

# **The Zoological Society 1988 Pension Scheme**

## **Statement of Investment Principles – September 2020**

### **1. Introduction**

The Trustee of the Zoological Society 1988 Pension Scheme (“the Scheme”) has drawn up this Statement of Investment Principles (“the Statement”) to comply with the requirements of the Pensions Act 1995 (“the Act”) and the Occupational Pension Schemes (Investment) Regulations 2005, as amended. The Statement is intended to affirm the investment principles that govern decisions about the Scheme’s investments.

The detail of how the Scheme’s assets are invested, based on the principles set out in the Statement, can be found in a separate Summary of Investment Arrangements document.

In preparing this Statement the Trustee has consulted the Scheme Sponsor to ascertain whether there are any material issues, of which the Trustee should be aware, in agreeing the Scheme’s investment arrangements.

The Trustee has obtained written advice from the Scheme’s Investment Consultant who the Trustee believes meet the requirements of Section 35 (3) of the Pensions Act 1995. Where matters described in this Statement may affect the Scheme’s funding position, input has also been obtained from the Scheme Actuary.

### **2. Fund Governance**

The Trustee retains direct responsibility for setting investment objectives, establishing risk and return targets and setting the Scheme’s benchmark. The Trustee sets the investment manager structure, retains and monitors appointed investment managers and other service providers.

The investment managers are responsible for day-to-day management of the Scheme’s assets in accordance with an Investment Manager Agreement agreed with the Trustee. The investment managers have discretion to buy, sell or retain individual securities in accordance with these guidelines. The investment managers report to the Trustee regularly regarding their activities and performance.

The custodian’s role is to ensure the safe keeping of the assets and facilitate all transactions entered into by the appointed investment managers. However, as the Scheme only invests in pooled vehicles, the investment managers (rather than the Trustee) are responsible for the appointment of the custodian.

The Scheme Actuary performs a valuation of the Scheme at least every three years, in accordance with regulatory requirements. The main purpose of the actuarial

valuation is to assess the extent to which the assets cover the accrued liabilities and agree an appropriate funding strategy for the Scheme. Full details of the current funding strategy and contributions payable will be found in the Statement of Funding Principles and Schedule of Contributions respectively.

The Scheme's Investment Consultant provides advice to the Trustee. The Investment Consultant's role encompasses, but is not limited to, providing assistance to the Trustee in formulating investment objectives, advice on investment strategy, advice on devising an appropriate investment manager structure and assisting in the selection and monitoring of investment managers and funds.

### **3. Process For Choosing Investments**

The process for choosing investments is as follows:

- Identify appropriate investment objectives
- Agree the level of risk consistent with meeting the objectives set
- Construct a portfolio of investments that is expected to allow the assets, together with agreed contributions, to be sufficient to meet the benefits to which members are entitled.

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

### **4. Investment Objectives**

The objective of the Trustee is to invest the Scheme's assets in the best interest of the members and beneficiaries. Within this framework the Trustee has agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Scheme is exposed. The primary objectives of the Trustee, which are consistent with those of the Scheme Sponsor, are as follows:

- To maintain the Scheme's fully funded position, on the Technical Provisions basis;
- By seeking opportunities to de-risk the Scheme's investment strategy to more effectively manage funding level volatility; and
- Reduce the likelihood that additional contributions are required from the Scheme Sponsor.

## 5. Risk Management and Measurement

The Trustee recognises that whilst increasing risk may increase potential returns over a long period, 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 (due to the mismatch between assets and liabilities). The Trustee has taken advice on the matter and (in light of the objectives noted previously) considered carefully the implications of adopting different levels of risk.

The willingness of the Trustee to take investment risk (i.e. not hold assets that broadly match the liabilities of the Scheme) is dependent on the continuing financial strength of the Scheme Sponsor and its willingness to contribute appropriately to the Scheme. The financial strength of the Scheme Sponsor and its perceived commitment to the Scheme is monitored and the Trustee may consider reducing investment risk relative to the liabilities should either of these deteriorate.

Should there be a material change in the Scheme's circumstances, the Trustee will review whether and to what extent the investment arrangements should be altered; in particular whether the current risk profile remains appropriate.

The following risks are taken into account by the Trustee, with independent advice sought as required, when setting the investment strategy:

- *Credit risk*: this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Trustee mitigate this risk by investing predominately in high quality instruments.
- *Currency risk*: this is the risk that the fair value of future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates. Changes in exchange rates will impact the relative value of the assets and liabilities. The Trustee accepts this risk and believe the non-Sterling exposure will generate long term expected returns in excess of the increase in the value of the liabilities.
- *Interest rate risk*: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates. The Trustee mitigates this risk by aligning a portion of the interest rate sensitivity of its assets with those of its liabilities.
- *Other price risk*: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. The Trustee mitigates this risk by investing its assets across a diversified range of asset classes.
- *Risk of erosion by inflation*. The Scheme's liabilities are explicitly linked to price- and wage inflation, subject to a cap. The Scheme's long-term financial

soundness will be determined by whether investment returns achieve a suitable margin above inflation. The Trustee manages this risk by holding assets with a degree of inflation sensitivity.

- *Asset and liability mismatch risk.* The Trustee has put in place an investment strategy which includes a significant proportion of equities and other assets which have good expected returns. However, the Trustee is aware that the expected returns are not guaranteed and that these assets may fail to deliver the returns necessary to meet the benefits. The Trustee accepts the risk inherent in such a strategy as this strategy is more likely to lead to the long-term affordability of the benefits and they believe in the strength of the Scheme sponsor's covenant, which is assessed regularly.
- *Liquidity risk.* The Scheme must be able to meet its liabilities as and when they become due. Consequently, the Scheme holds the majority of investments in easily marketable and realisable assets to meet such benefit payments as and when they become due.
- *Risk from lack of diversification.* The Trustee is satisfied that the spread of assets by type and the investment managers' policy on investing in individual securities within each type provides adequate diversification of investments.
- *Longevity risk:* Refers to the possibility that, on average, members live longer than is assumed by the Scheme Actuary when valuing the liabilities (thereby increasing their value).
- *Volatility risk:* This concerns the stability of the market value of assets such as equities, where the price achievable may be particularly affected by short term sentiment and is not certain until point of sale.
- *Regulatory risk:* The Trustee may invest in a market environment where the regulatory regime may change. This may be compounded by political risk in those environments subjected to unstable regimes.
- *Climate change risk:* The Trustee acknowledges that climate change may impact its investments, due to its effect on natural and human systems across geographical regions.

The Trustee is required to provide narrative disclosures on the credit and market risk (namely currency, interest rate and other price risk) arising from its investment arrangements in their annual report and accounts.

Further, following the implementation of the leveraged Liability Driven Investment ("LDI") solution during 2018, a number of additional sources of risk were introduced to the Scheme:

- *Counterparty risk* arises from the possibility that a counterparty to a derivative contract will default on its contractual obligations.

- *Collateral adequacy* risk which requires the Trustee to make available assets to meet derivative obligations in response to changes in interest rates and inflation expectations (typically arises when interest rates rise and/or inflation falls). A strong collateral management process should be used to mitigate the risk of not being able to meet these requirements.
- *Roll risk* which can arise if the manager forgets to roll a derivative contract or liquidity may become poor at future roll dates and in extreme circumstances, you may not be able to roll the position.

The Trustee delegates, to its LDI manager, the responsibility to monitor and manage these risks on a day-to-day basis.

## 6. Investment Strategy

In establishing an investment strategy for the Scheme, the Trustee has taken into account the risks and investment objectives identified previously. The Trustee will formally review the investment policy after each Actuarial Valuation or more frequently if required or advised by their Investment Consultant.

The Trustee has adopted a strategy with the aim of generating sufficient investment returns to achieve the Scheme's investment objectives. Should there be a material change in the Scheme's circumstance; the Trustee will review whether the investment strategy should be altered.

The Scheme's current benchmark is set out below:

<b>Asset Class</b>	<b>Benchmark Allocation (%)</b>
Equities	37.0
Diversified Growth	10.5
Multi-Asset Credit	7.5
UK Buy and Maintain Credit	15.0
LDI	30.0
Total	100.0

Details of the investment strategy, specifically the investment manager structure employed, can be found in the Summary of Investment Arrangements. The Trustee, having considered advice from their Investment Consultant, believe that this investment strategy alongside the agreed contributions will be sufficient for the Scheme to meet its liabilities as they fall due.

Although member views are not currently taken into account when determining the strategic asset allocation and underlying manager structure, the Trustee will review this position periodically.

It is the policy of the Trustee to monitor the Scheme's overall asset allocation against its benchmark at regular intervals (normally quarterly) and take action if required.

## **7. Day-to-Day Management of the Assets**

The Trustee delegates the day to day management of the assets to their investment manager, who are regulated by the relevant regulatory authority in their countries.

The Trustee has taken steps to satisfy themselves that the investment managers have the appropriate knowledge and experience for managing the Scheme's investments and that they are carrying out their work competently. Details of the mandates set for the investment managers by the Trustee can be found in the Summary of Investment Arrangements.

Having considered expert advice, the Trustee has determined a benchmark mix of asset types and ranges within which the appointed investment manager may operate.

The Trustee will review the continuing suitability of the Scheme's investments, including the appointed investment managers and the balance between active and passive management, following each Actuarial Valuation if not sooner. However, any such adjustments would be done with the aim of ensuring the overall level of expected return and risk is consistent with the aim of being able to provide the benefits.

The investment managers have full discretion to buy and sell investments on behalf of the Scheme, within parameters stipulated in their appointment documentation, which includes managing collateral needs associated with the LDI holding. They have been selected for their expertise in different specialisations and each investment manager manages assets for the Scheme to a specific mandate, which includes a performance objective, risk parameters and timescales over which their performance will be measured. The Summary of Investment Arrangements gives details of each individual investment manager's mandate as set out in their respective investment management agreement with the Trustee.

## **8. Types of investment**

The Scheme's funds may be invested in a broad range of securities which are quoted on a recognised stock exchange in the United Kingdom or abroad and which are appropriate for the prudent investment of the assets of a pension fund; in units of unit trusts or OICS and in protective derivative financial instruments (but only to the extent that such derivatives are contained within the unit trusts or OICS in which the Scheme invests).

As the Scheme only invests in pooled vehicles, the Trustee has limited scope to influence the investment restrictions on the underlying assets held.

## 9. Realisation of Investments

The investment managers have discretion in the realisation of investments and in considerations relating to the liquidity of those investments, subject to the parameters stipulated in the relevant appointment documentation. These are subject to review, by the Trustee, at its regular meetings.

To help meet the cashflows needs of the Scheme, monies are redeemed monthly from the asset portfolio and transferred to the Trustee Bank Account. If these monies are insufficient to meet a shortfall, further disinvestments will be required and the Trustee will seek advice from their Investment Consultant. In such circumstances, monies will typically be disinvested so that the Scheme's asset allocation is moved towards its benchmark allocation (see Section 6 for details).

## 10. Socially Responsible Investment

The Trustee has considered the extent to which social, environmental and ethical factors should be taken into account in the selection, retention and realisation of investments. The Trustee believes that social, environmental and ethical factors may have a material impact on risk and return outcomes. It also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration. The Trustee consider these issues in the context of the anticipated time horizon over which the assets will be held.

However, as the Scheme invests in pooled vehicles, the Trustee recognises that the investment manager sets the policy on social, environmental and ethical factors and degree to which they are integrated into their investment processes. To assess the extent to which the investment managers do so, the Trustee reviews the ESG ratings (provided by the Scheme's Investment Consultant) assigned to each pooled vehicle held on a quarterly basis. These ratings are also considered as part of any new manager selection exercises.

## 11. Corporate Governance

The Trustee has examined the issues in relation to corporate governance and on the exercise of voting rights.

As the Scheme only holds pooled investments, the way in which voting rights are exercised, by the investment managers, will be a decision for them. The Trustee is satisfied that the investment managers policies on corporate governance and their exercise of voting rights, reflect the key principles. The Scheme's voting rights are thus exercised in accordance with the corporate governance policy of the investment managers and take account of current best practice including the UK Corporate Governance Code and the UK Stewardship Code.

The Trustee encourages their managers to report on contentious issues through quarterly investment reports. The Trustee monitor the extent, and the manner in

which, the investment managers exercise voting and engagement rights every three years.

## **12. Investment Manager (“Manager”) Arrangements**

### **12.1 How the arrangements with the Managers incentives them to align its investment strategy and decisions with the trustees’ policies**

Managers are appointed based on their capabilities and, therefore, their perceived likelihood of achieving the expected return and risk characteristics required for the asset class they are selected to manage.

Ahead of investing, the Trustee undertakes due diligence<sup>1</sup> and seeks the views of its investment consultant to support decisions around selection (and retention). Should a Manager make changes to any of these factors, the Trustee will assess their impact and (where no longer aligned) consider what action to take.

The Trustee currently only invests in pooled investment vehicles. The Trustee therefore accepts it cannot specify the risk profile and return targets of the manager, but pooled funds are chosen with appropriate characteristics to align with the overall investment strategy.

### **12.2 How the arrangements incentivises the Manager to make decisions based on assessments of medium to long-term financial and non-financial performance of an issuer**

The Trustee aims to meet with each Manager as deemed appropriate, to discuss performance and other investment related matters (including integration of ESG and climate change into the investment process and voting and engagement activities). As part of this, the Trustee will challenge decisions that appear out of line with the Scheme’s stated objectives and/or policies.

To assist with this, the Trustee consider Mercer’s assessment of how each Manager embeds ESG considerations into its investment process and explores how it aligns with its responsible investment policy. This is monitored on a quarterly basis as part of the Scheme’s performance reporting.

The Trustee considers the method of remunerating Managers to be consistent with incentivising them to make decisions based on assessments of medium to long-term financial and non-financial performance of the issuer of debt or equity. By encouraging medium to long-term view, it will in turn encourage the Managers to

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<sup>1</sup> Which includes but not limited to: the underlying assets held and how they will allocate between them; risks associated with the underlying mix of assets and the steps the Manager takes to mitigate them; expected return targeted by the Managers and details around realisation of the investment; and impact of financial and non-financial factors, including but not limited to ESG factors and climate change, on the investment over the long term.



engage with issuers of debt and equity in order to improve their performance in the medium to long-term.

Each Manager is aware that their ongoing appointment is based on their success in delivering the mandate for which they are appointed over the long term. Consistent periods of underperformance could lead to a Manager being terminated.

**12.3 How the method (and time horizon) of the evaluation of the Manager's performance and the remuneration for asset management are in line with the policy of the Trustee**

The Trustee reviews the performance of the Managers on a regular basis versus agreed benchmarks and targets, over multiple time periods, with an emphasis on the long-term.

The Trustee takes a long-term view when assessing whether to replace the underlying investment managers, and such decisions would not be made solely based on short-term performance concerns. Instead, changes would be driven by a number of factors that may lead to significant reduction in the Trustee's confidence that the Manager will be able to perform in line with the stated objective of a strategy over the long term.

The majority of the Managers are remunerated by way of a fee calculated as a percentage of assets under management. The Trustee is also happy to consider paying a performance related fee where it believes it makes sense to do so.

**12.4 How the Trustee monitors portfolio turnover costs and how they define and monitor it**

Portfolio turnover costs refer to those incurred due to the buying, selling, lending or borrowing of investments. Given that the Scheme invests in a range of pooled investment vehicles, some of which invest across a wide range of asset classes, the Trustee does not have an overall portfolio turnover target.

The Trustee receives MiFID II reporting from the Managers, which provides this information, but does not monitor portfolio turnover costs and has not set ranges in respect of them. This position is kept under review.

**12.5 Duration of arrangement with Managers**

As the Trustee is a long-term investor, it does not expect to make underlying manager changes on a frequent basis.

The Scheme only holds open-ended vehicles and expects to retain them unless:

- There is a strategic change to the overall strategy that no longer requires exposure to that asset class or manager;
- The Manager appointed has been reviewed and the Trustee has decided to terminate the mandate.

**13. Investment Performance Benchmark**

The performance of the investment strategy is compared to the performance of a customised, composite benchmark, as well as its liabilities. The composite benchmark comprises a number of market indices, representing the underlying asset classes held by the Scheme, which is also used to assess the performance of each individual mandate.

**14. Review of this Statement**

The Trustee does not expect to revise this Statement frequently because it covers broad principles. The Statement will be reviewed at least once every three years and after any significant change in investment policy. Any change to this Statement will only be made after having obtained and considered the written advice of someone who the Trustee reasonably believes to be qualified by their ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of pension scheme investments.

**Signed on behalf of the Trustee of the Zoological Society 1988 Pension Scheme**

Signed: A BOSTOCK Date: 25 September 2020

Name: Alison Bostock