Statement of Investment Principles for the Hermes Group Pension Scheme

17 November 2022

This document was adopted by the Trustee on 1 December 2022.

1. Introduction

This Statement of Investment Principles ("SIP") sets out the policy of Hermes Pension Trustees Limited (the "Trustee") on various matters governing decisions about the investments of the Hermes Group Pension Scheme ("the Scheme"). This SIP replaces the previous SIP dated December 2021.

The Scheme is a Defined Benefit ("DB") pension scheme which closed to new members in 2008 and to further accruals on 31 October 2011.

The SIP is designed to meet the requirements of Section 35 (as amended) of the Pensions Act 1995 ("the Act"), the Occupational Pension Schemes (Investment) Regulations 2005 (as amended) and the Pension Regulator's guidance for defined benefit pension schemes (March 2017).

This SIP has been prepared after obtaining and considering written professional advice from LCP, the Trustee's investment adviser, whom the Trustee believe to be suitably qualified and experienced to provide such advice. The advice considers the suitability of investments including the need for diversification given the circumstances of the Scheme and the principles contained in this SIP. The Trustee has consulted with the Principal Employer to the Scheme (BT Pension Scheme Trustees Limited) in producing this SIP.

The Trustee will review this SIP from time to time and, with the help of its advisers, will amend it as appropriate. These reviews will take place as soon as practicable after any significant change in investment policy and at least once every three years.

- **Appendix 1** sets out details of the Scheme's investment governance structure, including the key responsibilities of the Trustee, investment advisers and investment managers. It also contains a description of the basis of remuneration of the investment adviser and the investment managers.
- **Appendix 2** sets out the Trustee's policy towards risk appetite, capacity, measurement and management.
- Alongside this SIP, the Trustee maintains an Investment Policy Implementation Document ("IPID") which sets out the Scheme's investment manager arrangements.

2. Investment objectives

The primary objective is to ensure that the Scheme should be able to meet benefit payments as they fall due. To achieve this objective, the Trustee is targeting the Scheme to be fully funded on a prudent self-sufficiency basis by the end of 2030. At that point, the Scheme is expected to be invested in very low risk investments which match the liabilities of the Scheme.

The Trustee is aware that there are various measures of funding and has given due weight to those considered most relevant to the Scheme.

3. Investment strategy

The Trustee, with the help of its advisers and in consultation with the Principal Employer, reviewed the investment strategy in October 2022, following heightened volatility in gilt yields which had caused the asset allocation to diverge significantly from the strategic allocation.

As a result of the review, the Trustee agreed that the investment strategy of the Scheme should be based on the allocation below in the immediate future.

Asset Class	Strategic Allocation
Global Low Carbon Equity (index matching)	10%
Property	7.5%
Diversified Credit[1]	15%
Buy & Maintain Corporate Bonds	22.5%
Liability hedging (including Cash)	45%
Total	**100%**

The Trustee also agreed that the Scheme should hedge 95% of the interest rate risk and 90% of the inflation risk inherent in the Scheme’s liabilities (as measured on a gilts flat liability basis).

There is no formal rebalancing policy. The Trustee monitors the asset allocation from time to time. If material deviations from the strategic allocation occur as a result of market movements, the Trustee will consider with its advisers whether it is appropriate to rebalance the assets considering factors such as market conditions and anticipated future cash flows. It should be noted that the need to maintain the liability hedging strategy can mean that the asset mix is not always rebalanced back to the percentages shown above.

In particular, the Trustee has decided not to make any further allocations to closed ended private credit vehicles (part of the Diversified Credit allocation). As the existing investments run off, the Trustee intends to reinvest the proceeds in either Asset Backed Securities (also part of the Diversified Credit allocation), or Buy & Maintain corporate bonds in order to increase the extent to which benefit cash flows are matched by this investment.

As the Scheme matures over time, the Trustee will seek to de-risk the investment strategy in line with the change in the liability profile of the Scheme. This means that the investment strategy will gradually target a higher allocation to lower risk assets as the Scheme matures.

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[1] The Diversified Credit allocation incorporates investments in Private Credit and Asset Backed Securities. See the IPID for more detail.

4. Considerations in setting the investment arrangements

When deciding how to invest the Scheme's assets, the Trustee considers several risks, including, but not limited to, those set out in Appendix 2. Some of these risks are more quantifiable than others, but the Trustee has tried to allow for the relative importance and magnitude of each risk.

The Trustee considered a wide range of asset classes for investment, taking account of the expected returns and key individual risks associated with those asset classes as well as how these risks can be mitigated where appropriate. The key financial assumption made by the Trustee in determining the investment arrangements is that equity-type investments will, over the long term, outperform gilts by around 5% per annum.

In setting the strategy the Trustee considered:

- the Scheme's investment objectives, including the target return required to meet the Trustee's investment objectives;
- the Scheme's cash flow requirements to meet benefit payments in the near to medium term;
- the best interests of all members and beneficiaries;
- the circumstances of the Scheme, including the profile of the benefit cash flows (and the ability to meet these in the near to medium term), the funding level, and the strength of the employer covenant;
- the risks, rewards and suitability of several possible asset classes and investment strategies and whether the return expected for taking any given investment risk is considered sufficient given the risk being taken;
- the need for appropriate diversification between different asset classes to ensure that both the Scheme's overall level of investment risk and the balance of individual asset risks are appropriate;
- any other considerations which the Trustee considers financially material over the time horizon that the Trustee considers is needed for the funding of future benefits by the investments of the Scheme; and
- the Trustee's investment beliefs about how investment markets work, and which factors are most likely to impact investment outcomes.

The Trustee's key investment beliefs, which influenced the setting of the investment arrangements, are set out in a standalone beliefs document which will be updated from time to time. This document is available on request.

5. Implementation of the investment arrangements

Before investing in any manner, the Trustee obtains and considers written advice from its investment adviser on the question of whether the investment is satisfactory, having regard to the need for suitable and appropriately diversified investments.

Details of the investment managers are set out in the Scheme's IPID.

The Trustee has entered into agreements with the investment managers setting out in detail the terms on which the portfolios are to be managed. The investment managers' primary role is the day-to-day investment management of the Scheme's investments. The managers are authorised under the Financial Services and Markets Act 2000 (as amended) to carry out such activities.

The Trustee and investment managers to whom discretion has been delegated exercise their powers to giving effect to the principles in this Statement of Investment Principles, so far as is reasonably practicable.

The Trustee has limited influence over managers' investment practices because all the Scheme's assets are held in pooled funds, but it encourages its managers to improve their practices where appropriate.

The Trustee's view is that the fees paid to the investment managers, and the possibility of their mandate being terminated, ensure they are incentivised to provide a high quality service that meets the stated objectives, guidelines and restrictions of the fund. However, in practice managers cannot fully align their strategy and decisions to the (potentially conflicting) policies of all their pooled fund investors in relation to strategy, long-term performance of debt/equity issuers, engagement and portfolio turnover.

It is the Trustee's responsibility to ensure that the managers' investment approaches are consistent with its policies before any new appointment, and to monitor and to consider terminating any existing arrangements that appear to be investing contrary to those policies. The Trustee expects investment managers, where appropriate, to make decisions based on assessments of the longer term financial and non-financial performance of debt/equity issuers, and to engage with issuers to improve their performance. It assesses this when selecting and monitoring managers.

The Trustee evaluates investment manager performance by considering performance over both shorter and longer-term periods as available. Except in closed-ended funds where the duration of the investment is determined by the fund's terms, the duration of a manager's appointment will depend on strategic considerations and the outlook for future performance. Generally, the Trustee would be unlikely to terminate a mandate on short-term performance grounds alone.

The Trustee's policy is to evaluate each of its investment managers by reference to the manager's individual performance as well the role it plays in helping the Scheme meet its overall long-term objectives, taking account of risk, the need for diversification and liquidity. Each manager's remuneration, and the value for money it provides, is assessed in light of these considerations.

The Trustee recognises that portfolio turnover and associated transaction costs are a necessary part of investment management and that the impact of portfolio turnover costs is reflected in performance figures provided by the investment managers. The Trustee expects its investment consultant to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Scheme's investment mandates.

6. Realisation of investments

The investment managers have discretion over the timing of realisation of investments of the Scheme within the portfolios that they manage, and in considerations relating to the liquidity of investments.

When appropriate, the Trustee, on the administrators' recommendation, decides on the amount of cash required for benefit payments and other outgoings and informs the investment managers of any liquidity requirements. The Trustee's preference is for investments that are readily realisable but recognise that achieving a well-diversified portfolio may mean holding some investments that are less liquid (for example, property or private credit). Where possible, the Trustee has selected an income distributing share class to provide some income to help meet cashflow requirements.

In particular, the allocation to short-dated buy and maintain corporate bonds, has been designed so that coupons and maturity proceeds should broadly cover cashflow requirements, allowing for income on the Scheme's other assets.

7. Consideration of financially material and non-financial matters

The Trustee has considered how environmental, social, governance ("ESG") and ethical factors should be considered in the selection, retention and realisation of investments, given the time horizon of the Scheme and its members.

The Trustee expects its active investment managers to take account of financially material considerations (including climate change and other ESG considerations) in the selection of investments. The Trustee seeks to appoint managers or select funds where there are appropriate skills and processes to do this, and from time to time reviews how its managers are taking account of these issues in practice.

The Trustee has limited influence over managers' investment practices where assets are held in pooled funds, but it encourages its managers to improve their practices where appropriate.

The Trustee does not take into account any non-financial matters (i.e. matters relating to the ethical and other views of members and beneficiaries, rather than considerations of financial risk and return) in the selection, retention and realisation of investments.

8. Stewardship

The Trustee recognises its responsibilities as an owner of capital, and believes that good stewardship practices, including monitoring and engaging with investee companies, and exercising voting rights attaching to investments, protect and enhance the long-term value of investments. The Trustee has delegated to its investment managers the exercise of rights attaching to investments, including voting rights, and engagement with issuers of debt and equity and other relevant persons about relevant matters such as performance, strategy, risks and ESG considerations.

The Trustee does not monitor or engage directly with issuers or other holders of debt or equity. It expects the investment managers to exercise ownership rights and undertake monitoring and engagement in line with the managers' general policies on stewardship, as provided to the Trustee from time to time, taking into account the long-term financial interests of the beneficiaries.

The Trustee seeks to appoint managers or select funds where there are strong stewardship policies and processes, reflecting where relevant the recommendations of the UK Stewardship Code issued by the Financial Reporting Council, and from time to time the Trustee reviews how these are implemented in practice. Furthermore, each of the Scheme's assets managers is a signatory of the United Nations Principles for Responsible Investment.

Investment governance, responsibilities, decision-making and fees

The Trustee has decided on the following division of responsibilities and decision-making for the Scheme. This division is based upon the Trustee's understanding of the various legal requirements placed upon it, and its view that the division of responsibility allows for efficient operation and governance of the Scheme overall. The Trustee's investment powers are set out within the Scheme's governing documentation.

1. Trustee

In broad terms, the Trustee is responsible in respect of investment matters for:

- developing a mutual understanding of investment and risk issues with the Principal Employer;
- setting the investment strategy, in consultation with the Principal Employer;
- formulating a policy in relation to financially material considerations, such as those relating to ESG considerations (including but not limited to climate change);
- formulating a policy on taking account of non-financial matters in the selection, retention and realisation of investments;
- setting the policy for rebalancing between asset classes;
- setting a policy on the exercise of rights (including voting rights) and undertaking engagement activities in respect of the investments;
- putting effective governance arrangements in place and documenting these arrangements in a suitable form;
- appointing (and, when necessary, dismissing) investment managers, investment advisers, actuary and other service providers;
- monitoring the exercise of the investment powers that they have delegated to the investment managers and monitoring compliance with Section 36 of the Act;
- communicating with members as appropriate on investment matters, such as the Trustee's assessment of its effectiveness as a decision-making body, the policies regarding responsible ownership and how such responsibilities have been discharged;
- reviewing the investment policy as part of any review of the investment strategy;
- reviewing the content of this SIP from time to time and modifying it if deemed appropriate; and
- consulting with the Principal Employer when reviewing the SIP.

The Trustee has delegated consideration of certain investment matters to an Investment Implementation Committee ("IIC") and the Trustee and IIC understand the different areas where each party makes decisions, provides oversight or recommendations. The Trustee remains responsible for setting the investment strategy; the IIC ensures the implementation of the investment strategy.

2. Investment managers

In broad terms, the investment managers will be responsible for:

- managing the portfolios of assets according to stated objectives, and within the guidelines and restrictions set out in their respective investment manager agreements and/or other relevant governing documentation;
- taking account of financially material considerations (including climate change and other ESG considerations) as appropriate when managing the portfolios of assets;
- exercising rights (including voting rights) attaching to investments and undertaking engagement activities in respect of investments;
- providing the Trustee with regular information concerning the management and performance of their respective portfolios; and
- having regard to the provisions of Section 36 of the Act insofar as it is necessary to do so.

The custodians of the portfolios (whether there is a direct relationship between the custodian and the Trustee or not) are responsible for safe keeping of the assets and facilitating all transactions within the portfolios.

3. Investment adviser

In broad terms, the investment adviser will be responsible, in respect of investment matters, as requested by the Trustee, for:

- advising on how material changes within the Scheme's benefits, membership, and funding position may affect the manner in which the assets should be invested and the asset allocation policy;
- 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);
  - the effect of portfolio turnover and resulting transaction costs on investment performance; and
- participating with the Trustee in reviews of this SIP.

The Trustee has set performance objectives for its investment adviser, to assess the adviser's performance. The performance of the adviser relative to these objectives is reviewed regularly.

4. Fee structures

The Trustee recognises that the provision of investment management and advisory services to the Scheme results in a range of charges to be met, directly or indirectly, by deduction from the Scheme's assets.

The Trustee has agreed Terms of Business with the Scheme's investment advisers, under which work undertaken is charged for by an agreed fixed fee or on a "time-cost" basis.

The investment managers receive fees calculated by reference to the market value of assets under management, the value of liabilities hedged (in respect of the liability hedging mandate) and in some cases a performance related fee. The fee rates are believed to be consistent with the manager's general terms for institutional clients and are considered by the Trustee to be reasonable when compared with those of other similar providers.

The fee structure used in each case has been selected with regard to existing custom and practice, and the Trustee's view as to the most appropriate arrangements for the Scheme. However, the Trustee will consider revising any given structure if and when it is considered appropriate to do so.

5. Performance assessment

The Trustee is satisfied, considering the external expertise available, that there are sufficient resources to support its investment responsibilities. The Trustee believes that it has sufficient expertise and appropriate training to carry out its role effectively.

It is the Trustee's policy to assess the performance of the Scheme's investments, investment providers and professional advisers from time to time. The Trustee will also periodically assess the effectiveness of its decision-making and investment governance processes and will decide how this may then be reported to members.

6. Working with the Scheme's employers

When reviewing matters regarding the Scheme's investment arrangements, such as the SIP, the Trustee seeks to give due consideration to the Principal Employer's perspective. While the requirement to consult does not mean that the Trustee needs to reach agreement with the Principal Employer, the Trustee believes that better outcomes will generally be achieved if the Trustee and Principal Employer work together collaboratively.

Policy towards risk

Appendix 2

1. Risk appetite and risk capacity

Risk appetite is a measure of how much risk the Trustee is willing to bear within the Scheme to meet its 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. Risk capacity is a measure of the extent to which the Trustee can tolerate deviation from its long-term objectives before attainment of those objectives is seriously impaired. The Trustee aims is to strike the right balance between risk appetite and risk capacity.

When assessing the risk appetite and risk capacity, the Trustee considered a range of qualitative and quantitative factors, including:

- the strength of the Principal Employer's covenant and how this may change in the near/medium future;
- the agreed journey plan;
- the Scheme's long-term and shorter-term funding targets;
- the Scheme's liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged;
- the Scheme's cash flow and target return requirements; and
- the level of expected return and risk, now and as the strategy evolves.

2. Approach to managing and monitoring investment risks

The Trustee considers that there are several different types of investment risk that are important to manage and monitor. These include, but are not limited to:

2.1. Risk of inadequate returns

A key objective of the Trustee is that, over the long-term, the Scheme should generate its target return so that it has adequate assets to meet its liabilities as they fall due. The Trustee therefore invests the assets of the Scheme to produce a sufficient long-term return in excess of the liabilities. There is also a risk that the performance of the Scheme's assets and liabilities diverges in certain financial and economic conditions in the short term. This risk has been taken into account in setting the investment strategy and is monitored by the Trustee on a regular basis.

2.2. Risk from lack of diversification

This is the risk that failure of a particular investment, or the general poor performance of a given investment type, could materially adversely affect the

Scheme's assets. The Trustee believes that the Scheme's assets are adequately diversified between different asset classes and within each asset class. This was a key consideration when determining the Scheme's investment arrangements and is monitored by the Trustee on a regular basis.

2.3. Investment manager risk

This is the risk that an investment manager fails to meet its investment objectives. Prior to appointing an investment manager, the Trustee receives written advice from a suitably qualified individual and will typically undertake an investment manager selection exercise. The Trustee monitors the investment managers on a regular basis to ensure they remain appropriate for its selected mandates.

2.4. Liquidity/marketability risk

This is the risk that the Scheme is unable to realise assets to meet benefit cash flows as they fall due, or that the Scheme will become a forced seller of assets in order to meet benefit payments. The Trustee is aware of the Scheme's cash flow requirements and believes that this risk is managed by maintaining an appropriate degree of liquidity across the Scheme's investments and by investing in income generating assets, where appropriate.

2.5. Environmental, social and governance (ESG) risks

Environmental, social and corporate governance (ESG) factors are sources of risk to the Scheme's investments, some of which could be financially material, over both the short and longer term. These potentially include risks relating to factors such as climate change, unsustainable business practices, and unsound corporate governance. The Trustee seeks to appoint investment managers or select funds were these risks are managed appropriately on its behalf and from time to time reviews how these risks are being managed in practice.

2.6. Interest rate and inflation risk

The Trustee believes that it is appropriate to manage exposures to these risks and to review them on a regular basis.

The Trustee has allocated 45% of the strategic asset allocation to a pooled, leveraged portfolio of gilt-edged bonds and derivatives managed by LGIM. This mandate is designed to hedge 95% of interest rate risk and 90% of inflation risk, after allowing for income and maturity proceeds from buy and maintain corporate bonds and rental income from property. This reduces the volatility of the Scheme's assets relative to its liabilities and, hence, the volatility of its funding position as measured on a gilts flat basis.

2.7. Collateral adequacy risk

The Scheme is invested in a leveraged bespoke fund to provide protection ("hedging") against adverse changes in interest rates and inflation expectations. The manager may from time to time call for additional cash to be paid to the fund in order to support a given level of leverage. Collateral adequacy risk is the risk that the Trustee when requested to do so will not be able to post additional cash to the fund within the required timeframe. A potential consequence of this risk is that the Scheme's interest rate and inflation hedging could be reduced and that the Scheme's funding level could suffer subsequently as a result. In order to manage this risk, the Trustee ensures that the Scheme has a sufficient allocation to cash and other highly liquid assets which can be readily realised, so that cash is available to the manager at short notice.

2.8. 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 Scheme is subject to direct credit risk through the security of its investments in pooled investment vehicles. This risk exposure is mitigated by the underlying assets of the pooled arrangements being ring-fenced from the pooled fund manager, the regulatory environments in which the pooled managers operate and diversification of investments amongst several pooled arrangements.

The Scheme is subject to indirect credit risk because it invests in bonds via pooled funds, and in derivative contracts to hedge interest rate and inflation risks via a pooled fund. The Trustee manages its exposure to indirect credit risk by only investing in pooled funds that have a diversified exposure to different credit issuers and derivative counterparties.

2.9. Currency risk

Whilst most of the currency exposure of the Scheme's assets is to Sterling, the Scheme is subject to currency risk because some of the Scheme's investments are held in overseas markets. The Trustee considers the overseas currency exposure in the context of the overall investment strategy and believes that the currency exposure that exists diversifies the strategy and is appropriate. Furthermore, the Trustee manages some of the amount of currency risk by investing in pooled funds that hedge currency exposure or implement separate currency hedging arrangements.

The Trustee has a policy to hedge 75% of the developed market currency risk associated with the Scheme's global equity portfolio with LGIM. The small exposure to emerging markets is unhedged.

2.10. Other non-investment risks

The Trustee recognises that there are other, non-investment, risks faced by the Scheme, and takes these into consideration as far as practical in setting the Scheme's investment arrangements as part of its assessment of the other aspects of the Scheme's Integrated Risk Management framework.

Examples include:

- longevity risk (the risk that members live, on average, longer than expected);
- sponsor covenant risk (the risk that, for whatever reason, the Principal Employer is unable to support the Scheme as anticipated);
- fraud risk.

Together, the investment and non-investment risks give rise generally to funding risk. This is the risk that the Scheme's funding position falls below what is considered an appropriate level. The Trustee regularly reviews progress towards the Scheme's funding target, both in the longer-term as well as against short-term milestones, comparing the actual versus the expected funding level.

By understanding, considering and monitoring the key risks that contribute to funding risk, the Trustee believes that it has appropriately addressed and is positioned to manage this general risk.