# STATEMENT OF INVESTMENT PRINCIPLES - MARCH 2019

## ARUP UK PENSION SCHEME

## 1. Introduction

The Trustees of the Arup UK Pension Scheme (the "Scheme") have prepared this Statement of Investment Principles (the "Statement") in accordance with Section 35 of the Pensions Act 1995 (as amended by the Pensions Act 2004, and the Occupational Pension Schemes (Investment) Regulations 2005). The Trustees will review this Statement and the Scheme's investment strategy annually from the effective date of this Statement and without delay after any significant change in the investment policy.

The Trustees are responsible for the investment strategy of the Scheme. The Scheme comprises two sections: one providing Defined Benefits whilst the other is a Defined Contribution Scheme known as the Money Purchase Section. There is no cross-subsidy between the different sections. The Trustees therefore consider it appropriate to look at each section separately when considering the investment policy.

The Trustees have consulted with the Principal Employer ("the Employer"), Ove Arup & Partners International Limited and will take the Employer's comments into account when they believe it is appropriate to do so.

The Trustees are ultimately responsible for the investment of the Scheme's assets and obtain written advice on the long term investment strategy appropriate for the Scheme, and on the preparation of this Statement. This advice was provided by Mercer who are authorised and regulated by the Financial Conduct Authority.

## 2. Investment objectives

In addition to ensuring that the assets of the Scheme are invested in the best interests of the members and beneficiaries, the Trustees' primary investment objectives are:

- To ensure that sufficient assets are available to pay members' benefits as and when they arise;
- To achieve full funding position on a self-sufficiency funding basis (defined as being gilts plus 0.60% p.a.) on or before the end of 2033 (the end of the recovery period).

## 3. Investment Risk Measurement and Management

The key investment risks are recognised as arising from asset allocation. The Trustees take advice on the continued appropriateness of the existing investment strategy, which is reviewed following each formal actuarial valuation of the Scheme (or more frequently should the circumstances of the Scheme change in a material way), and has agreed a framework whereby the Scheme de-risks as the funding position improves.

Risks associated with changes in the Employer covenant are assessed by monitoring the Failure Score (as defined for the purposes of calculating the risk-based element of the Pension Protection Fund levy). The Trustees also have an agreement with the Employer to receive notification of any events which have the potential to alter the creditworthiness of the Employer. In particular, the Trustees will be informed of Type A events, as defined in appropriate guidance issued by the Pensions Regulator and Employer-related Notifiable Events. On receipt of such notification, the Trustees will re-consider the continued appropriateness of the Scheme's existing investment strategy.

Following changes to accounting standards, the Trustees are now required to provide narrative disclosures on the credit and market risks arising from its investment arrangements in the Trustee Annual Report and Accounts. These are as follows:

- 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. In respect of the Scheme, this risk reflects the probability that coupon and redemption payments due under a bond might not be made by the issuer, and similarly that the dividends and rental income expected from equity and property investments respectively might not be paid.
- Market risk: this is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk, each of which is further detailed as follows:
    - Currency risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates. In respect of the Scheme, this is the risk occurs through investment in non-Sterling assets, given that the Scheme's liabilities are denominated in Sterling, because changes in exchange rates will impact the relative value of the assets and 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. In respect of the Scheme this risk exists if the cost of securing members benefits increases due to fall in long term gilt yields.
    - 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 Trustees monitor the risks arising through the selection or appointment of investment managers on a quarterly basis via investment monitoring reports prepared by their professional advisors. Expected deviation from the benchmark (for a passive manager) or outperformance target (for an active manager) is detailed in the Appendix of this Statement. The Trustees have appointed Mercer Limited to alert them on any matters of material significance that might affect the ability of each investment manager to achieve its objectives.

The Trustee acknowledges the Scheme is exposed to collateral management and counterparty risk in relation to the derivative instruments used within its investment arrangements. The Trustee understands the collateral requirements will change and these are reviewed regularly. The collateral requirement and counterparty exposure will be managed by the Scheme's investment manager but regularly monitored by the Trustee.

The Trustees acknowledge that investment returns achieved outside the expected deviation (positive or negative) may indicate that the Investment Manager is taking a higher level of risk than indicated. These issues were considered when appointing investment managers and will be considered as part of the regular ongoing investment review procedures that the Trustees have in place.

For due diligence purposes, the Trustees meet regularly and see their investment managers approximately every 18 months via the Investment Sub-Committee.

## 4. Investment Strategy

The types of investments held and the balance between them is deemed appropriate given the liability profile of the Scheme, its cashflow requirements, the funding level of the Scheme and the Trustees' objectives.

Assets held to cover the Scheme's technical provisions (the liabilities of the Scheme) are invested in a manner appropriate to the nature and duration of the expected future retirement benefits payable under the Scheme.

A broad range of available asset classes has been considered. This includes consideration of so called "alternative" asset classes (namely property, diversified growth funds, alternative credit and hedge funds).

The asset allocation set out in Appendix A was implemented after considering written advice from the Scheme's advisers.

The Trustees exercise their powers of investment in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole. In order to avoid an undue concentration of risk a spread of assets is held. The diversification is both within and across the major asset classes.

The assets of the Scheme are invested predominantly on regulated markets (with investments not on regulated markets being kept to a prudent level) and properly diversified to avoid excessive reliance on any particular asset, issuer or group of undertakings so as to avoid accumulations of risk in the portfolio as a whole.

Investment in derivatives is only made in so far as they contribute to the reduction of investment risks or facilitate efficient portfolio management and are managed such as to avoid excessive risk exposure to a single counterparty or other derivative operations.

A working balance of cash is held for immediate payment of benefits, expenses, etc. Under normal circumstances it is not the Trustees' intention to hold a significant cash balance and this is carefully monitored by the Scheme's administrator. Where there is a significant cash balance, the monies will be invested in a specialist cash fund in order to manage risk.

## 5. Day-to Day Management

The day-to-day management of the Scheme's assets has been delegated to investment managers who are appropriately authorised and regulated as required under the Financial Services and Markets Act 2000 (amended by the Financial Services Act 2012). Their regulatory status can be verified on the Financial Services Register at www.fca.org.uk/register/. A copy of this Statement is available to the investment managers appointed and to the members of the Scheme on request.

## 6. Expected return on investments

Over the long-term the Trustees' expectations are:

- for the "growth" assets (global equities, diversified growth funds, fund of hedge funds, alternative credit and property), to achieve a return in excess of the increase in value of the liabilities over the same period. The Trustees are willing to incur short-term volatility in asset price behaviour with the expectation that over the long term these assets will outperform asset classes which may be regarded as matching the liabilities;

- for the "matching" assets (liability-driven investment and corporate bonds) to achieve a rate of return which is proportionately (depending on the target hedge ratio) in line with the growth of liabilities;

The projected investment returns (technical provisions) for the asset classes taken from the actuarial valuation dated 31 March 2016 are:

- 4.6% p.a. for assets held in respect of pre-retirement liabilities;

- 2.9% p.a. for assets held in respect of post-retirement liabilities;

- 2.8% p.a. in respect of retail price inflation (RPI);

- 1.8% p.a. in respect of consumer price inflation (CPI);

The Scheme's final salary section closed to future accruals on 30 June 2010, at which point all active members became deferred and now their benefits increase in line with inflation (CPI).

Returns achieved by the fund managers are assessed against performance benchmarks set by the Trustees in consultation with their advisers and fund managers.

## 7. Realisation of Investments/Liquidity

The Trustees recognise that in order to help achieve their investment objectives they are able to tolerate a degree of illiquidity within the Scheme's asset portfolio. At present, most of the assets of the Scheme are currently held in pooled funds and are realisable at short notice through the sale of units if liquidity is required.

## 8. Custody

The Scheme's assets are invested in pooled funds, which give the Trustees a right to the cash value of the units rather than to the underlying assets. The managers of the pooled funds are responsible for the appointment and monitoring of the custodian of the fund's assets.

The custodians are independent of the Employer.

## 9. Social, Environmental or Ethical Considerations

The Trustees believe that environmental, social, and corporate governance (ESG) factors may have a material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustees also recognise that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration.

The Trustees have given appointed investment managers full discretion in evaluating ESG factors, including climate change considerations, and exercising voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code.

The Trustees consider how ESG, climate change and stewardship is integrated within investment processes in appointing new investment managers and monitoring existing investment managers. Monitoring of investment manager ESG integration is included in the quarterly investment monitoring reports prepared by the Trustees' professional advisors.

The Trustees do not currently have a policy of taking into account the views of the members and beneficiaries, including their ethical views and views in relation to social and environmental impact and their present and future quality of life, when considering the selection, retention and realisation of assets.

## 10. Investment Restrictions

The Trustees have not set any investment restrictions on the appointed investment managers in relation to particular products or activities, but may consider this in future.

## 11. Activism, and the Exercise of the Rights Attaching to Investments

The Trustees do not currently have a specific policy in relation to the exercise of the rights (including voting rights) attaching to investments. These matters are however kept under review and the Trustees are aware of the policy towards corporate governance adopted by their investment managers and receive regular reports on their activity.

## 12. Effective Decision Making

The Trustees recognise that decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. It also recognises that where it takes investment decisions, it must have sufficient expertise and appropriate training to be able to evaluate critically any advice it takes.

## 13. Money Purchase Section

The primary objectives are to ensure members have an appropriate choice of assets for their fund and to enable members to benefit from assets with growth potential until they are near to retirement, when they will be able to switch to assets suitable for stability close to the date on which they will have to use the fund to purchase benefits for retirement. Details about the funds available can be found in Appendix B.

## 14. Additional Voluntary Contributions ("AVCs") Arrangements

In addition to the salary related benefits, members who obtained further benefits by paying additional voluntary contributions to the Scheme secured further added years of pensionable service. This section closed with effect from 31 March 2007. The liabilities in respect of other AVC arrangements are invested separately from the main Scheme assets and are equal to the value of the members' individual funds. The Trustees review the nature of these funds periodically to ensure that they remain appropriate to the members' needs.

From time to time the Trustees review the choice of investments available to ensure that they remain appropriate to the members' needs.

.................................................................... 31/03/19

Signed on behalf of the Trustees of the Arup UK Pension Scheme    Date

# APPENDIX A - DEFINED BENEFIT SECTION MARCH 2019

## ARUP UK PENSION SCHEME

This Appendix sets out the Trustees' current investment strategy for the Defined Benefit section of Arup UK Pension Scheme ("the Scheme"), and is supplementary to the Trustees' Statement of Investment Principles (the "attached Statement").

The Trustees' investment strategy has been established in order to maximise the likelihood of achieving the primary objectives set out in the attached Statement.

### 1. Asset Allocation

| | Bmk (%) | Ranges (%) |
|---|---|---|
| Synthetic Equity* | 21.0 | +/- 5 |
| Diversified Growth Funds (DGF)/ Fund of Hedge Funds | 22.0 | +/- 10 |
| Property | 5.0 | +/- 5 |
| Alternative Credit | 9.0 | +/- 5 |
| **Total Growth** | **57.0** | |
| Corporate Bonds | 13.0 | +/- 5 |
| Bespoke LDI portfolio | 30.0 | +/- 20 |
| **Total Matching** | **43.0** | |
| **Total** | **100.0** | |

* 50% of notional exposure to Equity TRS and Equity Futures is hedged by a separate Currency Hedging Portfolio for the currencies in EUR, JPY and USD (all other overseas currencies are unhedged)

**Re-balancing Arrangements**

In the first instance cashflows are used to maintain the overall asset allocation within the agreed ranges. The asset distribution is then reviewed quarterly and appropriate corrective action is taken.

### 2. Investment Management Arrangements

The following describes the mandates given to the fund managers within each asset class.

**LGIM Qualifying Investor Alternative Investment Fund (QIAIF)**

The principal investment objectives of the QIAIF are:

- To implement a hedge of a proportion of the interest rate and inflation sensitivity of the Scheme's liabilities, as measured by the gilts-flat discount rate basis; and
- To replace physical equity holdings with synthetic equity market exposure to provide to release cash to help meet the above objective.

LGIM can invest in various instruments within the QIAIF including Gilts and index-linked gilts, gilt repos and reverse repos, interest rate swaps, inflation swaps, equity futures and equity total return swaps and various cash instruments.

### Diversified Growth Funds/ Fund of Hedge Funds

| Manager/Fund | Benchmark | Target | Expected Volatility |
|---|---|---|---|
| Newton Real Return Fund | 1 month Sterling LIBOR | 1 month LIBOR + 4% p.a. over rolling 5 year periods (gross of fees) | Expected long term volatility is intermediate between equities and government bonds |
| Nordea Stable Return Diversified Growth Fund | 3 month Sterling LIBOR* | 3 month LIBOR + 4% p.a. over the market cycle (gross of fees) | 4%-7% p.a. |
| Prisma Fund of Hedge Funds | 3 month US T-bills | + 4%-5% p.a. (net of fees) over the market cycle | 4%-6% p.a. |

** To be used for performance measurement purposes as no formal benchmark is provided by Nordea.*

To help meet the expected cashflow needs of the Scheme, the Trustees agreed to redeem £2.5m each quarter from the mandate with Prisma. The first redemption was processed on 30 September 2017 with the final payment processed on 31/12/2019.

### Bonds

| Manager/Fund | Benchmark | Weight | Target | Expected Tracking Error |
|---|---|---|---|---|
| LGIM Active Corporate Bond – Over 10 Year Fund | iBoxx £ Non-Gilt 10 Year + Index | 100% | +0.75% p.a. over rolling 3 year periods (gross of fees) | +/-1.5% p.a. |

### Property

| Manager/Fund | Benchmark | Weight | Target |
|---|---|---|---|
| Rockspring Hanover Property Unit Trust | IPD Balanced Property Unit Trust Median | 20-60% | Outperform the benchmark |
| Schroders Exempt Property Unit Trust (SEPUT) | IPD UK Pooled Property Fund Indices - All Balanced Funds Median | 40-80% | +0.5% p.a. (net of fees) over rolling 3 year period |

### Alternative Credit

| Manager/Fund | Benchmark | Weight | Target |
|---|---|---|---|
| Wellington – Absolute Return Bond Fund | 3 Month Sterling LIBID | 50% | + 4-6% p.a. (gross of fees) over full market cycle |
| Barings– Global High Yield Credit | 3 Month Sterling LIBOR | 50% | +5% p.a. (net of fees) over full market cycle |

**Fee Structure**

| Mandate | | Fees |
|---|---|---|
| LGIM – Corporate Bonds | | 0.200% p.a. |
| LGIM QIAIF | Liability Hedging Portfolio | 0.05% p.a. of the monthly average resent value of the first £750m of liabilities(1) hedged by Total Hedging Assets(2), and 0.04% p.a. of the remaining liabilities hedged by the Total Hedging Assets. |
| | Synthetic Equity Portfolio | 0.05% on the exposure (base) of Equity Futures and Equity TRS. |
| | Currency Hedging Portfolio | Nil- Costs included in the Synthetic Equity Portfolio cost |
| | Sterling Liquidity Fund | 0.125% p.a. in respect to Class 1 shares |
| Prisma – Fund of Hedge Fund | | 0.900% p.a. |
| Nordea Stable Return Diversified Growth Fund | | 0.700% p.a. |
| Newton Real Return Fund | | 0.650% p.a. |
| Schroders – Property | | 0.700% p.a. |
| Rockspring – Property | | 0.550% p.a.<br>Plus performance fee of 0.125% p.a. charged quarterly, if above benchmark performance over previous 36 months or 0.15% p.a. charged quarterly if in benchmark upper quartile performance over previous 36 months. |
| Wellington – Absolute Return Bond Fund | | 0.250% p.a.<br>Plus performance fee of 20% on any excess returns over the previous month. |
| Barings– Global High Yield Credit | | 0.525% p.a. |

(1) Liabilities hedged shall be the greater of:
a. Total Liability Cashflows PV * Total Hedging Assets PV01 / Total Liability Cashflows PV01.
b. Real Liability Cashflows PV * Total Hedging Assets IE01 / Real Liability Cashflows IE01
where reference to Total Liability Cashflows PV means the sum of Fixed Liability Cashflows PV and Real Liability Cashflows PV.
(2) Total Hedging Assets is defined as all assets within the Liability Hedging Portfolio plus the Other Assets. Total Liability Cashflows PV01 refers to the sum of the PV01 of the Nominal Liability Cashflows and PV01 of the Real Liability Cashflows

**Investment Managers Fees**

For passive mandates, or mandates where the manager is seeking to add incremental value in excess of the performance benchmark, the investment manager is remunerated as a set percentage of the assets under management. This is in keeping with market practice.

**Advisers**

The Trustees' investment advisers are paid for advice received on the basis of the time spent by the adviser. For significant areas of advice (e.g. one off special jobs, or large jobs, such as asset and liability modelling), the Trustees will endeavour to agree a project budget.

These arrangements recognise the bespoke nature of the advice given and that no investment decisions have been delegated to the adviser.

# APPENDIX B - MONEY PURCHASE SECTION APRIL 2016

## 1. Investment Options

The Trustees make available a range of investment options for members of the Money Purchase Section. All assets are currently held with Legal and General Investment Management ("LGIM") in pooled investment funds. The Fund range available is set out in the tale below.

| Fund | Benchmark | Outperformance Target | Expected Tracking Error |
|---|---|---|---|
| Global Equity 70:30 Index | 70.0% FTSE All-Share Index<br><br>12.0% FTSE North America Index<br><br>8.8% FTSE Developed Europe (ex-UK) Index<br><br>4.2% FTSE Japan Index<br><br>2.4% FTSE Developed Asia Pacific (ex-Japan) Index<br><br>2.6% FTSE Emerging Markets Index | To match the benchmark | Up to ±0.4% p.a. |
| UK Equity Index | FTSE All-Share Index | To match the benchmark | Up to ±0.25% p.a. |
| Ethical UK Equity Index | FTSE4Good UK Index | To match the benchmark | Up to ±0.5% p.a. |
| Ethical Global Equity Index | FTSE4Good Global Equity Index | To match the benchmark | Up to ±0.5% p.a. |
| World ex UK Index | FTSE World (ex-UK) Index | To match the benchmark | Up to ±0.5% p.a. |
| Active Corporate Bonds | Markit iBoxx Sterling Non-Gilts Over 10 Year Index | +0.75% p.a. (gross of fees) | Up to 1.5% p.a. |
| Managed Property | IPD All Balanced Property Index [(a)] | To match the benchmark | |
| Cash | 7 Day Sterling LIBID [(b)] | To match the benchmark | |

## 2. Fees

| Mandate | Fees |
|---|---|
| Global Equity (70:30) Equity | 0.16% p.a. |
| UK Equity | 0.10% p.a. |
| Ethical UK Equity | 0.20% p.a. |
| Ethical Global Equity | 0.30% p.a. |
| World (ex-UK) Equity | 0.22% p.a. |
| Active Corporate Bonds | 0.25% p.a. |
| Index-Linked Gilts | 0.10% p.a. |
| Managed Property | 0.70% p.a. |
| Cash | 0.13% p.a. |