with underlying investee companies, as part of an effective stewardship approach that meets the Group Trustee's expectations. The Group Trustee expects that voting and engagement activities are carried out in the best financial interests of the assets being managed.

The Group Trustee has delegated monitoring of underlying or external managers to BlackRock. As part of this responsibility, BlackRock is expected to:

- Use reasonable efforts to obtain voting and/or stewardship policies of the underlying or external managers.
- Inquire about underlying manager's voting activity with respect to their stated policies, where appropriate.
- Request that underlying investment managers report on an annual basis a summary of the voting actions which have been taken and any votes cast which differ from the stated voting policy of that manager.

- Provide a summary to the Group Trustee of the overall level of voting activity on an annual basis.

The Group Trustee will engage with BlackRock to understand any reports which have been provided and challenge any outcomes which they feel are not in keeping with policy. BlackRock is expected to engage with the underlying or external managers as and when required to facilitate this. Where an underlying or external manager is not adhering to this policy in line with the Trustee's expectations, the Trustee would expect BlackRock to consider appropriate actions having regard to the long-term financial interests of the Group.

## 9. Arrangements with asset managers

The Group Trustee recognises that the arrangements with all of the managers of the Group's assets are important to ensure that its interests are aligned as far as reasonably practicable. This includes arrangements with the Fiduciary Manager and the underlying or external managers. In particular, the Group Trustee seeks to ensure that the Fiduciary Manager is incentivised to act in a way which generates the best long-term results for the Group.

The Group Trustee agrees to share the SIP with the Fiduciary Manager and requests that the Fiduciary Manager reviews the SIP and confirms that it is aligned with the Group Trustee's policies.

The Group Trustee's arrangements with asset managers take into account the following five considerations:

1. How the arrangement with the Fiduciary Manager incentivises the Fiduciary Manager to align its investment strategy and investment decisions with the Group Trustee's investment policies.
2. How that arrangement incentivises the Fiduciary Manager to make decisions based on assessments about the medium to long-term financial and non-financial performance of issuers of debt or equity.
3. How the method and time horizon of the evaluation of the Fiduciary Manager's performance and the remuneration for services are in line with the Group Trustee's investment policies.
4. How the Group Trustee monitors "portfolio turnover costs" incurred by the Fiduciary Manager, and how they define and monitor targeted portfolio turnover or turnover range
5. The duration of the arrangement with the Fiduciary Manager.

In order to address the above considerations, the Group Trustee has set out a range of actions and expectations below.

The Group Trustee recognises that there are different ways to engage with its managers including legal documentation as well as more informal arrangements such as ad hoc communication and reporting and monitoring deliverables provided by each manager.

The Group Trustee recognises that the predominant manager it has arrangements with is the Fiduciary Manager. The arrangement is governed by the Investment Management Agreement ("IMA") between the Group Trustee and the Fiduciary Manager. The Group Trustee ensures that appropriate restrictions are outlined in the IMA in order to seek to ensure that the decisions which the Fiduciary Manager makes are in line with the long-term interests of the Group. This includes, but is not limited to, setting a clear investment objective, eligible instruments, asset allocation ranges and which asset classes are in scope for active and/or passive strategies.

The Group Trustee has also ensured that the IMA (and the supplemental disclosures provided by BlackRock) include conflicts of interest policies in order to seek to ensure that incentives are aligned between the Group Trustee and the Fiduciary Manager as far as is reasonably practicable.

The Fiduciary Manager provides the Group Trustee with an annual cost transparency report. The report provides information in line with latest regulatory requirements for fiduciary managers. The cost reporting will include detail on the portfolio turnover costs which the Group Trustee defines as the costs incurred in buying and selling the underlying securities held within each of the funds managed by the underlying managers. The cost reporting will also enable the Group Trustee to monitor that the portfolio turnover of the underlying funds is appropriate with respect to the targeted portfolio turnover, which the Group Trustee defines as the frequency within which the securities are expected to be bought or sold. On a quarterly basis, the Fiduciary Manager reports total performance



net of fees so that the Group Trustee is able to take into account the impact of fees and costs when evaluating performance. The Group Trustee believes that in order to appropriately assess the performance of its managers, the net of costs performance returns should be monitored over various time periods to ensure that managers are evaluated in line with the Group Trustee's policies.

The Group Trustee will review the arrangements with the Fiduciary Manager on a regular basis, however there is no restriction on the duration of any arrangement.

The Group Trustee expects that the Fiduciary Manager will review arrangements with the underlying or external managers which also have no restriction on duration of any arrangement. The Fiduciary Manager is expected to review these arrangements on an ongoing basis and take action to seek to revise any arrangements where it is understood to be in the best long-term interests of the Group. The Group Trustee recognises that turnover of underlying managers may incur costs however it acknowledges that this is necessary to ensure the Scheme's assets are managed in a way which is in the best long term interests of the Group.

The Fiduciary Manager is expected to take into consideration the Group Trustee's investment objective as well as Responsible Investing and Stewardship policies when selecting and/or appointing new underlying or external managers.

The Group Trustee believes that it has a clear governance framework in place in order to seek to ensure that the Fiduciary Manager's actions are aligned with the five arrangements policies listed above. If the Group Trustee has reason to believe that the Fiduciary Manager is acting outside of the Group Trustee's policies, then the Group Trustee will bring this to the attention of the Fiduciary Manager as soon as is reasonably practicable and engage with the Fiduciary Manager so that the parties can understand such actions and seek to resolve any concerns.

## **10. Additional Voluntary Contributions**

In addition, the Group Trustee is responsible for investing member Additional Voluntary Contributions ("AVCs") in line with members' preferences.

To ensure that members' long and short-term investment objectives can be met, and allowing for members' differing individual circumstances, the Group Trustee makes available a range of funds from which the member can select to invest their AVCs. In particular, the range of members' attitudes to risk and time to retirement are considered.

The Group Trustee obtains an annual report to assess the ongoing suitability of the funds it offers and reviews the wider market place on a triennial basis.

## **11. Monitoring**

The Group Trustee monitors the performance and risk exposures of the portfolio on a regular basis. The Group Trustee receives periodic reports providing information including but not limited to:

- Explanation of funding level performance over the period, referring to the economic environment, investment market moves and the Group's portfolio positioning
- The risks being taken in the assets, including the outcome of 'stress testing'
- Review of the funding level versus the Journey Plan
- Asset allocation summary versus any FMA constraints
- ESG metrics, including carbon emission figures
- Voting and cost disclosures, in line with the latest regulatory requirements

Monitoring of the underlying investment managers' suitability is delegated to the Fiduciary Manager. The Fiduciary Manager has been delegated the responsibility for ensuring the underlying pooled fund investments are satisfactory and appropriate for the investment strategy.

The performance of the Fiduciary Manager will be independently assessed by a specialist fiduciary oversight firm appointed by the Group Trustee.

**Signed for and on behalf of the Group Trustee**

Andrew Pace

Chair of the Trustee of the UK Power Networks Group of the Electricity Supply Pension Scheme

7 September 2023

## Appendix A – Investment Beliefs

The Group Trustee has sought advice and deliberated over a set of seven beliefs that will guide its strategic investment and governance decisions. It is hoped that these statements will provide an anchor for considered and consistent investment decisions over time and will help influence the regular review of the SIP. These statements were defined in December 2019, and will be tested from time to time, in light of significant changes to the Group or the constitution of the Group Trustee itself.

### **Investment objectives**

We believe that the success or failure of the Group's investment strategy should be judged relative to its liabilities, long-term funding goals and unique circumstances and constraints.

### **Governance**

We believe that clear investment objectives and accountability improve the likelihood of achieving the Group's targets.

### **Investment strategy**

We believe that asset allocation is a more important driver of returns than manager or stock selection. We believe that long-term Strategic Asset Allocation will be the primary driver of returns, but short-to- medium term Tactical Asset Allocation can also add value.

### **Risk**

We believe that risk is multi-faceted and best understood and monitored using a range of quantitative and qualitative approaches covering assets, factors (macro-economic and style) and sustainability considerations. A portfolio should be diversified across rewarded sources of risks and minimise exposures to unrewarded risks.

### **Active Management**

We believe that active management can add value; though it is difficult to identify and maintain skilled active managers. Active management should only be used where we have high conviction it will generate additional returns net of fees and costs, where the underlying drivers of the active return cannot be accessed more cheaply (for example through index and factor-based strategies) or where index-based strategies are unavailable or not appropriate (for example Alternative asset classes).

### **Value for money**

We believe that investment management fees and transition costs are an important consideration when assessing the merits of an investment, in a three-way trade off between risk, return and cost.

### **Environmental, Social and Corporate Governance**

We believe that the Group's investment managers are best placed to implement appropriate policies with respect to good stewardship principles and the incorporation of ESG factors into investment decisions wherever it is reasonably clear that doing so will add value to the Group's investment strategy.

We believe that our active investment managers should consider ESG factors when making investment decisions.

For passive investments, we believe that an ESG-optimised index approach should be used instead of a traditional market capitalisation approach where we have confidence that using the ESG-optimised approach will not detract from our ability to meet our investment objectives. The Fiduciary Manager will be responsible for making this assessment.

The Group's Fiduciary Manager is responsible for assessing and monitoring the investment managers with regards to ESG considerations and will report on this to the Group Trustee at least quarterly.

## Appendix B – Risks

Risk	Description
<b>Mismatching Risk</b>	The risk of a significant difference in the sensitivity of asset and liability values to changes in financial and demographic factors. The Group Trustee and its advisers considers this mismatching risk when setting the investment strategy.
<b>Cashflow risk</b>	The risk of a shortfall of liquid assets relative to the Group's immediate liabilities. The asset allocation has taken into account the Group's expected liability cashflow profile from the most recent Actuarial Valuation. This should offer sufficient liquidity to meet liquidity needs. Should liquidity requirements change then the Group Trustee will notify the Fiduciary Manager and update the FMA accordingly.
<b>Fiduciary Manager risk</b>	The failure by the Fiduciary Manager to achieve the rate of return required to meet the investment objective. This risk is considered by the Group Trustee upon the initial appointment of the Fiduciary Manager and on an ongoing basis thereafter (for example by regular monitoring).
<b>Risk of lack of diversification</b>	The failure to spread investment risk. The Group's assets are invested across a range of investments representing different assets classes in order to target the Group's objective, as set out in the FMA.
<b>Covenant risk</b>	The possibility of failure of the Group's Sponsor. The Group Trustee considers this risk by taking external advice when setting investment strategy and consults with the Sponsor as to the suitability of the proposed strategy.
<b>Currency risk</b>	The risk that exposure to overseas currencies has an adverse influence on investment values. The Group Trustee considers this risk when setting the Group's investment strategy and this is managed risk by hedging a proportion of the overseas currency exposure.
<b>ESG Risks</b>	The risk that Environmental, Social and Governance (ESG) factors, including but not limited to climate change, have an adverse effect on the long-term performance of the Group assets. The Group Trustee requires that the Fiduciary Manager explicitly incorporates ESG information into investment decisions, including when considering the appointment and de-selection of investment managers.
<b>Custodian risk</b>	The risk that a custodian defaults. Assets are managed primarily within pooled funds and custody-related risks in relation to underlying pooled fund investments are managed by management companies or operators of such pooled funds. Outside of the pooled fund investments, the Group Trustee works with the Scheme custodian (BNY Mellon) to manage cashflows and settle trades on time.
<b>Event risk</b>	The risk that events outside the control of the Group have an adverse influence on investment values. The Group Trustee periodically reviews stress tests on the portfolio to understand the effect that extreme events could have on the Group's funding level so that it is able to react accordingly. In addition, the Group invests in a diversified portfolio of assets to help manage event risk.
<b>Counterparty risk</b>	The risk that a counterparty fails to fulfil its side of the agreement it makes in connection with derivative transactions. The Group Trustee has appointed the Fiduciary Manager to mitigate this risk by assessing the credit quality of the counterparties it transacts with, ensures appropriate counterparty diversification and that collateral payments are made where required or delegating through to underlying managers.
<b>Operational risk</b>	The risk of fraud, poor advice or acts of negligence. The Group Trustee has 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.