

# *Addendum to the Statement of Investment Principles*

**For the Anglian Water Group Pension Scheme**

**Effective from: 15 September 2023**

This addendum to the Statement of Investment Principles (“SIP”) for the Anglian Water Group Pension Scheme (the “Scheme”) has been produced by Anglian Water Group Trustee Limited as the Trustee of the Scheme. It sets out a description of various matters which are not required to be included in the SIP, but which are relevant to the Scheme’s investment arrangements.



# Part 1:

## *Investment governance, responsibilities and decision-making*

**We have decided on the following division of responsibilities and decision making for the Scheme. This division is based upon our understanding of the various legal requirements placed upon us and our view that the division of responsibility allows for efficient operation and governance of the Scheme overall. Our investment powers are set out within the Scheme's governing documentation.**

### 1. Trustee

Our responsibilities include:

- setting structures and processes for carrying out our role;
- setting the investment strategy, and asset allocation, in consultation with the principal employer;
- setting investment policies, including those relating to financially material factors and the exercise of rights and engagement activities in respect of the investments;
- putting effective governance arrangements in place and documenting these arrangements in a suitable form;
- appointing Working Groups as and when required, who are authorised to take certain actions on our behalf (see below) and agreeing terms of reference for those Groups;
- monitoring, reviewing, engaging with and replacing investment managers, investment advisers, actuary, and other service providers;
- monitoring the exercise of investment powers that we have delegated to the investment managers and monitoring compliance with Section 36 of the Pensions Act 1995 (as amended);
- communicating with members as appropriate on investment matters, such as our assessment of our effectiveness as a decision-making body, the policies regarding responsible ownership and how such responsibilities have been discharged; and
- reviewing the SIP and modifying it as necessary.

### 2. Working Groups

We have delegated consideration of certain investment matters to Working Groups, although any decisions remain our responsibilities. These Working Groups will be responsible for:

- **Strategic Pensions Group (SPG)** – Set up with members from both the principal employer and the Trustee, to help inform strategy discussion and decision making by us; and
- other committees as required from time to time as agreed by us.

### 3. Investment managers

The investment managers' responsibilities include:

- managing the portfolios of assets according to their stated objectives, and within the guidelines and restrictions set out in their written contracts;
- taking account of financially material considerations (including climate change, net zero alignment and other Environmental, Social and Governance ("ESG") considerations) as appropriate in managing the assets;
- exercising rights (including voting rights) attaching to investments and undertaking engagement activities in respect of investments;
- providing regular information concerning the management and performance of their respective portfolios, including information on voting and engagement undertaken and progress on net zero alignment over time; and
- having regard to the provisions of Section 36 of the Act insofar as it is necessary to do so.

### 4. Custodians

We have appointed a custodian for the Scheme, who is independent of the Scheme's investment managers. In addition, where we invest in pooled funds the

respective investment manager will have appointed their own custodian for the fund. The custodians responsibilities include:

- safe keeping of the assets and facilitating all transactions within the portfolios; and
- administrative duties, such as the collection of interest and dividend payments and dealing with corporate actions.

## 5. Investment adviser

The investment adviser's responsibilities include:

- advise on all aspects of investment strategy, including selection and implementation with appropriate fund managers and on interaction between Scheme assets and liabilities;
- advising on and monitoring liability hedging and collateral management;
- advising on the selection, and review, of the investment managers, incorporating its assessment of the nature and effectiveness of the managers' approaches to financially material considerations (including climate change and other ESG considerations);
- supporting us in achieving the Scheme's net zero target, including through manager selection, monitoring and engagement;
- providing training as required; and
- assisting us with reviews of the SIP.

## 6. Performance assessment

We are satisfied that there are adequate resources to support our investment responsibilities, and that we have sufficient expertise to carry out our role effectively. It is our policy to assess the performance of the Scheme's investments, investment providers and professional advisers from time to time. We will also periodically assess the effectiveness of our decision-making and investment governance processes and will decide how this may then be reported to members.

## 7. Working with the sponsoring employer

When reviewing matters regarding the Scheme's investment arrangements, such as the SIP, we seek to give due consideration to the employer's perspective. Whilst the requirement to consult does not mean that we need to reach agreement with the employer, we believe that better outcomes will generally be achieved working collaboratively with the employer. This is achieved partly through regular meetings of the SPG.

# Part 2:

## Policy towards risk

### 1. Risk capacity and appetite

We view risk in terms of our investment strategy as the probability that the chosen strategy would result in the objectives not being met.

Risk capacity is the maximum level of risk that we consider to be appropriate to take in the investment strategy. Risk appetite is how much risk we believe is appropriate to take in order to meet the investment objectives. Taking more risk is expected to mean that those objectives can be achieved more quickly, but it also means that there is a greater likelihood that the objectives are missed, in the absence of remedial action.

When assessing risk and reviewing the investment strategy, we consider:

- the Scheme's long-term funding target and required return to achieve this;
- the strength of the employer covenant and how this may change over time;
- the impact of employer contributions;
- the Scheme's liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged;
- the Scheme's cash flow requirements; and
- the level of expected return and expected level of risk (as measured by Value at Risk ("VaR")), now and as the strategy evolves.

### 2. Approach to managing and monitoring risks

There are different types of investment risk that are important to manage, and we monitor these on a regular basis. These include, but are not limited to:

#### Mismatching Risk

This is the risk of Scheme assets moving out of line with Scheme liabilities. We manage this risk through a combination of interest rate, inflation and currency hedging (further details on which are set out below) and by increasing the allocation to matching assets over time, when it is possible to do so. We monitor

this risk through a quarterly review of the Scheme's funding level and hedging positions.

#### Interest rate and inflation risk

This is the risk of movements in interest rates or inflation adversely impacting the Scheme's funding position. This is measured by comparing the likely movement in the Scheme's liabilities and assets due to movements in inflation and interest rates. It is managed primarily through a committed framework for interest rate and inflation hedging. This is also supported by increasing the Scheme's exposure to other assets which broadly match movements in the value of the liabilities due to inflation and interest rates.

#### Currency risk

This is measured by the level of exposure to non-Sterling denominated assets and is managed through the currency hedging programme (a combination of a segregated currency hedging overlay and currency hedging carried out by some of the Scheme's investment managers) which reduces the impact of exchange rate movements on Scheme assets.

#### Equity risk

We consider exposure to equity risk in the context of the Scheme's overall investment strategy and monitor the level of exposure to this risk in relation to the required return needed to achieve the agreed funding target for the Scheme.

#### Investment manager risk

In aiming to control manager risk the focus of our attention is on the following aspects:

- the risk of the manager underperforming the objectives set; and
- the risks inherent in a particular manager's philosophy.

These issues are considered on the initial appointment of the managers and thereafter as part of the investment review procedures we have in place, and the regular manager monitoring undertaken by the investment advisor.

The risk of manager underperformance is monitored on a regular basis via an assessment of the appointed managers' investment portfolios, processes,

performance and of any developments which may impact on their ability to fulfil the objectives set and consequently their continuing appointment. In contrast, philosophy risk requires consideration of any changes in the Scheme's investment requirements regarding risk and return. An investment manager's philosophy is unlikely to change from one year to the next but a change in the Scheme's needs may mean that the appointment of a particular investment manager does not remain appropriate.

We periodically review the continuing suitability of our appointed managers and receive advice and written reports as and when required from our investment adviser, where appropriate.

### **Climate-related risks**

Climate change is a source of risk, which could be financially material over both the short and longer term. This risk relates to the transition to a low carbon economy, and the physical risks associated with climate change (eg extreme weather). We seek to appoint investment managers who will manage this risk appropriately, and we monitor how this risk is being managed in practice. We have agreed a net zero target for the Scheme and encourage our managers (where practical) to set credible net zero targets for the funds in which we invest. We monitor and engage with managers on their progress towards net zero alignment.

### **Other environmental, social and governance (ESG) risks**

ESG factors are sources of risk, which could be financially material over both the short and longer term. These include risks relating to unsustainable or socially harmful business practices, and unsound corporate governance. We seek to appoint investment managers who will manage these risks appropriately and monitor how these risks are being managed in practice.

### **Collateral adequacy risk**

The Scheme has a hedge portfolio and uses derivatives to manage its exposure to inflation, interest rates and currency. We may also use derivatives to gain exposure to certain market returns (eg equities), where appropriate. Collateral is posted daily and if the market value of these positions falls, the Scheme may have to post additional collateral to its counterparties to cover the loss. Generally, only gilts and cash can be used as collateral. If the Scheme does not hold sufficient cash and gilts to cover such a collateral call, the position will either need to be closed out or a divestment of assets would be necessary to raise the required collateral.

To mitigate this risk, we have a leverage management plan in place, which is reviewed and updated periodically. This sets out clearly the assets directly available to support the Scheme's hedging arrangements and the approach that is expected to be taken with regards to selling down these assets to support the hedging arrangements.

We have agreed a monitoring framework with the hedging manager and our investment adviser that allows us to monitor the collateral position on a monthly basis. The hedging manager monitors this position daily.

### **Liquidity Risk**

Liquidity risk relates to the realisation of investments and ensuring a sufficient level of cash income is received, to meet the benefit payments and other related expenses as and when they fall due. This helps to avoid the forced selling of assets at an inopportune time. We, in conjunction with the employer's Treasury Team, monitor and manage the Scheme's cash flow requirements over the short-term in order to minimise the possibility that this should occur.

### **Diversification Risk**

We aim to suitably diversify the Scheme's holdings in assets to avoid the risks of one market, one asset type, or one manager failing having a material impact on the Scheme's ability to achieve its objectives. A range of fund managers are appointed across a range of alternative asset classes, with diversified maturities. The level of diversification may reduce as the Scheme's funding level improves and the allocation to matching assets increases.

The Scheme's investment in any individual pooled fund should not be more than 10% of that fund's value unless specific exit safeguards are in place to protect the Scheme from a scenario where other investors exit. If it is more than 10%, we will consider whether the Scheme's investment is likely to move back below the limit within the foreseeable future. There are no specific limits on the amount of assets that can be held with a single manager but we keep this under review and ensure that there is adequate diversification between different fund managers and investment approaches, to ensure the Scheme is not overly reliant on a single manager or approach.

### **Default Risk**

This is the risk that an underlying company in which the Scheme holds investment interests, defaults on its debt obligations resulting in a loss in value of the investment. Management of this risk is delegated to investment managers but we will consider other factors that provide insights into the quality of underlying assets held by managers (eg credit ratings) when deciding on which managers to appoint. For segregated mandates, we will specify limits around the quality of assets that can be held by managers. Default risk also exists for derivative contracts where the counterparty in the contract defaults on its obligations. This risk is managed through the collateral posting process.

### **Custody Risk**

Custody risk involves any of the following:

- misappropriation of assets;
- delivery that is not in accordance with instructions;
- unauthorised use of assets for the benefit of other customers or the custodians;
- inadequate segregation of customer assets;
- failure to collect income, recover tax or respond to corporate events; and
- custodian default (insolvency).

We have a service level agreement in place with the appointed custodian and regularly monitor its performance.

### Operational Risk

This covers the risk of fraud, poor advice, misconduct or acts of negligence. We have sought to minimise such risk by ensuring that all advisors and third-party providers are suitably qualified and experienced, and that suitable liability and compensation clauses are included in all contracts for professional services received. In addition, the Scheme has a Secretary and representative within the Treasury Team to monitor and manage the investments and cashflows in order to help mitigate this risk.

### Covenant Risk

Covenant risk covers the possibility of the failure, breakdown of relationship and/or withdrawal of the Scheme's principal employer. Regular credit risk assessments of the principal employer are undertaken by us and our advisors, and the principal employer provides regular updates as to the financial strength of the organisation, and any changes in its business outlook or regulatory environment.

### Political Risk

This is measured by the level of concentration to any one market leading to the risk of an adverse influence on investment values arising from political intervention. It is managed by regular reviews of the actual investments and through the level of diversification between markets.

### Reputational Risk

This is the risk of financial loss due to actions that damage the principal employer's reputation. We are aware of the importance that the principal employer attaches to this risk and work closely with the principal employer to ensure that the reputational risks associated with the investment portfolio are monitored and managed.

### Reinvestment and Roll Risk

The Scheme will hold assets that provide a contractual level of returns (eg bonds and gilts) noting that there is a risk that future income and capital repayments from these holdings may not be reinvested at current rates of return (reinvestment risk). The Scheme will also hold derivative contracts which expire after a specified period and may need to be replaced to maintain hedging positions. When replacing expiring derivative contracts, there is a risk that they cannot be implemented on the same terms as the original contracts (roll risk).

We aim to manage these risks by working with our advisers and investment managers to spread the repayment of capital from contractual assets and rolling of derivative contracts as much as possible.

### Valuation risk

Some of the Scheme's assets (such as listed equities) can be valued regularly based upon observable market prices. For other assets (such as property and private credit), prices may only be estimated relatively infrequently using one or more of a range of approximate methods – eg mathematical models or recent sales prices achieved for equivalents.

At times of market stress, there is a risk for all assets that the valuations provided by investment managers do not reflect the actual sale proceeds which could be achieved if the assets were liquidated at short notice. This risk is particularly relevant for assets such as property.

We consider exposure to valuation risk in the context of the Scheme's overall investment strategy. We monitor and ensure that the level of exposure to this risk is appropriate.

# Part 3:

## *Sustainable investing and active ownership*

We have a policy on sustainable investing which covers related areas including our core beliefs, implementation of mandates and exclusions, in addition to our broader policies on these matters set out in the SIP. A core belief is that sustainable investments will outperform those that do not have regard for sustainability. We aim to include sustainability related guidelines in our mandates and we encourage our investment managers to improve sustainability standards.

### Stewardship priorities

We have selected some priority themes to provide a focus for our monitoring of investment managers' voting and engagement activities. We will review them regularly and update them if appropriate. The selected priorities are:

- Climate change;
- Diversity, equity & inclusion;
- Corporate transparency; and
- Business ethics.

We chose these priorities because we believe they are financially material and therefore it is in members best interests that our managers adopt strong practices in these areas.

We will write to our investment managers regularly to notify them of our stewardship priorities and remind them of our expectations of them in relation to responsible investment.

### Manager selection

We aim to appoint investment managers that have strong sustainable investment skills and processes.

When selecting new managers, we consider our investment adviser's assessment of potential managers' capabilities in this area. If we meet prospective managers, we will ask questions about responsible investment, focusing on our stewardship priorities.

We favour investment managers who are signatories to the Principles for Responsible Investment, the UK Stewardship Code as well as the Net Zero Asset Managers Initiative and Climate Action 100+.

### Manager monitoring

On a quarterly basis, we review the investment adviser's sustainable investment (SI) scores for the Scheme's investment managers, along with their qualitative SI assessments for each fund and red flags for any managers of concern. These scores cover each manager's approach to ESG factors, voting and engagement. The fund scores and assessments are based on the investment adviser's ongoing manager research programme and it is these that directly affect their manager and fund recommendations. We also monitor the investment managers' reported climate risk data, as well as progress that managers have made in signing up to industry wide initiatives including the UK Stewardship Code 2020, the Net Zero Asset Managers Initiative, and Climate Action 100+.

Additionally, we receive quarterly updates on ESG and stewardship related issues from our investment adviser and ad-hoc briefings on key industry developments including regulatory updates.

### Implementation statement including most significant votes

Following the end of each Scheme year, we prepare a statement which explains how we have implemented our strategy during each Scheme Year in comparison to the way we intend to do so as set out in our Statement of Investment Principles.

In the statement, we describe how our managers have voted on our behalf during the year, including the most significant votes cast. The votes are selected from a set of significant votes compiled by our investment consultant from those provided by our managers. In doing so, we have regard to:

- whether it relates to one of our stewardship priorities;
- the potential financial impact of the vote;
- any potential impact of the vote on our investor rights or influence;
- the size of our holding; and

whether the vote was high-profile or controversial.