Statement of Investment Principles (SIP)

This is the Statement of Investment Principles (the “Statement”) made by Water Pension Trustee Limited, as Trustee (the “Trustee”) of the South East Water Pension Scheme (“the Scheme”) in accordance with the Pensions Act 1995 (as amended). The Statement, which was approved by the Trustee on 22 March 2023, is subject to periodic review at least every three years and without delay after any significant change in investment policy.

In preparing this Statement, the Trustee has consulted with the employer to the Scheme South East Water Limited and has taken and considered written advice from the Investment Practice of Hymans Robertson LLP.

The Scheme is a defined benefit scheme that closed to further accruals on 31 March 2015 and to new members on 1 July 2002.

The Trustee is supportive of the UK Stewardship Code, which seeks to improve the quality of engagement between institutional investors and investee companies. Where appropriate, the Trustee expects investment managers to comply with the code and to produce a statement of their commitment to the code.

Scheme objective

The primary objective of the Scheme is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependants, on a defined benefits basis. The Trustee’s overriding funding principles for the Scheme are to set the employer contribution at a level that is sufficient:

- to recover any shortfall in assets relative to the value placed on accrued liabilities over the longer term; and
- to ensure that there are always sufficient assets of the Scheme (at their realisable value) to meet 100% of benefits as they fall due for payment to members.

The value of liabilities is calculated on the basis agreed by the Trustee and the Scheme Actuary. The funding position is monitored regularly by the Trustee and formally reviewed at each triennial actuarial valuation, or more frequently, as required by the Pensions Act 2004.

Investment strategy

The Trustee has translated its objectives into a suitable strategic (asset allocation) benchmark for the Scheme. The strategic benchmark is consistent with the Trustee’s view on the appropriate balance between seeking an enhanced long-term return on investments and accepting greater short-term volatility and risk.

The strategic benchmark is reflected in the choice and mix of funds in which the Scheme invests.

The investment strategy takes account of the maturity profile of the Scheme (in terms of the relative proportions of liabilities in respect of pensioners and deferred members), together with the level of disclosed surplus or deficit (relative to the funding bases used) and the Trustee’s view of the covenant of the principal employer.

The Trustee monitors strategy relative to its agreed asset allocation benchmark. It is intended that investment strategy will be reviewed at least every three years following actuarial valuations of the Scheme and will normally be reviewed annually. Written advice is received as required from professional advisers.

The Trustee monitors the performance of Scheme investments relative to agreed criteria on a regular basis.

The Trustee has delegated all day-to-day investment decisions to authorised investment managers.

Choosing investments

The Trustee has appointed six investment managers (plus Just Group plc who manage a buy-in policy) to manage Scheme investments. All investment managers are authorised under the Financial Services and Markets Act 2000 to undertake investment business. The Trustee, after taking appropriate advice, has given the investment managers specific guidelines including, but not limited to, asset allocation and geographic spread, on how investment mandates are to be managed. The investment managers are allowed some flexibility of choice subject to their benchmarks and other guidelines and are expected to maintain diversified portfolios.

The Trustee has decided to invest in a number of individual pooled funds. The Trustee is satisfied that the pooled funds selected are consistent with the objectives of the Scheme, particularly in relation to diversification, risk, expected return and liquidity.

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

The Trustee invests in pooled funds where the objectives of the fund and the policies of the investment manager will be evaluated by the Trustee to ensure that they are appropriate for the needs of the Scheme.

Remuneration for each mandate is determined at the inception of each mandate based on commercial considerations and typically set as a percentage of assets under management. Where appropriate to the nature of the mandate, the term of the mandate and the role the mandate plays within the investment strategy, the Trustee may agree to a fee structure where the manager is incentivised to deliver outperformance relative to an agreed benchmark, typically in conjunction with a lower ad valorem fee. The Trustee periodically reviews the fees paid to all its managers against industry standards.

The Trustee reviews the nature of Scheme investments on a regular basis, with particular reference to suitability and diversification. When determining the appropriateness of each manager and mandate for the Scheme, particularly in relation to diversification, risk, expected return and liquidity, the Trustee seeks and considers written advice from a person that is suitably qualified as evidenced by CF30 approval from the FCA, for example. If, at any time, investment in a security or product not previously known to the Trustee is proposed, appropriate advice is sought and considered to ensure its suitability. The Trustee recognises the long-term nature of its liability profile and appoints its managers to invest in such a way that generates long term sustainable returns. The Trustee will carry out necessary due diligence on the underlying investment decision making process, to ensure the manager makes investment decisions over an appropriate time horizon aligned with the Scheme objective.

The duration of each mandate is considered by the Trustee at the inception of each mandate. For open-ended investments, the Trustee generally engages managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Trustee expects the minimum duration of the appointment will be three years, this being the period over which performance of the mandate can be appropriately evaluated although all mandates are subject to ongoing review against various financial and non-financial metrics in addition to their continued appropriateness within the investment strategy. For close-ended investments, the Trustees expect the term of the appointment to be the lifetime of the investment.

The Trustee will measure a fund’s relative tracking error where appropriate. Managers are expected to provide explanation for any significant deviations away from benchmark or target.

A summary of the Scheme’s investment mandates, and the respective benchmarks and targets is included in the appendix.

Kinds of investment to be held

The Scheme may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds and cash, either directly or through pooled funds.

The Scheme may also make use of contracts of insurance, derivatives, and contracts for difference (or in pooled funds investing in these products) for the purpose of efficient portfolio management or to hedge specific risks. The Trustee considers all these classes of investment to be suitable in the circumstances of the Scheme.

Balance between different kinds of investments

The Scheme's investment managers will hold a mix of investments that reflects their views relative to their respective benchmarks or return targets. Within each major market, each manager will maintain a diversified portfolio of stocks.

The manager of the passive funds in which the Scheme invests holds a mix of investments within each pooled fund that reflects that of their respective benchmark indices.

Risk

The Scheme is exposed to a number of risks that pose a threat to the Scheme meeting its objectives. The principal risks affecting the Scheme are:

Funding risks

- Financial mismatch – The risk that Scheme assets fail to grow in line with the developing cost of meeting the liabilities.
- Changing demographics – The risk that longevity improves, and other demographic factors change, increasing the cost of the Scheme benefits.
- Systemic risk – The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Scheme's liabilities. Climate change is a particular systemic risk that has the potential to cause economic, financial, and demographic impacts.

The Trustee measures and manages financial mismatch in two ways. As indicated above, the Trustee has set a strategic asset allocation benchmark for the Scheme. The Trustee assesses risk relative to that benchmark by monitoring the Scheme's asset allocation and investment returns relative to the benchmark. The Trustee also assesses risk relative to liabilities by monitoring the delivery of returns relative to liabilities.

The Trustee keeps mortality and other demographic assumptions, which could influence the cost of benefits, under review. These assumptions are considered formally at triennial valuations and the Trustee may enter into insurance contracts (bulk annuities or longevity swaps) to reduce these demographic risks.

The Trustee seeks to mitigate systemic risks through a diversified portfolio, but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset risks

- Concentration – The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity – The risk that the Scheme cannot meet its immediate liabilities because it has insufficient liquid assets.

- Currency risk – The risk that the currency of the Scheme's assets underperforms relative to Sterling (i.e., the currency of the liabilities).
- Manager underperformance – The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.
- Environmental, Social and Governance (ESG) risks – the extent to which ESG issues are not reflected in asset prices and/or not considered in investment decision making, leading to underperformance relative to expectations. A list of example ESG factors that the Trustee considers is provided in the appendix.
- Climate risk – The extent to which climate change causes a material deterioration in asset values as a consequence of factors including but not limited to policy change, physical impacts, and the expected transition to a low-carbon economy.

The Trustee manages asset risks as follows. The Trustee provides a practical constraint on Scheme investments deviating greatly from the intended approach by investing in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrain risk within their expected parameters.

By investing across a range of assets, including quoted equities, bonds (and possibly in the future bulk annuity policies), the Trustee recognises the need to access funds in the short term to pay benefits. The risk of manager underperformance is mitigated by the inclusion of passive investment mandates within the investment portfolio.

In appointing several investment managers, the Trustee has considered the risk of underperformance by any single investment manager.

The Trustee does not expect managers to take excess short-term risk and will regularly monitor the manager's performance against the benchmarks and objectives set on a short, medium, and long terms basis.

The Trustee's approach to the consideration of ESG risks and climate risk is set out in further detail below.

Other provider risk

- Transition risk – The risk of incurring unexpected costs in relation to the transition of assets among managers.
- Custody risk – The risk of loss of Scheme assets or a loss of economic rights to Scheme assets, when held in custody or when being traded.
- Credit default – The possibility of default of a counterparty in meeting its obligations.

The Trustee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Scheme or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g., custody risk in relation to pooled funds). When carrying out significant transitions, the Trustee seeks professional advice.

Expected return on investments

The investment strategy aims to achieve a return on Scheme assets, which taken in conjunction with contributions is sufficient over time to match growth in the Scheme's pension liabilities.

Realisation of investments

The majority of the Scheme's investments may be realised quickly if required.

Portfolio turnover

The Trustee has expectations of the level of turnover within each mandate which is determined at the inception of the mandate, based on the Trustee's knowledge of the manager, investment process and the nature of the portfolio. Whilst the Trustee expects performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustee expects managers to report on at least an annual basis on the underlying assets held within the portfolio and details of any transactions over the period. The Trustee will challenge its managers if there is a sudden change in portfolio turnover or if the level of turnover seems excessive.

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

Consideration of financially material factors in investment arrangements

The Trustee recognises that the consideration of financially material factors, including ESG factors, is relevant at different stages of the investment process.

Strategic considerations

The strategic benchmark has been determined using appropriate long-term 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.

Given the inherent uncertainty, the Trustee has not made explicit allowance for the risks of climate change in setting its strategic benchmark. The Trustee periodically discusses climate change with its investment adviser/investment managers to consider the potential implications for the Scheme's investments.

Structural considerations

Given the discretion afforded to the active Investment Managers, the Trustee expects that its Investment Managers will take account of all financially material factors including the potential impact of ESG factors in the implementation of their mandates.

Selecting investment managers

Within active mandates, the Trustee has delegated responsibility for the consideration of stock specific issues to its individual Investment Managers. The Trustee has discussed the extent to which ESG issues, where relevant to the investment mandate, are integrated into the investment processes of its Investment Managers and is satisfied that the Investment Managers are following an approach that takes account of all financially material factors.

In passive mandates, the Trustee recognises that the choice of benchmark dictates the assets held by the investment manager and that the manager has minimal freedom to take account of factors that may be deemed to be financially material. The Trustee accepts that the role of the passive manager is to deliver returns in line with the benchmark and believes this approach is in line with the basis on which its current strategy has been set.

In selecting new investment managers for the Scheme, where relevant to the investment mandate, the Trustee explicitly considers potential managers' approach to responsible investment, and the extent to which managers integrate ESG issues in the investment process, as a factor in their decision making. The Trustee imposes minimum standards for all managers and monitor compliance with these standards on a periodic basis.

The Trustee meets with the Scheme's investment managers regularly, and the managers are expected to address manager performance and company engagement. Managers will be challenged on their approach where this is not aligned to the Trustee's policies.

The Trustee expects its investment consultants to provide input and analysis to assist the Trustee in assessing their managers' performance. Where necessary, the Trustee will highlight any areas of concern identified during such reviews to the manager as part of its engagement process and request that the manager takes appropriate action. This may include concerns over performance, risk management, stewardship practices, investment process and operational issues and, where such concerns are raised, the Trustee will require the manager to demonstrate levels of improvement. Failure to achieve the desired improvements will result in the mandate being reduced or terminated.

Consideration of non-financially material factors in investment arrangements

Given the objectives of the Scheme, the Trustee has not considered any non-financially material factors in the development and implementation of its investment strategy.

The Trustee has not imposed any restrictions or exclusions to the investment arrangements based on non-financially material factors.

Stewardship

The Trustee recognises that stewardship encompasses the exercise of voting rights, engagement by and with investment managers and the monitoring of compliance with agreed policies.

Voting and engagement

The Trustee has adopted a policy of delegating voting decisions on stocks to its Investment Managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long-term shareholder value. The Investment Managers are expected to exercise the voting rights attached to individual investments in accordance with their own house policy.

Where relevant, the Trustee has reviewed the voting policies of its Investment Managers and determined that these policies are appropriate.

The Trustee does not engage directly but actively encourages its investment managers to engage with key stakeholders which may including corporate management, regulators, and governance bodies, relating to their investments in order to consider the management of conflicts of interest and improve corporate behaviours, improve performance, and mitigate financial risks. The Trustee will review engagement activity undertaken by their investment managers as part of its broader monitoring activity.

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

Monitoring

The Trustee aims to meet with all its Investment Managers on a periodic basis. The Trustee provides its managers with an agenda for discussion, including issues relating to individual holdings and, where appropriate, ESG issues. Managers are challenged both directly by the Trustee and by its investment advisers on the impact of any significant issues including, where appropriate, ESG issues that may affect the prospects for return from the portfolio.

Additional Voluntary Contributions (AVCs)

The Trustee gives members the opportunity to pay AVCs to Aviva at members’ discretion.

Signed For and on Behalf of the Trustee of the South East Water Pension Scheme.

Trustee Director

Trustee Director

Date

Date

Appendix:

Manager benchmarks and performance targets

Manager / Mandate	Benchmark Description	Performance Target
LGIM RAFI Multi-Factor Climate Transition Index Fund	RAFI Multi-Factor Climate Transition Developed Index	Track underlying index
M&G Alpha Opportunities	SONIA	SONIA + 3-5% p.a.
Schroders Private Equity	-	-
Barings Global Higher Yield Strategies	3m SOFR	3m SOFR + 5% p.a. over 3 years
LGIM LDI	Composite Benchmark	Match benchmark
LGIM Sterling Liquidity	SONIA	Outperform benchmark
Insight Global ABS	SONIA	Outperform benchmark. Unofficial target is SONIA + 2% p.a..
TwentyFour Monument Bond	SONIA	SONIA + 2% p.a.

ESG Factors

The following table provides examples of some ESG factors that the Trustee has considered. This list is not exhaustive and is just included to give an idea of the factors that the Trustee considers:

Environmental	Social	Governance
Climate Change	Customer satisfaction	Board Structure
Resource scarcity	Community relations	Accounting & Audit
Water stress	Working conditions	Executive remuneration
Biodiversity	Diversity	Bribery & corruption
Pollution	Health & Safety	Shareholder rights
Energy efficiency	Employee wellbeing	Transparency
Waste management	Data protection	Political contributions