NHBC Pension Scheme

Statement of Investment Principles April 2023 (Replaces September 2022)

1. **Introduction**

NHBC Pension Trustee Limited, the Trustee of the NHBC Pension Scheme ("the Scheme"), has drawn up this Statement of Investment Principles to comply with the requirements of the Pensions Act 1995, the Occupational Pension Schemes (Investment) Regulations 2005 and subsequent legislation and associated requirements.

The Statement is intended to affirm the investment principles that govern decisions about the Scheme's investments. A separate document detailing the specifics of the Scheme's investment arrangements is available upon request.

In preparing this Statement, the Trustee has obtained written advice from the Scheme's Investment Consultant and the Trustee believes the Investment Consultant meets the requirements of Section 35(5) of the Pensions Act 1995 (as amended). The Trustee has also consulted NHBC, the Sponsoring Employer, in relation to this Statement and to ascertain whether there are any material issues of which the Trustee should be aware in agreeing the Scheme's investment arrangements.

2. **Process For Choosing Investments**

The Trustee has considered its investment and funding objectives together and in light of the strength of the Sponsoring Employer covenant to ensure that the two are compatible and supportable. The Trustee has then constructed a portfolio of investments consistent with these objectives and which it hopes will will deliver the maximum level of return (net of all costs) for the level of risk taken on (taking into account limitations on the overall complexity of arrangements appropriate to the size of assets under management).

The Trustee takes into account what it believes to be financially material considerations over an appropriate time horizon, which can include risk and return expectations as well as Environmental, Social and Governance ("ESG") issues where these are considered to have a material impact on income, value or volatility of an investment held or the overall portfolio of investments held by the Scheme. Specific considerations are detailed throughout this Statement.

In considering the appropriate investments for the Scheme the Trustee has obtained and considered the written advice of Mercer Limited, whom the Trustee believes to be suitably qualified to provide such advice. The advice received and arrangements implemented are, in the Trustee's opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended).

3. Investment Objectives

The objectives set out here, and the risks and other factors referenced are those that the Trustee determines to be financially material considerations in relation to the Scheme.

The Trustee's objective is to invest the Scheme's assets in the best interests of the members and beneficiaries, and in the case of a potential conflict of interest with the Company in the sole interest of the members and beneficiaries. Within this framework the Trustee has agreed the following objectives to help guide it in its strategic management of the assets and control of the various risks to which the Scheme is exposed:

- To restore and then maintain the Scheme's funding position, on an ongoing (i.e. Technical Provisions) basis, to at least 100%, taking account of short term fluctuations.

- To ensure that it can meet its obligation to the beneficiaries of the Scheme.

- To ensure that the Scheme's investment and funding strategies are consistent.

Given the nature of the liabilities, the investment time horizon of the Scheme is potentially long-term (in excess of 10-15 years). However, any future opportunities to transfer liabilities (fully or partially) to an insurance company (e.g. through the purchase of bulk annuities with an insurance company) may shorten the Scheme's investment horizon significantly.

4. Risk Management and Measurement

There are various risks to which any pension scheme is exposed, which the Trustee believes may be financially material to the Scheme. The Trustee's policy on risk management over the Scheme's anticipated lifetime is set out below.

- The primary risk upon which the Trustee focuses is that arising through a mismatch between the Scheme's assets and its liabilities. Key strategic investment risks that impact on Scheme funding are as follows:

    - **Interest rate and inflation risk –** the risk that changes in the value of the assets do not move in line with changes in the value placed on the Scheme's liabilities in response to changes in interest rates and inflation;

    - **Credit Risk** - the risk that one party to a financial instrument will cause a financial loss to the Scheme by failing to discharge an obligation.

    - **Currency Risk** – the risk that foreign currency exposure causes asset valuations to fluctuate in an uncorrelated way with the value of the liabilities which are denominated in Sterling.

    - **Liquidity Risk** – the risk that the Scheme doesn't have sufficient liquid assets to meet payments.

- Considerations specific to Environmental, Social and Governance issues are addressed in Section 11.

- The Trustee recognises that whilst increasing risk increases potential returns over the longer term, it also increases the risk of a shortfall in returns relative to that required to cover the Scheme's liabilities as well as producing more short-term volatility in the Scheme's funding position. The Trustee has established an investment policy designed to reduce this risk, without damaging the Scheme's long term return prospects using asset-liability modelling conducted by its professional advisors to measure the contribution of different risk factors to overall Value at Risk ("VaR").

- The Trustee has developed a Liability Driven Investment ("LDI") framework which seeks to reduce the mismatch between the sensitivity of the assets and the liabilities to changes in interest rates and inflation. The LDI portfolio targets hedge ratios of 90% for interest rates and 90% for inflation relative to Technical Provisions (based on point in time modelling analysis that is refreshed periodically). The Trustee recognises that the target LDI portfolio will not produce a perfect match for the liability values.

- The Scheme's LDI portfolio is invested on a pooled fund basis. However, the underlying investments include derivative exposures that introduce other specific risks that are additional to the risks presented from investing in the equivalent physical asset. These include:

  - basis risk (the risk that the derivative invested in does not perfectly match the physical asset that the derivative has replaced);

  - roll risk (the risk that the terms available when the derivative or repurchase agreement ("repo") is taken out are not available when the contract expires and is replaced);

  - recapitalisation risk (the risk that adverse price movements require payment of capital in order to maintain the position);

  - collateral and counterparty risk (the risk that the party with whom the LDI manager has contracted defaults and that any collateral is insufficient to make good any resulting loss);

  These risks are mitigated through the specific arrangements that are implemented so that the likelihood of the risks is low and/or the impact of them is low.

- Credit risk is managed via the strategic allocation and investing in pooled fund(s) with diversified holdings of bonds that are predominantly of investment grade quality.

- Regarding liquidity risk, the Trustee believes that the majority of the Scheme's investments are realisable at short notice in most prevailing market conditions.

- The Trustee recognises the risks that may arise from the lack of diversification of investments. Subject to managing the risk from a mismatch of assets and liabilities, the Trustee aims to ensure the asset allocation policy in place results in an adequately diversified portfolio. In addition, the Scheme's investment managers are expected to hold diversified portfolios of assets to control the risk of over-exposure to individual stocks.

- The documents governing the manager appointments include a number of guidelines which, among other things, are designed to ensure that only suitable investments are held by the Scheme. The managers are prevented from investing in asset classes outside their mandates without the Trustee's prior consent.

- Arrangements are in place to monitor the Scheme's investments to help the Trustee check that nothing has occurred that would bring into question the continuing suitability of the current investments. The Trustee receives regular reports from all the investment managers and the Investment Consultant. These reports include an analysis of the overall level of risk and return, along with their component parts, to ensure the risks taken and returns achieved are consistent with those expected. In addition, there is a program in place to meet with the Scheme's investment managers should it be deemed necessary.

The Trustee's willingness to take investment risk is dependent on the continuing financial strength of the Sponsoring Employer and its willingness to contribute appropriately to the Scheme. The financial strength of the Sponsoring Employer and its perceived commitment to the Scheme is monitored and the Trustee will consider reducing investment risk relative to the liabilities should either of these deteriorate.

The degree of investment risk the Trustee is willing to take also depends on other circumstances, including the financial health of the Scheme, the Scheme's liability profile and investment time horizon. It will monitor these with a view to altering the investment objectives, risk tolerance and/or return target should there be a significant change in these factors.

5. Portfolio Construction

The Trustee has adopted the following control framework in structuring the Scheme's investments:

- There is a role for both **active and passive management**. Passive management involves employing investment managers to track the return of a chosen benchmark appropriate to the asset class held. Active management involves employing investment managers who aim to outperform a benchmark but with the risk that they will underperform. By employing both the Trustee aims to take advantage of active management where it believes it is likely to lead to outperformance net of fees, while using passive management in other areas or alongside active management to control overall manager risk and to manage overall fee levels.

- The Trustee recognises that active management gives rise to **active risk**, examples of which are:
  - Active management within an asset category, defined as holding a combination of securities that differs from the asset class benchmark.
  - Active management across asset categories, which arises when the combination of asset categories held differs from that of the benchmark.
  - Skill-based investment strategies, e.g. market-neutral and arbitrage strategies, which are usually largely made up of active risk.
  - Manager selection risk arises due to the potential for selecting an active manager that underperforms its benchmark on a net of management and transaction fees basis.

- **Active** and "**buy and maintain**" approaches to corporate bond management are used, as opposed to passive management, given inefficiencies associated with market capitalisation corporate bond indices and associated turnover costs.

- To help **diversify** manager specific risk, more than one manager has been appointed.

- At the total Scheme level and within individual manager appointments investments should be broadly **diversified** to ensure there is not a concentration of investment with any one issuer. This restriction does not apply to investment in UK Government debt.

- Decisions on **segregated vs pooled** investments will be taken based on the particular circumstances, including the need for diversification, available vehicle, investment restrictions contained in pooled funds, the need for and availability of an independent custodian, ease of administration and portability of underlying investments. However, the Trustee anticipates investing on a pooled basis.

- **Specialist managers** are preferred over generalists because of the potential to access a higher level of expertise.

- The amount invested in highly **concentrated portfolios** will take into account the level of risk this represents.

- The Trustee recognises that there is **liquidity risk** in holding assets that are not readily marketable and realisable. Given the long-term investment horizon of the Scheme, it believes that a degree of liquidity risk is acceptable because it expects to be rewarded for assuming it.

- Investment in **derivatives** is permitted either directly or within pooled funds as long as they contribute to a reduction in risk or facilitate efficient portfolio management (including the reduction of cost or the generation of additional capital or income with an acceptable level of risk).

- Investment may be made in securities that are not traded on **regulated markets**. The Trustee recognises the associated risks of these investments, in particular liquidity risk, and will consider its tolerance to these risks in setting a strategic allocation to such securities.

- The Trustee will not invest directly in the **Employer**, but acknowledge that indirect investment is possible as a result of the investment policies of the Scheme's pooled investment managers. The Trustee will invest in such a way that indirect exposure will not exceed 5% of total assets.

- No investment is permitted by an appointed investment manager in the securities issued by the relevant **manager's company or any affiliated companies** (other than any such securities held within a pooled fund in which the Trustee invests).

- **Direct borrowing** (such as the use of an overdraft facility) is not permitted except to cover short term liquidity requirements. The use of **borrowing within pooled funds** is reviewed by the Trustee as part of the onboarding process for new investments.

- The safe **custody** of the Scheme's assets is delegated to professional custodians (either directly or via the use of pooled vehicles).

- Across all of the Scheme's investments, the Trustee is aware of the potential for regulatory and political risks. **Regulatory risk** arises from investing in a market environment where the regulatory regime may change. This may be compounded by **political risk** in those environments subject to unstable regimes.

6. Investment Strategy

The Trustee has agreed, based on expert advice, an investment strategy as set out in the table below.

Asset Class	Target Allocation (%)
Growth Assets	**14.0**
Multi-Asset Credit ("MAC")	8.0
Senior Private Debt	6.0
Matching Assets	**86.0**
UK Corporate Bonds	43.0
Liability Driven Investment ("LDI")	43.0
Total	**100.0**
Hedge Ratios[1]	**90%**

Source: Mercer.
[1]Hedge ratios are interest rate and inflation hedge ratios measured as a proportion of Technical Provisions liabilities.

The Scheme's investment strategy is implemented using a range of specialist investment managers. As such the Scheme's asset allocation is not automatically rebalanced. The Trustee monitors the allocation of the Scheme's investments relative to the strategic targets outlined above and will consider whether to take action if actual allocations deviate significantly from their targets. In the normal course of events the Trustee would not expect the allocation between growth and matching assets to deviate by more than +/- 5% from the target allocations. However, the actual allocations will vary from the above due to market price movements and intervals between rebalancing the portfolio.

The Scheme's LDI portfolio utilises leverage to achieve an increased level of interest rate and inflation hedging than would otherwise be possible. Leverage levels and associated collateral support were a key consideration for the Trustee when designing an appropriate hedging solution for the Scheme. The Trustee also monitors the amount of leverage / collateral in the LDI portfolio with the aim of maintaining appropriate and manageable levels.

The Trustee will consider from time to time holding other asset classes so as to diversify the Scheme's assets further and improve returns on a risk adjusted basis and / or reduce funding level volatility / improve cashflow matching.

7. Day–to-Day Management of the Assets

The Trustee delegates the day-to-day management of the assets, including selection, retention and realisation, to a number of investment managers across a range of mandates. The Trustee has taken steps to satisfy itself that the managers have the appropriate knowledge and experience for managing the Scheme's investments and that they are carrying out their work competently.

- The Trustee has determined, based on expert advice, a benchmark mix of asset types and ranges within which each appointed investment manager may operate.

- The Trustee regularly reviews the continuing suitability of the Scheme's investments, including the appointed managers. It does so via regular reports and presentations from the appointed managers with the assistance of the Scheme's appointed investment advisor. Any adjustment would be done with the aim of ensuring consistency with this Statement.

- Details of the appointed managers and their mandates can be found in a separate document produced by the Trustee entitled "Summary of Investment Arrangements", which is available to members upon request.

Section 13 sets out how the Trustee incentivises investment managers, where applicable, to operate in line with the Trustee's objectives.

8. Expected Return

The Trustee expects to generate a return, over the long term, at least in line with that of the actuarial assumptions under which the Scheme's funding has been agreed. It is recognised that over the short term performance may deviate significantly from the long term target.

9. Additional Assets

Under the terms of the Trust Deed the Trustee is responsible for the investment of Additional Voluntary Contributions ("AVCs") paid by members and also the assets relating to some members' transferred-in benefits. The Trustee reviews the investment performance of the funds in which assets are held on a regular basis and takes advice as to the providers' continued suitability.

10. Selection, Retention and Realisation of Investments

The selection, retention and realisation of assets is carried out in a way consistent with maintaining the Scheme's overall strategic allocation and consistent with the overall principles set out in this Statement.

The Scheme's investment managers have discretion in the timing of realisation of investments and in considerations relating to the liquidity of those investments within parameters stipulated in the relevant appointment documentation and pooled fund prospectuses.

The Trustee decides (with the advice from their investment managers and/or investment consultants) on how investments should be realised for cash to meet Scheme expenses.

11. ESG, Stewardship and Climate Change

The Trustee believes that financially material factors, including environmental, social, and corporate governance (ESG) factors, may have a material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that may apply over the Scheme's investment time horizon and increasingly may require explicit consideration.

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

The Scheme's assets are invested in pooled vehicles and the day-to-day management of the assets has been delegated to Investment Manager(s), including the selection, retention and realisation of investments within their mandates. In doing so these investment managers are expected and encouraged to undertake engagement activities on relevant matters including ESG factors (including climate change considerations) and to exercise any voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code. The Trustee engages with existing investment managers on these issues through (amongst other things) regular meetings and periodic correspondence. Managers who are FCA registered are expected to report on their adherence to the UK Stewardship Code on an annual basis. This applies to any equity and debt investments, as appropriate, and covers a range of matters including the issuers' performance, strategy, capital structure, management of actual or potential conflicts of interest, risks, social and environmental impact and corporate governance.

Notwithstanding the above, the Trustee recognises that in passive mandates the choice of benchmark dictates the assets held by the investment manager and that the manager has limited freedom to take account of factors that may be deemed to be financially material as part of stock selection decision-making. The Trustee accepts that the primary role of its passive manager(s) is to deliver returns in line with the market and believes this approach is in line with the basis on which the current strategy has been set.

The Trustee considers how ESG, climate change and stewardship is integrated within investment processes in appointing new investment managers, monitoring existing investment managers and retaining or withdrawing from investment managers. The relative importance of these factors compared to other factors will depend on the asset class being considered. Monitoring of the existing Investment Managers is undertaken on a regular basis and this makes use of the Investment Consultant's ESG ratings. This is documented at least annually and the Trustee is informed of any changes to ESG ratings usually on a quarterly basis. The Trustee will challenge managers who it believes are taking insufficient account of ESG considerations in implementing their mandates. The Trustee will also monitor investment manager engagement activity (such as voting) at least annually.

The Trustee has not set any investment restrictions on the appointed investment manager(s) in relation to particular products or activities, but may consider this in future.

The Trustee will not consider the ESG policies of Additional Voluntary Contributions providers and associated investment funds as these are a small proportion of total assets.

12. Non-Financial Matters

"Non-financial matters" (where "non-financial matters" includes members' ethical views separate from financial considerations such as financially material ESG issues) are not explicitly taken into account in the selection, retention and realisation of investments. The Trustee would review this policy in response to significant member demand.

13. Investment Manager Arrangements

Alignment of Investment Manager Objectives and Incentivisation

Investment managers are appointed based on their perceived capabilities and, therefore, their perceived likelihood of achieving the expected return and risk characteristics for the asset class or specific investment strategy they are selected to manage over a suitably long time horizon. This includes, in relation to active management, appropriate levels of outperformance, and in relation to passive management suitable levels of "tracking error" against a relevant benchmark.

The Trustee seeks expert advice in relation to these appointments. This advice may consider factors such as the manager's idea generation, portfolio construction, implementation and business management, as well as the investment manager's approach to ESG and engagement activity, as they apply to the specific investment strategy being considered.

Where relevant, the Trustee specifies the investment objectives and guidelines in an investment manager agreement ("IMA") and sets these so that they are in line with the Trustee's specific investment requirements. In relation to pooled investment vehicles, the Trustee accepts that they have no ability to specify the risk profile and return targets of the manager other than through the choice of specific vehicles. They will therefore select vehicles that best align with the Trustee's own policy in terms of investment objectives and guidelines (as set out in relevant governing documents) and, once appointed, will review the appointment should there be any material changes in these terms.

The Trustee makes appointments with the view to them being long term (to the extent this is consistent with the Trustee's overall investment time horizon) and there is typically no set duration for the manager appointments. However, appointments can typically be terminated at relatively short notice (up to two months) with the exception of private markets investments (which represent a small proportion of the overall asset allocation).

For each appointment retention is dependent upon the Trustee having ongoing confidence that the investment manager will achieve its investment objective. The Trustee makes this assessment taking into account various factors which includes performance to date as well as an assessment of future prospects.

Investment managers are therefore incentivised both to achieve the objectives set for them, which are consistent with the Trustee's policies and objectives, and to ensure that they remain capable of doing so on a rolling basis. This encourages investment managers to take a suitably long term view when assessing the performance prospects of, and engaging with, any equity and debt issuers in which they invest or seek to invest.

Performance Assessment and Fees

The Trustee receives reporting on asset class and investment manager performance on a regular basis, via a combination of formal independent reports and presentations from the investment managers.

Investment returns (and volatility) are measured on both an absolute basis and relative to one or more suitable benchmarks and targets. Returns are considered net of fees and ongoing transaction costs.

As well as assessing investment returns the Trustee will consider a range of other factors, with the assistance of the investment adviser, when assessing investment managers, which may include:

- Personnel and business change
- Portfolio characteristics (including risk and compatibility with objectives) and turnover
- Voting and engagement activity
- Service standards
- The adviser's assessment of ongoing prospects based on their research ratings

The majority of investment managers are remunerated by way of a fee calculated as a percentage of assets under management. For liability hedging a fee is payable calculated as a percentage of the hedged exposure. In each case, the principal incentive is for the investment manager to retain their appointment (in full), by achieving their objectives, in order to continue to receive their fee in full. On some mandates, performance related fees are also in operation. Performance related fees incentivise the manager to outperform their target as they take a share of the outperformance. The Trustee will consider introduction of performance related fees on a case by case basis where not in operation and would also consider requesting fee reductions. Investment managers are not remunerated based on portfolio turnover.

Portfolio Turnover Costs

Turnover costs arise from a) "ongoing" transactions within an investment manager's portfolio and b) "cashflow" costs incurred when investing in or realising assets from a mandate.

The Trustee has not historically monitored investment managers' ongoing transaction costs explicitly but measure these implicitly through ongoing performance assessments which are net of these costs. The Trustee will now seek explicit reporting on ongoing costs for all appointed managers.

The Trustee does not monitor regular cashflow costs (but seeks to minimise them through ongoing cashflow policy). The Trustee monitors the costs of implementing strategic change via the investment consultant.

14. Compliance with and review of this Statement

The Trustee will monitor compliance with this Statement annually, and in any event will review this Statement at least once every three years and without delay after any significant change in investment policy. The Statement will also be reviewed in response to any material changes to any aspects of the Scheme and its liabilities, finances and attitude to risk of the Trustee and the Company which it judges to have a bearing on the stated investment policy. Any such review will be based on written expert investment advice and will be in consultation with the Company.

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On behalf of
the NHBC Pension Trustee Limited