

The logo for the Pension Protection Fund, featuring a white arc above the text.

Pension  
Protection  
Fund

Protecting  
people's futures

A large, thick white arc that curves around the central text, framing it.

# Statement of Investment Principles

February 2023



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# Contents

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Introduction	<b>2</b>
Governance of the Pension Protection Fund	<b>3</b>
Funding Objective	<b>5</b>
Risk measurement and management	<b>6</b>
Investment Strategy	<b>11</b>
Day-to-day investment management of the assets	<b>14</b>
Day-to-day custody of the assets	<b>18</b>
Transition of assets to the Fund	<b>19</b>
Responsible investment and corporate governance	<b>20</b>
Compliance with this Statement	<b>22</b>
Annex 1 Governance structure	<b>23</b>
Annex 2 Permitted Asset Classes	<b>26</b>
Annex 3 UN Principles for Responsible Investment	<b>29</b>

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# 1. Introduction

- 1.1 The Board of the Pension Protection Fund (“the PPF”) has prepared this Statement of Investment Principles (“the Statement”) in accordance with Section 114 of the Pensions Act 2004 (“the Act”) and the Pension Protection Fund (Statement of Investment Principles) Regulations 2005 (“the Regulations”).
- 1.2 This written Statement outlines the principles and policies governing determinations about investments made by or on behalf of the PPF in the management of the assets of the Pension Protection Fund (“the Fund”). This Statement also takes account of industry best practice for institutional investment decision-making.
- 1.3 This Statement will be reviewed annually, or when there is, or the PPF anticipates that there might be, a significant change in relation to any matter contained in this Statement or to any of the matters which this Statement is required to cover by the Regulations.
- 1.4 This Statement is specifically concerned with the investment of the:
- accumulated levy contributions paid into the Fund.
  - assets transferred into the Fund from eligible pension schemes.
  - monies recovered from insolvent employers.
  - accumulated investment returns.
- Although this Statement does not apply to the assets of schemes in an assessment period (as defined in Section 132 of the Act), the PPF, where appropriate, will work with the trustees of such schemes to encourage co-ordination with the investment strategy of the PPF and to minimise the costs of transitions.
- This Statement covers the Fund. It does not cover the Fraud Compensation Fund for which the PPF is also responsible. A separate Statement of Investment Principles is in place for the Fraud Compensation Fund.
- 1.5 This Statement will be published.

## 2. Governance of the Pension Protection Fund

### 2.1 Investment powers and compliance with the Pensions Act 2004

2.1.1 Section 113 of the Act provides that the PPF may invest for the purposes of the prudent management of its financial affairs. When exercising its power to invest the PPF will consider the interests of current and potential beneficiaries of the Fund and the interests of stakeholders affected by the rate of the levies.

2.1.2 The PPF's Board ("the Board") is responsible for the governance and investment of the PPF's assets. The Board is satisfied that it has sufficient expertise, information and resources to carry out its role effectively. Several members of the Board have significant working experience in the investment industry. Attached in Annex 1 is a breakdown of the governance structure and the associated responsibilities.

2.1.3 In preparing this Statement, the PPF has obtained and considered the written advice of individual specialists employed by the PPF, and of its independent investment advisor, Redington. The Board is satisfied that those individuals have the appropriate knowledge and experience for providing advice to the PPF on the preparation or, as the case may be, revision of the Statement.

The advice considers the matters prescribed under Section 114 of the Act and the Pension Protection Fund (Statement of Investment Principles) Regulations 2005. In addition to the advice needed for the preparation of the SIP, any required actuarial advice relating to the assets and liabilities of the Fund is sought from the PPF's Chief Actuary.

### 2.2 Investment Committee and Asset and Liability Committee

2.2.1 The PPF's funding objective and the appetite for investment risk are the responsibility of the Board.

2.2.2 The Board has established an Investment Committee to set an appropriate mix of assets consistent with the PPF's funding objective and appetite for risk and provide oversight of its implementation. The Investment Committee is accountable to the Board.

2.2.3 The Chief Executive has also established an executive committee, the Asset and Liability Committee ("ALCO"), to oversee the day-to-day investment activities of the PPF.

## 2. Governance of the Pension Protection Fund continued

### 2.3 Day-to-day fund management

2.3.1 The day-to-day fund management of the assets is performed both by external professional fund managers (each of which is authorised and regulated by the Financial Conduct Authority or a similar local regulatory authority as required), and the Chief Investment Officer, with authority to delegate to an in-house team of investment professionals, appointed in accordance with Section 113 of the Act. The Investment Committee is satisfied that the appointed external and in-house fund managers have the appropriate knowledge and experience to carry out their role in accordance with Section 113(6) of the Act. More detail is contained in Section 6.1.

2.3.2 The Investment Committee approves the framework for, and oversees the appointment, monitoring, funding, termination, and performance of, the professional fund managers. ALCO is responsible for confirmation of the selection and funding of managers, as well as monitoring performance and termination for reasons other than redemption or divestment.

## 3. Funding Objective

- 3.1 The PPF's primary aim is to have sufficient funds to pay all the PPF's members, both current and future, their compensation when it falls due. In order to achieve this, the Board has built up reserves in excess of their best estimate of the cost of paying compensation to current members.
- 3.2 Over the next phase of its funding journey the Board has agreed an objective of maintaining financial resilience, which is defined as having a high level of confidence of being able to pay compensation to both the PPF's current and future members in full. The strategic decisions the Board will take in support of this objective will depend on how its reserves compare with the level required to meet the 'Financial Resilience Test. This test requires that reserves must provide a high level of confidence of being able to pay compensation, without relying on investment returns and the levy.
- 3.3 The Board has a very low risk appetite for funding dropping below that needed to meet the cost of paying compensation to current members and has therefore decided to:
- Fully hedge the inflation and interest rate risk in respect of the PPF's current members.
  - Build or maintain a reserve to protect against longevity risk for the PPF's current members.
  - In addition, the Board will seek to continue to build a reserve to cover the potential cost of future claims.
- 3.4 The Board has agreed that the best way to achieve these objectives is to run two separate portfolios:
- A Matching portfolio which focuses on the first of these objectives and is dedicated to paying current member benefits as they fall due.
  - A Growth Portfolio which focuses on protecting and prudently building reserves and is designed to generate a return with the aim of providing for future claims, increased longevity and any other risks that may materialise.
- 3.5 On an annual basis there will be a transfer of funds from the Growth Portfolio to the Matching Portfolio, as per the multi-year plan agreed with the Board. These payments will continue to be made until the Matching Portfolio is fully funded.
- 3.6 The Board will formally review the approach to funding and the appropriateness of the investment strategy every year, with an in-depth review carried out at least every three years.

## 4. Risk measurement and management

- 4.1 The Growth portfolio targets a strategic investment risk level of between 5% and 9%
- The Investment Committee reviews and approves the investment assumptions underlying the strategic investment risk targets for the Growth and Matching portfolios on an annual basis. The allocation to each of the Growth and Matching portfolios, is approximately 50% of total assets by value (as of 1 April 2023) although this is not a fixed target and will vary over time.
- 4.2 In addition to the risk metrics described in 4.1, and with the specific aim of protecting reserves, the PPF's investment strategy is designed such that there is a very low risk of the PPF's reserves declining over a 5-year horizon.
- 4.3 Among the risks assessed and considered by the PPF on an ongoing basis are the following key risks relating to its investments:

**“Liability basis risk”** – This risk arises where changes in the value of the PPF's liabilities are not matched by changes in the value of the PPF's portfolio of liability hedging assets. The PPF manages this risk by defining a liability benchmark as a portfolio of nominal and inflation-linked cashflows which replicates the inflation and interest rate sensitivities of the PPF's expected liability cash flows. The liability hedging assets are managed to closely match the risks of the liability benchmark. The liability benchmark is also regularly recalibrated to the sensitivities of the PPF's expected liability cashflows which change over time.

**“Strategic investment risk”** – This is the risk that the strategic asset allocation (SAA) delivers investment returns that are not consistent with the PPF's investment risk and return objectives. The PPF manages this risk by setting appropriate long and short-term risk measures and limits. These are monitored regularly; if the level of observed or modelled risk is inconsistent with these limits the investment strategy will be reviewed.



**“Illiquidity risk”** – This risk relates to the inability to meet short-term cashflow obligations or the inability to manage unintentional deviations from the SAA because the investment portfolio holds insufficient liquid assets and is unable to sell assets in a timely manner at fair market values. The PPF manages this risk by prudently limiting the exposure to illiquid assets in the strategic asset allocation and by maintaining a level of liquidity in the fund that is sufficient to meet expected cashflow obligations in a stressed scenario.

**“Tactical investment risk”** – This risk arises when the asset allocation of the investment portfolio is moved away from the strategic asset allocation (“SAA”). The PPF’s investment team may implement tactical deviations from the SAA if they believe that this will improve the risk-adjusted return of the Fund in the short-term. The PPF mitigates this risk by limiting the size of asset allocation deviations from the SAA, setting out a list of allowable instruments and asset classes (as set out in Section 6.2.3 and Annex 1 of this Statement), limiting the level of individual and aggregate risk of such positions and by monitoring the level of risk and performance of tactical positions.

**“Currency risk”** – The PPF has determined target currency hedge ratios for each asset class in the strategic asset allocation. Currency risk arises when the non-GBP currency exposure in the investment portfolio differs from the targeted exposure. Deviations may arise from passive changes in currency and asset values or from active decisions taken by the fund managers. This risk is managed by monitoring and limiting the deviations from the targeted exposures.

**“Longevity risk”** – This is the risk that members of the PPF live longer than expected and this leads to greater compensation payments being made from the Fund than expected. The PPF monitors mortality experience and monitors mortality trends and the likely outlook for future experience. Sensitivity testing on the mortality assumptions will be carried out to determine the impact of changes in the assumptions. The PPF is prepared to hedge longevity risk if it feels that this risk has become significant and hedging costs are reasonable. In the absence of hedging we will hold a reserve to protect against the risk materialising.

## 4. Risk measurement and management continued

**“Credit risk”** – This is the risk of default by issuers of financial assets and the risk that the value of these assets may depreciate as a result of an increase in the overall level of perceived credit risk in the market. The PPF controls credit risk exposure by imposing limits on the amount and type of credit assets of the Fund.

**“Concentration risk”** – This is the risk that the PPF has excessive exposure to a single institution or institutions that share a common risk factor, for example by operating in the same industry. The PPF controls this risk by ensuring that the spread of assets, the fund managers’ policies on investing in individual securities and the PPF’s investment guidelines to fund managers provide adequate diversification of investments.

**“Counterparty risk”** – This risk arises when the PPF (or a fund manager appointed by the PPF) enters a financial contract with a third party which then fails, probably through default, to fulfil its obligations. The PPF controls this risk by setting an appropriately high minimum credit rating of counterparties it will transact with and limiting the exposure to any single counterparty.

The PPF requires collateral from counterparties to financial contracts to mitigate the loss in the event they fail to fulfil their obligations under the contracts. Investment Management Agreements with fund managers similarly contain provisions to limit counterparty risk to the PPF. The PPF and its in-house investment team monitor and manage the aggregate exposure of the Fund to each counterparty.

**“Pipeline risks”** – These risks arise from schemes in an assessment period (“SIA”). They include the risk that the investments of the SIA do not sufficiently hedge the risks in the scheme’s liabilities, and the risk that incorrect data regarding the assets and liabilities of SIA leads to inaccurate hedging decisions made by the PPF. To control these risks, the PPF monitors the investments of SIA and liaises with the trustees of SIA regarding their investment policy, monitors the quality of the data, and looks to minimise the length of the assessment period. The PPF may exercise its power of direction if necessary (see Section 5.3).

**“Investment operational risk”**

– This is the risk of loss resulting from inadequate or failed internal processes, people or systems and external events in relation to internal or external operational risk. This includes risk arising from the custody or transfer of assets, either internally or from schemes entering the PPF. The PPF manages these risks by ensuring processes and procedures are robust, documented and operated by trained individuals. Systems are appropriately tested and appropriate business continuity plans are in place. The custodian is subject to ongoing review.

**“Fund manager risk”** – This is the risk that a fund manager makes excessive or persistent losses, or does not perform in a way consistent with its return target. This risk is mitigated through a robust manager selection and monitoring process, and through manager diversification. Upon appointment the PPF will set a performance benchmark and risk expectations and limits. The PPF will also assess and monitor its fund managers against a range of qualitative factors which it believes support successful fund management. These factors are monitored on a regular basis as part of the manager oversight process.

**“Valuation risk”** – This is the risk that assets are mis-valued, in turn resulting in inappropriate investment decisions or inferences – for example, a misallocation of assets, or the mis-statement of the funding level of the Fund. This risk is mitigated through a valuation governance framework that defines the pricing principles, controls, sensitivities and stress tests appropriate to each asset class, together with monitoring processes for them.

**“Market risk”** – The risk of experiencing excessive or persistent losses due to factors that affect the overall performance of the financial markets. This risk is managed through implementation of an investment strategy that is diversified across a range of asset classes, geographical regions and market sectors. Extreme or dysfunctional market conditions may also temporarily hamper the PPF’s ability to accurately maintain its liability hedge. While such conditions are unlikely to exist for long, the PPF mitigates this risk by maintaining a wide range of counterparties for both funded and unfunded securities.

## 4. Risk measurement and management continued

**“Environmental, Social and Governance (ESG) risk”** – This is the risk that material issues or events related to environmental, social or governance concerns can have a significant impact on the long-term performance of assets. For example, climate-related risks (such as policy risks, physical risks or transition risks) are perceived to be systemic in nature, with the potential to impact businesses, markets and economies globally in several ways. ESG risk is mitigated through a responsible investment framework that integrates ESG considerations, including performing due diligence during the manager selection process and ongoing monitoring of portfolios against contractual ESG requirements.

All these risks are a potential threat to the achievement of the PPF's objectives as stated in Section 3. These risks are monitored on a regular basis through ALCO, with periodic review by the Investment Committee.

# 5. Investment Strategy

- 5.1 The PPF regards the selection of asset classes as the decision which has most influence on its ability to achieve its investment objectives.
- 5.2 **Establishing the strategic asset allocation**
- 5.2.1 The Board has approved a strategic asset allocation (SAA) for both the Matching Portfolio and the Growth Portfolio. The construction of the Matching Portfolio considers the nature and timing of liabilities in respect of our current members. The primary on-going objective of the Matching Portfolio is to ensure that we can pay compensation to current members as payments fall due. This is achieved primarily by hedging the inflation and interest rate risks associated with the liabilities. The ultimate, long-term objective for this portfolio is to become self-sufficient and fully funded.
- 5.2.2 The Matching Portfolio is predominantly made up of hedging assets that aim to replicate the interest rate and inflation sensitivities of the PPF's liabilities so that changes in the value of the liabilities will be closely matched by changes in the value of the hedging assets. These assets include bonds, derivatives, and hybrid assets. Hybrid assets have hedging characteristics but also generate excess returns which help to finance the limited leverage in this portfolio.
- 5.2.3 The SAA for the Growth Portfolio currently has a long-term expected return of 6% with strategic risk of 7.4%. The portfolio is also designed such there is very low risk that the portfolio will produce a negative cumulative return over a 5-year horizon.
- 5.2.4 The Growth Portfolio is made up of a diversified set of assets which, over the long term, are expected to generate an expected return for the given strategic risk target, as stated above.

## 5. Investment Strategy continued

- 5.2.5 At any given time, a minimum level of assets of sufficient liquidity and quality will be held across both the Matching and Growth portfolios to ensure the PPF is able to satisfy collateral or margin calls which may arise as a result of the derivatives positions it holds.
- 5.2.6 Alongside the strategic asset allocation, the PPF also permits tactical investment views to be taken in both the Growth and Matching Portfolios, either to enhance return, or to control risk. The combination of the strategic asset allocation and any tactical positions taken must operate within the range of investment risk targeted by the PPF for the relevant portfolio.
- 5.2.7 Asset protection, or hedging, strategies may also be employed, as appropriate, to mitigate the risk of a fall in the value of assets.
- 5.2.8 The performance of the two portfolios is measured separately. The Matching Portfolio is measured against the liability benchmark. This benchmark will change periodically as a result of the PPF accepting the legal obligation to pay compensation to members of eligible pension schemes, as well as changes to the actuarial assumptions used to determine it. The performance of the Growth Portfolio will be assessed against an objective of a SAA-weighted composite of asset class benchmarks for the Growth Portfolio.
- 5.2.9 The strategic asset allocation described in 6.2.2 will be reviewed annually by the Investment Committee. An earlier review may be conducted in the event of any significant change in capital markets, the liabilities of the Fund, or governing legislation.

## 5.3 Schemes in Assessment

5.3.1 The PPF and the in-house investment team will also monitor the investment strategies and liabilities of pension schemes in assessment and consider whether and how the investment risks associated with these schemes might be mitigated within the investment strategy of the PPF for the Fund.

5.3.2 Specifically, the PPF will:

- Engage, where appropriate, with the trustees of schemes entering an assessment period to encourage co-ordination with the investment strategy of the PPF and to minimise the costs of transition.
- Monitor the asset allocation of schemes in assessment and, where necessary, adjust the asset allocation of the Fund to compensate for any imbalance caused by these schemes.
- Consider the use of its program of interest rate and inflation hedging to mitigate the residual risks not covered by the investment strategies of schemes in assessment. The PPF will control these risks by monitoring their key characteristics, setting appropriate tolerances and taking corrective action when these tolerances are exceeded.

The PPF also has the power to make a direction, under Section 134 of the Act, to the trustees of a scheme in assessment with a view to ensuring that the scheme's protected liabilities do not exceed its assets or, if they do, to keep the excess to minimum as this poses a risk to the PPF.

The PPF is also able to make a loan to a scheme in assessment under Section 139 of the Act where the trustees of such a scheme are unable to pay benefits to the members as they fall due.

## 5.4 Cash flow

5.4.1 The PPF is satisfied that, to the extent required by its Liquidity Risk Policy, the mandates awarded to the fund managers mean that sufficient assets held will be readily realisable to provide cash to meet payments out of the Fund.

5.4.2 To assist with cash flow management the PPF also has the power to undertake borrowing in accordance with Sections 115 and 115A of the Act.

## 6. Day-to-day investment management of the assets

### 6.1 Fund management

- 6.1.1 For the management of the portfolios, the PPF employs the services of investment experts as its external and internal fund managers and has specified investment guidelines and instructions concerning various types or categories of investment decisions. The fund managers make their trading decisions independently of the PPF.
- 6.1.2 The external fund managers are selected by a competitive tender process. As part of this selection, due diligence is performed to ensure that the assets are invested with sufficient security, liquidity and consideration for the medium to long-term, and that each fund manager has sufficient expertise and experience to carry out their role.

This includes an operational due diligence assessment of the manager's operational infrastructure, processes and controls supporting the management of the PPF's investment. As part of the procurement process, fund managers are expected to comply with the PPF's ESG requirements (see Section 9.6) as a minimum and, furthermore, managers are evaluated on the strength of their responsible investment practices.

- 6.1.3 Fund managers' activities are defined and constrained by detailed agreements, to ensure that each fund manager is fully aware of the PPF's specific objectives, time horizons and expectations for any given asset class or strategy. This is to align the fund managers' investment approach with that of PPF's, and to ensure that each manager is appropriately incentivised to meet these requirements.



**6.1.4** Manager agreements explicitly incorporate the PPF's ESG requirements on issues relating to responsible investment, such as integration of material ESG considerations into assessments of issuers; stewardship practices including engagement and voting activities; exclusions; and reporting.

**6.1.5** On an ongoing basis, the PPF conducts regular manager monitoring and holds review meetings with each of the managers, to review performance against set objectives and discuss portfolio positioning and the future outlook. The PPF's manager monitoring includes periodic reviews of each manager's operational processes and controls. Managers are also required to report against the PPF's ESG requirements and are expected to update their responsible investment approach in line with best practice.

**6.1.6** The fund managers are set specific benchmark and performance objectives by the PPF. As a way of limiting the extent to which fund managers may deviate from their benchmark, the PPF agrees tracking error ranges or specific volatility targets, with the fund managers. Fund manager performance and risks are monitored by ALCO. Material or unexpected deviations may result in a formal review.

## **6.2 Investment performance benchmarks**

**6.2.1** The performance of the Matching Portfolio is measured against a liability benchmark. This is a notional portfolio of zero-coupon fixed interest instruments and zero-coupon inflation-linked instruments that is designed to replicate the inflation and interest rate sensitivities of the Fund's expected liability cash flows. The liability benchmark portfolio will change over time as new pension schemes transfer to the PPF.

**6.2.2** The investment performance of the Growth Portfolio is measured against a weighted composite of benchmark returns for Permitted Asset Classes. More detail on what constitutes Permitted Asset Classes is included in Annex 2.

The PPF will monitor the asset allocation of both the Matching portfolio and the Growth portfolio with respect to the target strategic asset allocation. The Portfolios will be constructed from the Permitted Asset Classes with approximate asset allocations as shown in the tables below:

## 6. Day-to-day investment management of the assets continued

MATCHING PORTFOLIO		
Permitted Asset Class	Strategic Allocation	Asset Benchmark Index
<b>Liability hedging instruments:</b> <ul style="list-style-type: none"> <li>– UK conventional and index-linked Gilts</li> <li>– Interest rates and inflation swaps</li> <li>– UK gilt repurchase agreements</li> <li>– Exchange traded derivatives</li> <li>– Cash</li> </ul>	<b>70%</b>	Liability benchmark
Hybrid assets (assets with return-seeking and liability hedging characteristics)	<b>30%</b>	Independent bespoke performance review process

GROWTH PORTFOLIO		
Permitted Asset Class	Strategic Allocation	Asset Benchmark Index
Global Government Bonds	<b>0%</b>	JP Morgan Global Government Bond Index (ex-UK)
Global Corporate Bonds	<b>6%</b>	Bloomberg Barclays Global Credit Index
Emerging Market Debt	<b>8%</b>	Absolute return & JP Morgan EM Indices
Public Equity	<b>12%</b>	FTSE All World Low Carbon Minimum Variance Index
Alternatives (including property, private equity, alternative credit, infrastructure, farmland and timberland)	<b>50%</b>	MSCI Real Estate, Cambridge Associates, CS Leveraged Loan Index, EDHEC Infrastructure Equity Index
Absolute return strategies	<b>10%</b>	Absolute return
Short Duration Sterling Credit	<b>10%</b>	Independent bespoke performance review process
Cash	<b>4%</b>	SONIA based benchmarks

- 6.2.3** For the purpose of judging performance, particularly where an asset class is liquid and readily traded, an appropriate benchmark will be used. Where no market index or generally accepted benchmark is available, the Investment Committee will define an appropriate benchmark or performance review process.
- 6.2.4** Any tactical or hedging position taken must be expressed using Permitted Asset Classes (Annex 2) or their derivative instruments, and within strictly defined limits set by the Investment Committee.
- 6.2.5** Deviations from the target asset allocation in both the Growth and Matching Portfolios will be managed within agreed tolerance ranges and with respect to the target risk and agreed risk limits.
- 6.2.6** Mandates for each fund manager will be agreed prior to their appointment. Strategies relating to the control of transaction costs and soft commission will be specified in these mandates. Where managers are no longer delivering on the objectives for which they were appointed, the PPF will consider moving assets to an alternative manager or re-procure for that particular strategy.
- 6.3 External Fund Manager Fees**
- 6.3.1** The PPF will pay such fees and expenses as are negotiated with external fund managers from the Fund in accordance with the Pension Protection Fund (Prescribed Payments) Regulations 2008 No 664, as amended<sup>2</sup>.
- 6.3.2** The fund managers are currently remunerated by an ad valorem fee based on the level of assets under management and, in some cases, a performance-related fee based on out-performance over a specific benchmark or target.
- 6.3.3** The costs of management and transactions, including the costs of portfolio turnover, will be reviewed from time to time, and if appropriate, renegotiated. Where relevant for certain asset classes or strategies, appropriate levels of turnover may be determined and monitored to ensure they remain within the PPF's expectations for that particular mandate.

<sup>2</sup> Amended by the Pension Protection Fund (Prescribed Payments and Investment Costs – Amendment) Regulations 2011 No 671

## 7. Day-to-day custody of the assets

7.1 The PPF appoints custodians with regard to the safekeeping of the assets in the Fund and other investment administrative requirements.

7.1.1 The PPF may participate in securities lending within limits set by the PPF.

### 7.2 Performance

7.2.1 ALCO will consider from time to time, and at least annually, the performance of the custodians according to specifically agreed key performance indicators.

### 7.3 Custody fees

7.3.1 The PPF will pay such fees and expenses as are negotiated with the custodians from the Fund in accordance with the Pension Protection Fund (Prescribed Payments) Regulations 2008, as amended.

7.3.2 The costs of management and transactions are reviewed at least annually and if necessary renegotiated. The overall performance of the custodians is reviewed at least annually by ALCO.

## 8. Transition of assets to the Fund

- 8.1 The PPF recognises that the asset allocation of eligible pension schemes may not reflect the PPF's strategic asset allocation but would expect to manage the transition of those assets into the Fund periodically to be consistent with the funding objectives in 3.1.
- 8.2 The PPF will consider the timing, liquidity, and cost of transition of assets of transferring schemes that do not match the asset strategy of the PPF. The PPF will merge these assets into the Fund at the time it deems most appropriate. The PPF may also retain without limit annuity contracts held by transferring schemes to meet specific liabilities.

## 9. Responsible investment and corporate governance

- 9.1 The PPF's primary concern, in setting its investment strategy, is to act in the best financial interests of the Fund and its beneficiaries, seeking the best return that is consistent with a prudent and appropriate level of risk.
- 9.2 The PPF believes that in order to fulfil this commitment and to protect and enhance the value of the investments in the Fund, it must act as a responsible and vigilant asset owner and market participant.
- 9.3 The PPF further believes that ESG factors can have an impact on the performance of its investments, and that the management of ESG risks and exploitation of ESG opportunities, particularly for a portfolio-wide issue like climate change, can add value to its portfolio.
- 9.4 The PPF defines ESG factors as the interaction of its investments with:
- the physical environment (environmental);
  - communities, workforces, wider society and economies (social);
  - the governance structures of the organisations and markets we invest in, as well as of our agents (governance, including corporate governance).
- 9.5 The PPF is a signatory to the UN-supported Principles for Responsible Investment (PRI), a set of best practice principles on Responsible Investment. The PPF intends to use these Principles (set out in Annex 3) as a benchmark with which to guide its own approach to responsible investment, and in doing so will seek to apply responsible investment practices across all the assets in which it invests, across both Portfolios.
- 9.6 The PPF will integrate the consideration of material ESG and climate-related issues throughout the investment process, across all asset classes and markets in which it invests. The PPF expects its fund managers, where appropriate, to have integrated material ESG factors, including climate-related risks, as part of their investment analysis and decision-making process. Appropriate weight will be given to ESG policies, processes, stewardship activities and reporting in the appointment of fund managers. The PPF will engage with and hold fund managers to account in this regard as part of its regular monitoring process.

- 9.7 The PPF will also demonstrate appropriate stewardship activities through responsible allocation, engagement, and monitoring of its fund managers, investee companies and other agents. In particular the PPF, or its agents on its behalf, will exercise its ownership rights, including access to company management and voting rights on matters including capital structure, risk, strategy, performance, social and environmental issues (including climate change) and corporate governance, in order to safeguard sustainable returns. Where there is a potential for any conflicts of interest, the PPF expects its external agents to identify and manage any conflicts in accordance with Principle 3 of the FRC's UK Stewardship Code, putting the best interests of clients and beneficiaries first.
- 9.8 In addition to engaging with companies either directly, or through external agents, the PPF also undertakes joint or collaborative engagements with other asset owners or institutional investors, through public policy and industry initiatives in the various markets in which the Fund invests to promote better practices.
- 9.9 In line with its commitment to transparency, the PPF will report to its stakeholders on its responsible investment activities.

# 10. Compliance with this Statement

- 10.1 The Investment Committee will monitor compliance with this Statement annually. The Investment team and Compliance team will obtain written confirmation from both the external and in-house fund managers that they have complied with the investment restrictions of their mandates and advise the fund managers promptly and in writing of any material change to this Statement.



# Annex 1

## Governance structure

### **The Board is responsible for:**

- Setting structures and processes for carrying out its role
- Setting the funding framework, including objectives and an acceptable investment risk appetite within that framework
- Securing that this Statement is reviewed and, if necessary, revised, at prescribed intervals, and obtaining and considering the written advice of the investment adviser, the PPF's actuary and legal adviser and modifying it if deemed appropriate
- Providing oversight of the Investment Committee
- Consulting with relevant bodies when reviewing investment policy issues

### **The Investment Committee is responsible for:**

- Developing the investment principles and strategic approach to investment of the Fund
- Reviewing this Statement at prescribed intervals and approving revisions to this Statement or recommending changes, and where these are material, referring them to the Board for approval
- Developing and maintaining the responsible investment principles in respect of the Fund
- Determining the overall approach to risk management of investments and asset liability matching, including setting the asset allocation strategy, and the flexibility around which any risk budget may be expressed
- Determining the principles for dealing with the investments of schemes in assessment and subsequent transfer to the Fund
- Approval of the framework and oversight of the appointment, retirement and contractual review of the fund managers (as defined in Section 113(6) of the Act) including the assessment of appropriate knowledge and experience under Section 113(6) of the Act
- General oversight of the investment performance
- Approval of the framework for the appointment, retirement and contractual review of any investment advisers
- Approval of the framework for the appointment, retirement and contractual review of the custodian of the Fund

# Annex 1 continued

## Governance structure continued

### The Asset and Liability Committee is responsible for:

- Monitoring the implementation of the investment strategy and this Statement
- Confirmation of the appointment, funding, termination (for reasons other than redemption or divestment) and contractual review of the fund managers (as defined in Section 113(5) of the Act) including the assessment of appropriate knowledge and experience under Section 113(6) of the Act
- Confirmation of the appointment, retirement and contractual review of any investment advisers
- Confirmation of the appointment, retirement and contractual review of the custodian of the Fund
- Reviewing on a monthly basis the investment managers' investment performance and compliance with investment mandates
- Monitoring the performance of the custodian of the Fund
- Monitoring the flows of cash and scheme assets transferred to the Fund making sure the asset allocation does not deviate significantly from the strategic asset allocation
- Monitoring financial risks including, all investment risks relative to the liabilities, insurance risks and, where necessary, initiate remedial measures
- Collaborating with the Chief Actuary in the annual valuation of the Fund, including choice of actuarial assumptions
- Sponsoring the development of specific risk mitigation measures such as liability hedges

### The Investment Advisor to the Investment Committee is responsible for:

- Advising on all aspects of the investment of the Fund assets including implementation of strategy
- Advising on this Statement
- Providing training in investment matters to the Board

**The fund managers are responsible for:**

- Discretionary management of the portfolio, including implementation (within guidelines given by the Investment Committee) of changes in the asset mix and selecting securities within each asset class
- Providing the PPF with quarterly statements of the assets together with a quarterly report on actions and future intentions, and any changes to the processes applied to their portfolio
- Informing the PPF of any changes in the internal objectives and guidelines of any pooled funds used by the PPF as soon as practicable
- The safekeeping of the assets within the pooled funds in which the PPF invests
- Investing income paid into the Fund in a timely manner
- Reconciling the manager's record of assets held with those of the Custodian

**The custodians are responsible for:**

- The safekeeping of all the directly held assets of the Fund
- Undertaking all appropriate administration relating to the held assets of the Fund
- Processing all income with respect to the Fund in a timely manner
- Processing all tax reclaims in a timely manner
- Investing cash in a suitable low risk manner consistent with the provision set out in the investment management agreements as agreed by the PPF
- Reconciling records of assets held with those of the managers

**The transition managers are responsible for:**

- Moving assets between fund managers and/or asset types in a cost-efficient way whilst minimising risks
- Managing the asset transition process when pension schemes in assessment fall into the PPF

# Annex 2

## Permitted Asset Classes

The assets of the Fund will be invested in a portfolio taken from the following list of Permitted Asset Classes (all global unless specified):

### MATCHING PORTFOLIO

#### Liability-Hedging Assets

- UK Gilts (fixed and inflation linked)
- Annuity contracts held by the PPF secured on the life of specific members
- Sterling denominated interest rate and inflation swaps
- Exchange traded derivatives
- UK Gilts repurchase agreements
- Sterling corporate bonds from government backed institutions and Sterling corporate bonds from systemically important institutions with very high financial and/or operational linkage to government
- Repo, reverse repo and total return swap agreements
- Swaptions

#### Hybrid Assets

- Sterling corporate debt (including index linked corporate debt)
- Municipal bonds
- Asset backed securities
- Structured notes
- Collateral upgrade trades
- Assets with long-term stable cash flows (e.g. long-term lease property, infrastructure debt, infrastructure project loans, real estate debt)

## GROWTH PORTFOLIO

### Return-seeking assets

- Global sovereign bonds
- Other bonds of investment grade or sub-investment grade credit quality
- Emerging market debt
- Equities listed on recognised stock markets, including Exchange Traded Funds (ETFs)
- Property
- Private Equity
- Alternative credit (including illiquid credit assets such as senior loans, leveraged loans, distressed debt, long and short positions on credit default swaps, mezzanine debt)
- Infrastructure
- Farmland
- Timberland
- Commodities (limited to Diversified Commodity Index Products, Energy futures (for strategic hedging purposes in private market portfolios), long only positions in Emission Trading Scheme Futures).

# Annex 2 continued

## Permitted Asset Classes continued

### MATCHING & GROWTH PORTFOLIOS

#### Cash Assets

- Sterling short maturity, highly liquid, interest-bearing investments (e.g. Commercial paper (CP), certificates of deposit (CD), short dated government bonds and bills, term deposits, highly rated fixed and floating rate bonds)
- Money market funds
- Liquidity funds
- Sterling interest rate swaps and futures
- Repo and reverse repo agreements
- Short term foreign currency bills, CDs and CP hedged to Sterling
- Foreign Exchange contracts to control currency risk

Tactical and hedging positions may be taken using the Permitted Asset Classes above and their derivative instruments (with limits on the use of commodities).

Positions in commodities may be used to strategically hedge illiquid exposure with commodity related risk. They may not be used to hedge liquid positions taken by fund managers. In tactical portfolios only, diversified commodity index products and long only positions in Emission Trading Scheme futures may be used.

# Annex 3

## UN Principles for Responsible Investment

- Principle 1:** We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2:** We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3:** We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4:** We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5:** We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6:** We will each report on our activities and progress towards implementing the Principles.



Pension  
Protection  
Fund