DB Statement of Investment Principles

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Contents

Introduction

- Zurich Financial Services UK Pension Trustee Limited ("the Trustee") has produced this Statement of Investment Principles which sets out how the Trustee invests the defined benefit (DB) assets for the Zurich Financial Services UK Pension Scheme ("the Scheme"). A separate Statement of Investment Principles is available for the defined contribution (DC) arrangement held within the Scheme.
- This Statement has been prepared in accordance with all relevant legislations in force at the date of approval. It outlines the principles and policies governing investment decisions made by, or on behalf of, the Trustee for the management of the defined benefit assets and the Trustee's policy for complying with Sections 35 and 36 of the Pensions Act 1995 and subsequent legislation.
- This Statement will be reviewed by the Trustee at least every three years, and may require amendment as general investment conditions alter and as the liabilities of the Scheme change over time. Before revising this Statement the Trustee will obtain and consider the written advice of the Trustee's appointed Investment Adviser ("the Adviser") to ensure its contents are appropriate to the circumstances of the Scheme. The Trustee also consults the principal employer Zurich Financial Services (UKISA) Limited ("the Employer") as to the contents of this statement as well as any material change to its investment strategy not explicitly described in this Statement.

Investment objectives

The Trustee has agreed the following overall objectives for the two defined benefit arrangements, ZPensionBuilder and ES Executives' section:

1) To invest in assets of appropriate quality and liquidity, which meet, together with contributions from the employers, the benefits the Scheme provides as and when they fall due, as set out in the Trust Deed and Rules and
2) To manage the investment risk relative to the agreed levels to which the Trustee is prepared to expose the Scheme.

Choosing investments

- The Trustee takes the overall strategic investment decisions, recognising that implementing an investment strategy requires specialist knowledge and understanding.
- It has formed a sub-committee (the Funding Committee) to act on behalf of the Trustee and to make proposals to the Trustee on investment matters not delegated to the Funding Committee.
- The Funding Committee have delegated authority on straightforward matters, such as investment decisions which fall within already agreed investment management agreements (IMA).
- The Trustee has a service agreement in place with Zurich Insurance Company Ltd which covers Analytical and Advisory Services which are provided in line with the Investment Management standards established by Zurich Insurance Group.
- The Trustee from time to time also receives advice from other appropriately qualified experts as to the suitability of investments.
- The Trustee appoints the Asset Managers ("the Managers") to carry out all the day-to-day investment decisions relating to the management of the assets and their administration. The selection of particular investments is the responsibility of the Managers within the scope of their agreed IMA. Managers are only appointed following detailed due diligence.
- The Trustee appoints one or more custodians ("the Custodian") to hold the Scheme's assets.
- The Trustee ensures compliance with legal requirements by monitoring these requirements, reflecting them in any IMA the Trustee enters into, and by having clear terms of reference for the Funding Committee set out in its Charter and taking appropriate formal investment advice where required.

The kinds of investment to be held

The Trustee may invest in a wide range of assets including:

- Shares in any company
- Loans to any company, sovereign state or public body
- Land and property at any location
- Infrastructure debt
- Insurance policies
- Derivatives and repurchase agreements
- Scottish Limited Partnership (SLP)
- Cash deposits.

Investment in assets may be held directly or indirectly (e.g. via funds).

The Trustee may impose restrictions on the proportions held in various kinds of investments. Details of any such restrictions are made known in writing to each Manager and are contained in the relevant investment guidelines.

The balance between different kinds of investment

The Trustee recognises that the return received from different kinds of investment is achieved in different ways (for example, high income but little opportunity for capital growth or low income but substantial opportunity for capital growth).

The liabilities of the Scheme vary in nature (for example, current pensioners require an immediate income whereas deferred members require no immediate pension income but will do so in future).

The Trustee seeks to balance the investments held against the current and future needs of the Scheme.

The Trustee will review the balance of investments periodically to ensure it continues to be appropriate for the Scheme's objectives.

Risk

The funding risk within a DB scheme sits with the Employer. Using an integrated risk management (IRM) approach, in consultation with the Employer, the Trustee takes an overall approach to managing this risk. The IRM approach considers how covenant, funding and investment risk are all linked and inter-dependent.

The Trustee has considered all of the risks it is exposed to and ways of measuring and managing risks when designing the investment strategy.

In terms of the investment strategy the Trustee views risk as the probability that its chosen strategy would result in the objectives not being met. The strategy is designed to maximise the probability of meeting the objectives whilst aiming to control those factors which may result in the objective not being met.

In arriving at the investment strategy, the Trustee therefore considers the following risks:

Risk	Definition	How we address the risk
Changing demographics risk	The uncertainty in the actual future benefits to be paid to members, for example related to member life expectancy or the way in which members take their benefits.	The demographic assumptions are kept under review; this is formally considered during the valuation process every three years.
Climate risk	The extent to which climate change causes a material decrease 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. This is a macro-economic risk.	Integrating the consideration of climate risk and opportunities into the Trustee's decision-making processes. Engagement with the Adviser and Managers to understand the potential implications for the Scheme's assets. Monitoring exposure to different climate risk considerations across the Scheme's assets. The Trustee has set a net zero ambition for its investment strategy to be net zero for greenhouse gas emissions by 2050, if not earlier.
Concentration risk	The failure of some of the investments that constitute a significant proportion of the assets.	The Managers invest in a range of different asset classes and in different securities in each class. The Trustee has taken advice from the Adviser on the suitability of the asset within the SLP as it represented around a 13% holding of the Scheme's assets at the point of investment.
Covenant risk	The employer is no longer able to support the Scheme.	An external in-depth covenant review takes place as part of the triennial valuation. The Trustee receives regular updates from the Employer. Covenant updates are regularly reviewed at the Funding Committee. Investment strategy and funding proposals consider the strength of the covenant.

Risk	Definition	How we address the risk
Credit risk	That one party to a financial instrument will cause financial loss for the other party by defaulting or falling in value.	Credit quality limits are outlined in the IMAs with the Managers with a focus on diversification across many issuers. Derivative contracts have collateral arrangements in place. Annual payments are required directly from the Employer should the SLP fail.
Currency risk	The currency of the Scheme's assets underperforms relative to Sterling, leading to losses in the value of the assets.	Currency risk is monitored on a regular basis. If there is ever a requirement to reduce currency risk, the Scheme would discuss with the Managers.
Custodian risk	Actions by or insolvency of the custodian could prejudice the ability of the Scheme to meet its liabilities.	The Trustee will review and scrutinise the custodian's Systems and Organisation Controls (SOC 1) report. The SOC 1 report is an annual independent report commissioned by the custodian to assess the design and operating effectiveness of its controls environment. The Trustee reviews the operational service level agreements regularly; this serves as an early warning.
ESG (Environmental, Social and Governance) risk	The extent to which ESG issues (including, but not limited to, climate change) are not reflected in asset prices and/or not considered in investment decision making, leading to underperformance relative to expectations over the timescale relevant to the funding of Scheme benefits.	The Trustee has defined a responsible investment strategy. The day-to-day investment decisions are delegated to the Managers. The Trustee monitors the ESG activities of its Managers and the ESG risks and exposures within the underlying portfolios, and will engage periodically.
Equity risk	The risk that equities may fall in value due to fluctuations in the market.	The Trustee manages equity risk primarily through investing in a diversified range of assets. Equity risk is monitored on a regular basis and is considered relative to other significant risks (e.g. interest and inflation risks).
Financial mismatch risk	Scheme assets fail to grow in line with the developing cost of meeting the liabilities.	The Trustee has set a strategic asset allocation benchmark; the risk/return of each asset class within the benchmark is reviewed periodically. Assessment of the risk relative to liabilities by monitoring the actual return from the assets against the liabilities.

Risk	Definition	How we address the risk
Inflation risk	An increase in inflation would mean the real investment return could be reduced and fail to keep pace with the Scheme's requirement to pay inflation-linked benefits.	The Trustee has a liability-driven investment (LDI) portfolio that seeks to manage interest rate and inflation liability risk. A portion of the Scheme's assets are invested to match the liabilities arising from interest rate and inflation changes.
Interest rate risk	A fall in interest rates causes the present value of liabilities to rise.	The Trustee has an LDI portfolio that seeks to manage interest rate and inflation liability risks. A portion of the Scheme's assets are invested to match the liabilities arising from interest rate and inflation changes.
Liquidity risk	The need to have sufficient liquidity to cover benefits or other financial obligations in the short term.	The Trustee has defined a re-balancing policy and avoids having to sell less liquid assets. The Trustee has defined a clear process with its LDI manager to manage potential liquidity requirements from the LDI portfolio. Drawing income from Scheme assets and carrying out re-balancing activities.
Manager risk	A Manager underperforms against the benchmark which they are being assessed against in the long term or fails to comply with the IMA.	Performance of the Scheme's Managers is monitored on a regular basis. Regular meetings are held with the Managers. Compliance with the IMA is monitored on a regular basis. Risk metrics are monitored to ensure that excessive risk taking is limited.
Operational risk	The loss or error arising from the failure of people, processes and systems, or disruption due to an external event.	Appropriate processes and controls are integrated into business activities. Key controls include segregation of duties, appointment of an external custodian, supervisory controls and managerial oversight and review. Business continuity plans are in place.
Political risk	The level of concentration in any one market leading to the risk of a negative influence on investment values arising from political intervention of other events.	Diversification of the Scheme's assets. The Trustee assesses political risk relative to the investment strategy.

Risk	Definition	How we address the risk
Real estate risk	The risk that real estate may fall in value due to fluctuations in the market.	The Trustee manages real estate risk primarily through investing in a diversified range of assets. Real estate risk is monitored on a regular basis and is considered relative to other significant risks (e.g. interest and inflation risks).
Systemic risk	The possibility of an interlinked and simultaneous failure of several asset classes and/or Managers, possibly compounded by financial contagion, resulting in an increase in the cost of meeting the liabilities.	Diversification of the Scheme's assets. The Trustee acknowledges it is not possible to address all possible scenarios presented within this risk category.
Any other risk as the Trustee deems appropriate with relevant input from the Adviser and other parties.		

Responsible investments

The Trustee accepts its fiduciary duties as a long-term investor and believes that incorporating ESG factors and climate change into investment decisions improves long-term risk-adjusted returns. The Trustee therefore seeks to ensure that financially material ESG risks are always identified and appropriately managed within the chosen strategy.

Selecting managers

The Trustee always aims to appoint the most suitable manager for each investment mandate (including funds). The selection process includes an assessment of the Manager's responsible investment practices, integration of ESG factors into decision making and review of the Managers' approach to stewardship including, where applicable, voting policy.

Financially material considerations

The Trustee considers ESG factors at each step in the development and implementation of its investment strategy.

Within the Scheme's mandates, the Trustee has delegated responsibility for the consideration of stock-specific issues to the respective Managers. The Trustee has discussed the extent to which ESG factors, where relevant to the investment mandate, are integrated into the investment processes of the Managers and is satisfied that the Managers are following an approach which takes account of all financially material factors when selecting, retaining and realising investments. The Trustee is also satisfied that these factors are considered over a time horizon which is appropriate for the Scheme.

The Trustee also notes the approach taken by the Zurich Group to responsible investment and will both consider and leverage the Group's policies and resources, including any potentially restricted securities, where the Trustee believes it appropriate to do so. Where restrictions are applied on any securities, the Trustee will provide this information to its Managers and require the Managers to comply with the restrictions. The Trustee will periodically review such compliance.

The Trustee believes that addressing climate change is in the best financial interests of the Scheme and its members. In order to reflect this belief, the Trustee has set a long-term ambition for the Scheme's investment strategy to be net zero for greenhouse gas emissions by 2050, if not earlier.

In considering the expected transition to a low-carbon economy, the Trustee has determined that investment in companies that derive material revenues from the mining of, or generation of energy from, thermal coal may pose investment risk to the Scheme. Where the Scheme directly holds securities (as opposed to a fund), the Trustee has explicitly determined to exclude investments in the equity and debt of such companies within portfolios.

Stewardship themes

In order to concentrate its stewardship efforts, the Trustee will maintain a set of 'Stewardship Themes' covering topics that are particularly relevant to its beliefs and objectives. The purpose of setting Stewardship Themes is to ensure the Trustee can more readily scrutinise stewardship activity carried out on its behalf and to ensure that the exercise of stewardship achieves the desired outcomes.

The Trustee's Stewardship Themes will be set out annually within its Implementation Statement. The Trustee will make its Managers aware of its Stewardship Themes and its expectation with regard to them. The Trustee will use the Stewardship Themes to:

- Scrutinise the activity of its Managers;
- Ensure that stewardship outcomes are in line with expectations; and
- Identify any potential areas of concern.

The Trustee will also seek reporting of voting and engagement activity, including case studies, against the Stewardship Themes.

Voting

The Trustee will seek to exercise its voting rights, where the Scheme directly holds securities, in the best long-term interests of Scheme members. The Trustee recognises that its Managers maintain a house voting policy with the expectation that voting power will be exercised by them with the objective of preserving and enhancing long-term shareholder value. The Trustee has reviewed these house voting policies and is satisfied that these policies are reflective of the Trustee's objectives. The Trustee has instructed its Managers to exercise all voting rights attached to individual investments in accordance with these house policies.

The Trustee recognises that its Managers will review and update their house voting policy on a periodic basis to reflect changes to their views and prevailing best practice. The Trustee will review these policies on an annual basis.

Managers are required to report on voting activity to the Trustee on at least an annual basis. The Trustee will monitor voting activity which may include:

- The extent to which votes have been cast;
- Voting patterns, including trends through time;
- Voting on the Trustee's Stewardship Themes;
- Voting on particular companies.

Where appropriate, the Trustee may require its Managers to provide an explanation of why votes have been cast.

Engagement

The Trustee aims to meet with all its Managers on a regular basis. Managers are challenged on the impact of any significant issues including, where appropriate, ESG factors and the exercise of stewardship including voting.

The Trustee believes it is appropriate for its Managers to engage with key stakeholders, which may include corporate management of issuers of debt or equity, regulators and governance bodies, relating to their investments for the Scheme in order to improve corporate behaviours (including the management of actual or potential conflicts of interest), improve performance and strategy and mitigate financial risks (including ESG factors).

The Trustee expects its Managers to consider the capital structure of investments and the appropriateness of any investment made. Where Managers are responsible for investing in new issuance, the Trustee expects the Manager to engage with the issuer about the terms on which capital is issued and the potential impact on the rights of new and existing investors.

The Trustee will review engagement activities undertaken by their Managers as part of its broader monitoring activity. The Trustee believes that such engagement incentivises the Managers to preserve and enhance long-term shareholder value of its investments. The Trustee will also consider the extent to which its Managers have engaged on its Stewardship Themes and seek evidence of such engagements.

Conflicts of interest

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. Managers are required to disclose any potential or actual conflict of interest in writing to the Trustee.

Escalation

The Trustee expects that the Managers' approach to stewardship, including the framing of house policies, will broadly align with the Trustee's views. The Trustee further expects that its Managers are active stewards of the Scheme's assets.

If the Trustee's stewardship expectations are not met, then the Trustee will further engage with the Manager. Where assets are directly held by the Trustee, the Trustee may set explicit guidelines or expectations within the IMA. Where assets are held within pooled funds, the Trustee will communicate its concerns to the Manager.

After a period of engaging with the Manager, if the Trustee's expectations continue to not be met, the Trustee will consider terminating the mandate and replacing the Manager.

Non-financial matters

Where the Scheme directly holds securities, the Trustee has determined to exclude investment in the debt and equity of companies involved in the manufacture of UN-sanctioned weapons from investment portfolios. The Trustee has not imposed any other restriction for non-financial reasons but will periodically review its position.

Member engagement

The Trustee does not have a formal policy of soliciting member or beneficiary views on non-financial matters in their investment decision making but will periodically review its position.

The expected return from investments

The investment strategy aims to achieve a return on Scheme assets, together with contributions from the Employer, to meet the benefits the Scheme provides as and when they fall due.

Having established the IMA the Managers are expected to follow, the Trustee monitors the performance of the Managers.

The realisation of investments

The Trustee will consider the liquidity of an asset class before deciding to make an investment of that kind. Assets such as property and private debt are less easy to sell. In particular, they will consider liquidity in the context of the Scheme's likely need for cash in the short and longer term, the income generated from an investment of that kind and the prospects for liquidity at a future date.

Ultimately, the investments will all have to be sold by the time the Scheme's life comes to an end. The Trustee is advised by the Scheme Actuary as to the solvency of the Scheme should all the assets be sold immediately. In this situation, the Trustee is aware of the fact that the realisable value of some investments, were there to be a forced sale, might be lower than the market value as shown in the accounts.

Performance measurement

The Trustee has agreed, based on advice from the Adviser and other appropriately qualified experts, the benchmark against which the performance of each of the Managers is measured.

The Trustee regularly monitors actual performance against the benchmarks set. The Trustee would not expect to replace a Manager based on short-term underperformance as the focus is on longer-term outcomes; this aligns with the Trustee's beliefs on corporate governance.

An IMA with a Manager could cease within a short timeframe due to other factors such as a significant change in business structure or the investment team.

The Trustee will review on a regular basis the investment performance of the Scheme's assets together with the continuing suitability of the Managers. If the review showed that performance or continuing suitability needed to be addressed, the Funding Committee would either make a decision on behalf of the Trustee, or for more substantial issues it would recommend an action to the Trustee.

Asset managers

Turnover
In the normal course of events the Managers will sell investments from time to time to be replaced by others. The Trustee monitors the turnover and the transaction costs that are generated to ensure it is not excessive. The Managers are aware that the expenses involved in transactions can affect performance and that excessive transactions may give rise to an income tax liability if it were to be regarded as trading by HM Revenue & Customs.

There are no specific targets set by the Trustee on transaction costs. The Trustee will monitor that the level of transaction costs is in line with the Managers' strategy and adheres to the Scheme's investment strategy.

Duration
The agreements between the Trustee and its Managers will continue through until the Scheme's life comes to an end, or until the lifespan of the investment ceases. The Trustee or the Manager may take measures in line with the IMA to end the agreement, subject to any relevant notice periods.

Incentives
The Managers are paid for their services based on the value or exposure of the assets they manage for the Trustee. Within some of the IMAs performance fees apply. Performance fees are applied for outperforming the benchmark. Medium to long-term outperformance is incentivised as any poor performance may require the performance fees to be repaid. For a number of IMAs tiered fees apply, meaning the fees reduce with additional assets under management.

The Trustee is satisfied that the Managers are remunerated in such a way that they are incentivised to act in accordance with the Trustee's policies and in the best interest of the Scheme and its beneficiaries.

Glossary

- **Adviser:** A person who is reasonably believed by the Trustee 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 the investments of trust-based pensions. The names of our Advisers can be found in the Annual Report and Accounts.
- **Asset Manager:** A person or organisation employed by the Trustee with delegated responsibility to make investments in portfolios under the investment objectives and parameters defined by the Investment Manager Agreement (IMA).
- **Collateral agreement:** An agreement between two parties that sees cash or assets moving between two entities when the value of a derivative contract changes.
- **Environmental, Social and Governance (ESG):** ESG criteria are a set of standards for a company's operations that investors use to screen potential investments. Environmental criteria consider how a company performs as a steward of nature. Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights.
- **Financial contagion:** The spread of market disturbances, mostly on the downside, from one country to the other, a process observed through co-movements in exchange rates, stock prices, sovereign spreads and capital flows.
- **Financially material considerations:** include (but are not limited to) environmental, social and governance considerations (including but not limited to climate change), which the Trustee considers financially material.
- **Funding volatility:** The amount of variability between the Scheme's assets and liabilities.
- **Integrated Risk Management (IRM):** IRM is a risk management tool that helps the Trustee identify and manage the factors that affect the prospects of meeting the Scheme's objectives. It considers the three fundamental risks to DB schemes as covenant, funding and investment risk. IRM examines the interrelationship of these risks and seeks to understand in turn how one may affect the other two risks.
- **Liabilities:** The estimated future pension payments of the Scheme.
- **Liability-Driven Investment (LDI):** An approach to investing that seeks to match the liabilities related to the movement in interest rates and inflation.
- **Liquidity:** The ease of which an asset or security can be converted into cash.
- **Macroeconomic:** This means it affects the economy as a whole, not just a specific sector.
- **Nominal investment returns:** The investment return before the effect of inflation has been accounted for.
- **Non-financial matters:** The views of the members and beneficiaries including (but not limited to) their ethical views and their views in relation to social and environmental impact and present and future quality of life of the members and beneficiaries of the Scheme.
- **Real investment return:** The actual investment return once the effect of inflation has been accounted for.
- **Trust Deed and Rules:** These are the legal documents by which the Scheme is governed.