Nestlé UK Pension Fund (DC Section)

Statement of Investment Principles

August 2019

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Introduction

The law requires Nestlé UK Pension Trust Limited ('the Trustee') to produce a formal 'Statement of Investment Principles' or SIPs for the Nestlé UK Pension Fund ('the Fund') default arrangement and its other investment options. This SIP sets out what the Trustee aims to achieve with the investment options and the investment policies which guide how members' money is invested.

This SIP covers a number of technical points to comply with legislation as well as meet the expectations of the Pensions Regulator and needs of the Fund's Auditors which, as far as possible, are shown separately in 'For the record' boxes. The Fund compromises of both a defined benefit section and defined contribution section. This document only covers the defined contribution section (DC Section) of the Fund.

Statement of Investment Principles

The Trustee's Statement of Investment Principles for the DC Section contained in this document includes the:

1. Statement of the aims and objectives for the default arrangement*;

2. Statement of the aims and objectives for investment options outside the default arrangement*; and

3. Statement of investment beliefs, risks and policies**.

The Statement of Investment Principles for the DC Section of the Fund ** comprises items 1, 2 and 3.

The Statement of Investment Principles for the DC Section of the Fund's default arrangement *** comprises items 1 and 3.

Members' contributions (including those of the employer) are directed into the DC Start or DC Core of the Fund (herein referred to as the 'DC Section').

Investment Implementation Document

It is intended that this SIP should be ‘principles-based’ in nature, and as such further details on the specific elements of the investment strategy are contained in a separate document, titled the Investment Implementation Document (‘IID’). Both the SIP and the IID should be read in conjunction with each other.

For the record

* In accordance with Regulation 2A(1) of the Occupational Pension Schemes (Investment) Regulations 2005.

** In accordance with Regulation 2 of the Occupational Pension Schemes (Investment) Regulations 2005 as modified by subsequent Regulations and section 35 of the 1995 Act.

*** As required by the Occupational Pension Schemes (Charges and Governance) Regulations 2015.

The Trustee has taken proper written advice from their Investment Consultant(s) and consulted the Principal Employer to the Fund in the preparation of this Statement of Investment Principles.

The Trustee will review the SIP and the IID at least every three years or more frequently as required by the Regulations, and without delay after a significant change in investment policy or demographic profile of the Fund’s membership.

This Statement of Investment Principles was completed in August 2019. It will be next reviewed no later than August 2022.

Signed on behalf of the Trustee Directors of Nestlé UK Pension Trustee Limited as Trustee of the Nestlé UK Pension Fund:

Name	Signature	Date
JD Chillman		Aug 2019

Name	Signature	Date
SJ Robinson		Aug 2019

Section 1: Statement of the aims and objectives for the default arrangement

1.1 Reasons for the Default Arrangement

The Trustee decided that the DC Section should have a default investment arrangement because:

- The Fund is a qualifying scheme for auto-enrolment purposes and therefore must have a default arrangement;
- It should be easy to become a member of the DC Section and start building retirement benefits without the need to make any investment decisions; and
- The majority of the DC Section's members are expected to have broadly similar investment needs.

The DC Section makes available a default 'lifestyle strategy' (Default Option), for members who choose not to make an active investment choice. Members in DC Start have their accounts automatically invested in the Default Option while members in DC Core have a choice about where their account is invested.

1.2 Choosing the default arrangement

The Trustee believes that understanding the DC Section's membership is essential to designing and maintaining a default arrangement which meets the needs of the majority of members.

In choosing what is felt to be an appropriate default, the Trustee has taken into account a number of factors including: members' projected pot sizes at retirement, contribution levels, the level of replacement income that members are likely to require, and the likely return on investments after the deduction of charges payable on the funds used by the default option.

1.3 Objectives for the default arrangement

The Trustee's overall objective is to invest contributions in the best interests of members and their beneficiaries.

The main objective of Default Option is to provide good member outcomes at retirement while subject to a level of investment risk which is appropriate to the majority of members who do not make active investment choices.

The Trustee believes that it is in the best interests of the majority of members to offer a default which:

- Manages the principal investment risks members' face during their membership of the Fund;
- Maximises investment returns relative to inflation while taking an appropriate level of risk during membership of the Fund for the majority of members who do not make investment choices; and
- Reflects members' likely benefit choices at retirement.

1.4 The default arrangement

The default arrangement is therefore a lifestyle strategy which:

- Gradually moves investments between different funds to manage the levels of investment returns and principal investment risks at each stage of membership of the DC Section; and
- Targets the majority of members who are expected to take cash at retirement and/or UFPLS for a few years into retirement.

The expected levels of investment returns (after the deduction of charges) and risks for the funds used are consistent with the Trustee's objectives for the default arrangement. The expected investment returns and approach to managing investment risks including financially material considerations such as climate change are described in Section 3.

Full details of the current default arrangement are given in the IID.

Section 2: Statement of the aims and objectives for investment options outside the default arrangement

2.1 Reasons for the investment options

In addition to the default arrangement, the DC Section offers members a choice of self-select options because:

- While the default arrangement is intended to meet the needs of a majority of the DC Section's members, it may not meet the needs of a wider cross-section of members;
- Attitudes to investment risks and the need for investment returns will vary from member to member and will also vary for each member over time, in particular as they approach retirement;
- Members have differing investment needs and these needs change during their working lives; and
- Some members will want to be more closely involved in choosing where their contributions are invested.

2.2 Choosing the investment options

Membership analysis

The Trustee believes that understanding the DC Section's membership is important to maintaining an appropriate range of investment options. The Trustee has taken into account many aspects including:

- The members' age and salary profile;
- The likely sizes of members' pension pots at retirement;
- Members' retirement dates and likely range of benefit choices at retirement;
- The levels of investment risk and return members may be willing to take;
- The degree to which members are likely to take an interest in where their contributions are invested; and
- The number of members who are likely to want responsible, ethical or faith-based investment choices.

Costs of investment options

The investment costs are borne by members and so a balance needs to be struck between choice and costs.

2.3 Objectives for the investment options

The DC Section offers members a choice of investment options as an alternative to the default arrangement. The objectives of the self-select fund range are to:

- Provide a choice of individual funds for members who want to be more closely involved in choosing where their pension pots are invested;
- Complement the objectives of the Default Arrangement;
- Provide a broader choice of levels of investment risk and return;
- Help members more closely tailor how their pension pots are invested to their personal needs and attitude to risk; and
- Help members more closely tailor how their pension pots are invested to reflect the benefits they intend to take at retirement.

Nevertheless, the self-select fund range cannot be expected to cover all the investment needs of all members.

Risk and return

The expected levels of investment returns (after the deduction of charges) and risks for the funds used are consistent with the Trustee's objectives for these investment options. The expected investment returns and approach to managing investment risks including financially material considerations such as climate change, are described in Section 3.

Full details of the current options are provided in the IID.

Section 3: Statement of investment beliefs, risks and policies

This Statement sets out the investment beliefs and policies which guide the Trustee's decision making.

3.1 Investment beliefs

The Trustee's investment decisions are made in the context of their investment beliefs, which are:

- An effective investment strategy must have clearly defined objectives for both return and risk, and clear measures of success that allow progress to be monitored.
- To meet our objectives, we need a clear understanding of the risks that we are taking and to only take risks that we believe are adequately rewarded. To the extent it is possible, we try and mitigate any unrewarded risks through strategies such as hedging.
- The most significant contribution to meeting our investment objectives will come from our asset allocation and risk management choices.
- Good governance and decision-making will positively impact our ability to meet our objectives.
- Our approach to investment should avoid unnecessary complexity.
- Over the long term, higher-risk assets (such as equities) are expected to outperform lower-risk assets (such as bonds), but their returns are also expected to show higher variability.
- Diversification within and across asset classes reduces the risk created by particular investments failing and should lower the volatility of overall returns.
- We believe that investments should be assessed in a value-based context, i.e. the impact of investments on both expected and actual risk-adjusted returns should be viewed net of costs. Additionally, the impact of costs needs to be understood before we invest and they should be kept as low as possible without compromising our objectives.

3.2 Risks

3.2.1 Principal investment risks

The Trustee believes that the three principal investment risks most members will face are:

Inflation risk – The risk that investment returns over members' working lives may not keep pace with inflation and, as a result, not produce adequate retirement benefits.

For members further away from retirement, the Default Option invests in 'return-seeking' assets during the 'growth' phase, which are expected to produce returns well in excess of inflation over the longer term.

Benefit conversion risk – The risk that market movements in the period just prior to retirement lead to an increase in the cost of turning members' account values into retirement benefits.

Following the previous freedoms introduced in April 2015, the Default Option has been designed to facilitate members taking cash and/or income drawdown at retirement by switching into cash and into a lower volatility portfolio of assets during the pre-retirement phase.

For members planning to buy an annuity at retirement, the DC Section makes available, on a self-select basis, an annuity fund, which may be expected to broadly follow movements in annuity rates caused by interest rate changes as retirement approaches.

Volatility/Market risk – The risk that adverse movements in investment market values in the period prior to retirement lead to a reduction in the anticipated level of benefits.

For members approaching retirement, the Default Option invests in a greater allocation of funds which are expected to be subject to lower levels of volatility.

3.2.2 Other investment risks

The Trustee believes that other investment risks members may face include:

Active management risk – The risk that an investment manager will not deliver investment returns in line with investment markets generally or other Investment Managers.

The Trustee recognises that an actively managed fund may not deliver performance in line with the fund's objectives/agreed benchmarks. The Trustee regularly monitors fund performance in order to monitor this risk.

Liquidity risk – The risk that funds which invest in more illiquid assets will not be able to accept investments or disinvestments requested by the Trustee and/or members.

The Trustee is satisfied that the pooled funds in which they invest have sufficient liquidity and may be realised quickly if required.

Counterparty risk – The risk that counterparties holding derivative-based assets may default leading to a reduction in a fund's value.

The Trustee, in conjunction with their Investment Managers, manages counterparty risk by investing in pooled funds that offer suitable counterparty protection.

Currency risk – changes in exchange rates will impact the values of investments outside the UK when they are being bought or sold.

Interest rate risk – the value of funds which invest in bonds will be affected by changes in interest rates.

Default risk – for investments in bonds (where money is lent in return for the payment of interest), the company or government borrowing money fails to pay the interest due or repay the loan.

Environmental, Social and Governance (ESG) risks – The risk that ESG issues are not reflected in asset prices and/or not considered in investment decision making leading to underperformance relative to expectations.

Climate risk – The risk that climate change causes a material deterioration in asset values as a consequence of factors including, but not limited to: policy change, physical impacts and the expected transition to a low-carbon economy.

3.2.3 Managing investment risks

The Trustee has developed and maintain a framework for assessing the impact of all investment risks on long-term investment returns.

Principal investment risks

The Trustee monitors the age profile of the DC Section's membership to arrive at an appropriate investment horizon when considering all investment risks. As a result, investment risks need to be considered over a multi-decade time horizon.

The Trustee believes that taking investment risk is usually rewarded in the long term, while asset allocation (i.e. the choice between asset classes, such as equities and bonds) is the key tool for managing the balance between risk and return.

To help mitigate the principal investment risks, the Trustee offers the Default Option, which automatically switches members from higher risk investments to lower risk investments as they approach retirement.

The Trustee believes that the self-select investment options available are appropriate for managing these risks.

Other investment risks

The Trustee manages the other investment risks as part of the process for selecting and ongoing monitoring of the funds used by the DC Section.

The funds used give a good spread of investments which will help manage risks associated with market conditions, fund manager actions and default.

At this time, the Trustee has not made explicit allowance for climate change within the development or implementation of its investment strategy. The Trustee does discuss the potential impact of climate risks with its adviser and managers on a periodic basis and will monitor developments in this area.

3.3 Responsible investment principles

The Trustee has an objective to stay up to date with new developments and emerging risks in Environmental, Social and Governance ('ESG') factors. The Trustee's policy on ESG is summarised by these points:

- ESG factors (which include climate change) are likely to be financially material to the Fund's default arrangement and self-select options over the time horizon applicable to members invested in those options.
- In the long term, better financial returns are likely to be achieved by investing in companies and assets that demonstrate they contribute to the long-term sustainable success of the global economy.
- ESG factors will become increasingly financially material and an important factor in strategic decision making.
- All else being equal, the strategy should allocate to asset classes where ESG can be integrated into decision making. However, this does not mean that the Trustee will allocate to asset classes for ESG reasons alone or preclude the use of asset classes where this is not possible; ESG will be assessed along with other factors such as investment risk and return.
- For each new asset class considered, the relevance of ESG will be assessed and weighted accordingly when carrying out manager selection exercises and while determining the investment approach (e.g. active or passive). Whilst, for existing asset managers we regularly review their processes to ensure the extent to which they integrate ESG into their investment process is sufficient for that asset class.For each asset class, the relevance of good stewardship should be assessed to ensure that Investment Managers engage with companies where appropriate. Where voting rights are held (e.g. through direct equity ownership), these rights should be exercised.
- Require Investment Managers to provide quantitative reporting on ESG where possible and monitor quantitative ESG reporting, using this to inform future manager selection and asset allocation decisions.

3.4 Expected returns on investments

The Trustee believes that it is important to balance investment risks with the likely long-term returns from different types of assets used in funds (taking the funds' costs and charges into account). The expected returns on the principal asset classes and fund types within the DC Section are:

Equities – Should achieve a strong positive return relative to inflation over the longer-term, but tends to be the most volatile asset class over the shorter term;

Corporate Bonds – Should achieve a positive return relative to inflation over the longer term which is lower than that for equities, but with a lower level of shorter-term volatility than equities;

Cash – Should deliver a positive return which may not always keep pace with inflation, while normally providing a minimal level of volatility and high degree of capital security;

Long-dated Government Bonds (Gilts) – Values should move broadly in line with the financial factors influencing annuity rates;

Diversified Growth/Multi-Asset Funds – Invest in a varying mix of asset classes with an objective of delivering a target level of returns relative to inflation over the longer term, with a target level of shorter-term volatility lower than equities; and

Property – Should deliver a positive return but with lower levels of return and volatility compared to equities.

3.5 Types of funds used

3.5.1 Delegation of investment decisions

The DC Section invests through pooled investment vehicles considered appropriate for tax-exempt approved occupational pension schemes. These funds may invest in:

- Quoted and unquoted securities of UK and overseas markets including equities, fixed interest and index-linked bonds, cash, commercial and residential property;
- Infrastructure and commodities through collective investment vehicles; and
- Derivatives to facilitate efficient portfolio management.

This enables the DC Section to invest in a range of funds giving a good spread of investments in a cost-effective manner. It does mean that the Trustee has delegated day to day investment decisions including the management of financially material considerations to the fund managers.

For passively managed funds, the Trustee recognises that the role of the manager is to track an index and the choice of index will dictate the assets held. The Trustee will periodically review the indices used for this purpose.

For actively managed funds (where the fund manager decides where to invest) fund managers are expected to take financially material considerations into account when deciding on the selection, retention and realisation of investments where permissible within the applicable guidelines and instructions.

3.5.2 Security of assets

The funds are provided through a policy of insurance issued to the Trustee by the platform provider. As a result, the value of the funds may be affected in the event of the provider getting into financial difficulties.

The underlying funds used by the provider's platform are accessed through reassurance agreements/unit purchase agreements/segregated investment mandates. In the event of a fund manager getting into financial difficulties, the values in these underlying funds will depend upon the nature of the contract with the platform provider and the fund vehicles used by the fund managers' funds.

3.5.3 Realisation of investments

Funds need to be sold to make payments of benefits and to undertake fund switches either in accordance with the asset allocation changes as prescribed by the Default Option or as requested by individual members. The Trustee normally expects the Investment Managers to be able to realise the funds within a reasonable timescale. The Trustee recognises that the Investment Managers may at times need to impose restrictions on the timing of purchases and sales of funds (most notably investing in property) in some market conditions to protect the interests of all investors in a fund.

3.5.4 Balance of investments

Given the size and nature of the DC Section, the Trustee invests on a pooled fund basis. The Investment Managers are expected to maintain diversified portfolios. Subject to the funds' benchmarks and guidelines, the Investment Managers are given discretion over the choice of securities and, for 'multi-asset' funds, of asset classes.

The Trustee is satisfied that the range of funds used by the DC Section provide adequate diversification within and across asset classes.

3.6 Stewardship

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

3.6.1 Members' financial interests

The Trustee has requested that the Investment Managers will have the members' financial interests as their first priority when choosing investments.

3.6.2 Voting and engagement

The Trustee believes that engagement with the companies in which the DC Section invests, including the proactive use of shareholder voting rights, can improve the longer-term returns on the DC Section's investments.

The DC Section invests via an investment platform provider, who in turn invests in funds which are pooled with other investors to keep costs down and ensure adequate diversification. As a result, the Trustee has adopted a policy of delegating voting decisions on stocks to the underlying fund managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. The fund managers are expected to exercise the voting rights attached to individual investments in accordance with their own house policy.

Where relevant, the Trustee is planning to review the voting and engagement policies of the fund managers over the coming year as well as the approach to governance of the investment platform provider and determined that these policies are appropriate. Going forward, on an annual basis, the Trustee will request that the investment platform provider and fund managers provide details of any change in their house policy.

Where appropriate, the Trustee will engage with and may seek further information from the investment platform provider and fund managers on how portfolios may be affected by a particular issue.

The Trustee does not engage directly, but believes it is sometimes appropriate for the fund managers to engage, with key stakeholders, which may include corporate management, regulators and governance bodies, relating to their investments in order to improve corporate behaviours, improve performance and mitigate financial risks. The Trustee aims to review engagement activity undertaken by the fund managers as part of its broader monitoring activity.

3.6.3 Non-financial factors

The Trustee recognises that some members will have strong personal views or religious convictions that influence where they believe their savings should, or should not, be invested.

The Trustee recognises the importance of offering a suitable range of investment options for members who wish to express an ethical preference in their pension saving. The Trustee offers a number of ethical funds as self-select investment options and keeps the range of self-selected funds under review.

While the Trustee may take members' views into account when reviewing the suitability of the Fund's investment options and choice of funds used, the Trustee notes that non-financial factors can affect various investment risks which are borne by members and may under perform other funds with broader-based investment approaches. The Trustee does not take non-financial factors into account in the selection, retention and realisation of investments in the default arrangement and other lifestyle strategies.