

SEPTEMBER 2020

# Mizuho Bank London Final Salary Scheme - DC Section Statement of Investment Principles

# 1 Statement of the aims and objectives for the DC Section

## Primary Objective

The Trustee's investment objective for the Scheme's DC section (including members' AVCs) is to make available to members of the DC section a range of investment options designed to generate income and capital growth, which will provide retirement funds suitable for meeting members' long and short-term needs, differing circumstances and attitudes to risk.

A balance has been struck between offering sufficient funds to meet this objective and the costs and practical constraints e.g. relating to the monitoring of each fund.

## Investment considerations

Members who are many years from retirement (and thus from the need to realise their funds) may generally expect to invest for long-term growth, which means investing in equity-oriented funds, accepting those funds' values may be volatile.

As members approach retirement it is likely they will want more certainty and so invest in funds more closely matching the benefits they wish to take e.g. bond-based funds if they wish to buy an annuity and cash-based funds if they wish to take a lump sum.

Some members prefer to diversify risk by selecting funds that invest in a balance of different asset classes and markets while others are prepared to take more risk in the expectation of greater growth by selecting funds that specialise in certain asset classes and/or markets.

## Default Arrangement and range of investment funds

The Trustee has decided to offer members a range of funds giving members exposure to a number of different asset classes, markets and investment managers, and thereby funds with different expected levels of risk and return. Nevertheless, the fund range cannot be expected to cover all the investment needs of all members. In setting the default investment option, the Trustee has considered the investment risk factors and is satisfied that the concluded approach for the default investment option will provide opportunities to minimise these risks efficiently for funds building up for members who have not yet retired.

The Trustee's key aims and objectives with regard to investments are as follows:

- To offer a range of passively managed funds with different objectives and risk profiles from which members can make a choice.
- To offer a default investment strategy in the event that members are unwilling to make their own investment choice.
- In selecting the fund choices offered to members of the DC section, the Trustee has considered the historical rates of return earned on the various asset classes available.
- The members' investments are held in funds which are sufficiently liquid to be realised to provide pension benefits on retirement or on earlier payment.
- The Trustee will review the suitability of the funds offered from time to time.

Members who do not make an active investment decision have their fund invested in a default fund. The Trustee will obtain written advice on these funds periodically to check that they remain appropriate. The investment costs are borne by members and so a balance needs to be struck between choice and costs.

## 2 Statement of investment policies

### Introduction

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

This Statement of investment beliefs has been prepared in accordance with the Occupational Pension Scheme (Investment) Regulations 2005 as amended by the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 and the Occupational Pension Schemes (Investment and Disclosure) Regulations 2019.

### Risks

#### Principal investment risks

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

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

Further from retirement, this risk should be countered by funds investing in equities and other growth orientated assets which are expected to produce returns well in excess of inflation over the longer term. Approaching retirement, the impact of this risk needs to be balanced against the other main risks members face.

**2) Benefit conversion risk** – investment conditions just prior to retirement may increase the cost of turning members' fund values into retirement benefits.

For members taking cash at retirement, funds investing in cash deposits and other short-term interest-bearing investments provide a high degree of (but not complete) capital security. Funds investing in a mix of different assets are expected to be broadly suitable for members planning income drawdown during retirement. For members buying an annuity at retirement, the value of funds investing in longer-dated bonds may be expected to broadly follow changes in annuity rates caused by long-term interest rates.

**3) Volatility/Market risk** – falls in fund values prior to retirement lead to a reduction in retirement benefits.

Funds investing in bonds or a mix of assets or investment techniques intended to manage short-term risks may be expected to be subject to lower levels of short-term fluctuations in values - although there may be occasions when this does not hold good.

#### Other investment risks

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

**Active management risk** – a fund manager's selection of holdings may not lead to investment returns in line with the fund's objectives and investment markets generally.

**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 bond funds (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.

**Liquidity risk** – funds which invest in assets which cannot be easily bought or sold may at times not be able to accept new investments or disinvestments of existing holdings.

**Counterparty risk** – the financial institutions holding a fund's assets may get into financial difficulties leading to a reduction in a fund's value.

**Market risks** - Shifts in market sentiment (for example, in response to economic news or geopolitical events) or momentum in general market trading can lead to widespread changes and/or volatility in asset values over the short-term.

This can include short-term changes in the normally expected correlations of the behaviour of risks and returns seen between different asset classes, when standard approaches to mitigating risks such as diversification are temporarily ineffective.

**Environmental, Social and Governance (ESG) risks** – the extent to which 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 extent to which 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.

**Legislative/Regulatory** - Changes in government policy or taxation may have a long-term positive or negative impact on certain sectors of a country's economy or one country relative to its neighbours over the medium to longer-term. Changes in Regulations can also affect the operational costs, tax efficiency and security of one investment vehicle relative to other vehicles over the shorter-term.

### Managing risks

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

### Time horizon

The Trustee monitors the age profile of the Scheme's membership to arrive at an appropriate investment horizon when considering all investment risks. The Scheme has been closed to future contributions since 30 September 2002. The target retirement date is assumed to be the members 60<sup>th</sup> birthday unless members elects otherwise in writing. Members are expected to take cash upon retirement. The time horizon for the Scheme's investments is therefore expected to be at maximum 25 years.

### Principal investment risks

The fund range provides members with a choice of funds with differing risk and return characteristics which are expected to meet the investment needs of a majority of members.

### Ability to invest/disinvest promptly

The Trustee recognises that it is important that members' funds can be invested promptly in selected investment funds, and that these can be sold promptly for example when members wish to change where they are invested, transfer to another arrangement or if they wish to draw on their pension pot. The Trustee manages this risk by selecting pooled investment funds which can be dealt on a daily basis. For example, this situation could occur in the event of significant economic uncertainty impacting on the ability for fund managers to value the underlying assets.

### Other investment risks

The Trustee seeks to manage the other investment risks as part of the process for selecting and ongoing monitoring of the funds used by the Scheme.

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 of the fund range. The Trustee will discuss the potential impact of climate risks with its adviser when reviewing the investment strategy, and with managers on a periodic basis and will monitor developments in this area including the availability of solutions to mitigate climate-related risks.

### **Financially material considerations**

The Trustee recognises that:

- The consideration of financially material considerations, including ESG factors and climate risk, over the appropriate time horizon are relevant at different stages of the investment of members' defined contribution benefits; and
- The financial materiality of any factor, including ESG factors and climate risk, may be relevant to different degrees according to the asset class or classes in which a fund invests.

The Trustee will consider financially material considerations, including ESG factors and climate risk in the development and implementation of the Scheme's investment arrangements for the purposes of determining the selection, retention and realisation of investments where there is sufficient data or evidence to allow them to systematically do so. The Trustee will also seek to engage with the investment manager to ensure they take such considerations into account within their decision making, and challenge where appropriate.

The Trustee has explicitly acknowledged the relevance of ESG factors including climate change in framing their investment beliefs set out below and the broader implementation of these beliefs.

### **Implementation**

The Scheme uses standard passively managed pooled funds offered by BlackRock. This gives access to a range of funds while keeping down costs to members, but this means that the Trustee cannot adopt an approach to managing financially material considerations specific to the Scheme. The Trustee nevertheless seeks to manage financially material considerations to protect long-term returns by:

- Choosing fund managers who have clearly articulated policies for managing financially material considerations including climate change;
- For passively managed funds, the Trustee recognises that the choice of benchmark dictates the assets held by each fund and that the investment manager has minimal freedom to take account of factors that may be deemed to be financially material. The Trustee accepts that the role of the passive manager is to deliver returns in line with the benchmark index (which may or may not include ESG factors) and which the Trustee believes will deliver appropriate risk adjusted returns in line with their current investment strategy. The Trustee will review periodically the choice of fund and index benchmarks used;
- For all funds, expect fund managers to engage with companies in which the fund invests to encourage business strategies which should improve or protect the value of those investments; and
- Require fund managers who are signatories to the Financial Reporting Council's Stewardship Code in the UK and the United Nations supported Principles for Responsible Investment.

### **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).

Asset class	Expected long-term investment returns relative to inflation	Expected shorter- term volatility in fund values
Equities (i.e. company shares)	Strong return relative to inflation	Most volatile in the short-term
Corporate Bonds (i.e. loan stocks issued by companies)	Positive, but lower than equities and property	Lower than equities or property
Fixed Interest Government Bonds (e.g. UK Gilts)	Positive, but lower than equities, property or corporate bonds	Lower than equities, property or corporate bonds
Index-Linked Government Bonds (e.g. UK Index-Linked Gilts)	In line with inflation	Lower than equities, property or corporate bonds
Cash (and other short-term interest-bearing investments)	Return may not keep pace with inflation	Minimal with high degree (but not complete) of capital security

**Long-dated Bonds** (e.g. UK Gilts and Corporate Bonds with a duration of 15 years or more) – should give fund values which move broadly in line with the financial factors influencing annuity rates.

**Multi-asset funds** (i.e. investing in a varying mix of asset classes) - should deliver positive returns relative to inflation over the longer-term, with lower short-term volatility than equities.

**Derivatives** (e.g. currency hedging) - typically to reduce shorter-term investment risks or to facilitate changing where funds are invested, should help achieve a fund's expected levels of risk and return.

### Types of funds used

#### Structure of arrangement

The Scheme's funds are invested directly in pooled investment vehicles with BlackRock. The processing of core financial transactions is monitored by the administrator Goddard Perry who have documented internal control procedures that help to ensure that core financial transactions are processed promptly and accurately. These include controls and procedures to manage the accuracy of investment allocations and payments – of benefits as well as individual transfers out.

#### Delegation of investment decisions

The Trustee has delegated day to day investment decisions including the management of financially material considerations to BlackRock. The Trustee expects its investment managers to take all financially material factors into account in implementing the Trustee's strategy where relevant and the terms of the mandate permit.

- In passive mandates, the Trustee recognises that the choice of benchmark dictates the assets held by the investment manager and that the manager has minimal freedom to take account of factors that may be deemed to be financially material. The Trustee accepts that the role of the passive manager is to deliver returns in line with the market and believe this approach is in line with the basis on which its current strategy has been set. The Trustee will review the appropriateness of index benchmarks at least every three years.
- In active mandates, the Trustee recognises that the manager has freedom to exercise discretion as to the choice of assets held. The Trustee expects the manager to take into account all financially material factors in the selection of assets within their portfolios and to be able to demonstrate their approach when challenged.

In selecting new investment managers for the Scheme, where relevant to the investment mandate, the Trustee explicitly considers potential managers' approach to responsible investment and the extent to which managers integrate ESG issues in the investment process as a factor in their decision making.

### **Selection of funds**

The Trustee have selected the funds available to members with BlackRock to provide a range of exposures to different asset classes and markets and therefore provide different expected levels of return and risk. In the selection of these options for members' the Trustee considers various criteria, including:

- Reputation and commitment to the DC market
- Quality of investment process
- Research capability
- Track Record
- Quality of Member communications
- Administration and reporting capabilities
- Costs and Charges

The Trustee will periodically review the choice of funds, at which time the above will be key criteria in assessing the suitability of manager and fund range.

### **Manager incentives**

The Trustee will seek transparency of all costs and charges borne by members. Nevertheless, the Trustee expects that it will be in the interests of BlackRock to produce growth in asset values in line with the funds' investment objectives. For passively managed funds this should be within an acceptable margin of the index the fund tracks.

When selecting funds, the Trustee will ask their investment advisor to consider the investment managers' remuneration strategies and appropriateness of each fund's investment guidelines to ensure that there is no inducement or scope to take an undue level of risk and that the investment managers will act in line with the interests of the Scheme's members.

In accordance with the 2015 Regulations, the Trustee conducts an annual Value for Members assessment and will take action should the manager be found to be giving poor value. In addition, in accordance with guidance from the Pensions Regulator, the Trustee will periodically review the Scheme's investment and administrative arrangements to ensure their charges and services remain competitive. The Trustee believes that these steps are the most effective way of incentivising and delivering Value for Members, of which investment management charges and investment performance are key considerations.

The Trustee monitors the investment managers against a series of metrics on a quarterly basis over a long-term time horizon of 5 years including:

- Performance of their funds' respective benchmarks;
- Relative tracking error where appropriate;
- The management of risks.

The Trustee periodically monitors the managers on the exercise of stewardship responsibilities (including engagement with issuers).

Investment managers are expected to provide explanations for any significant divergence from a fund's objectives. A material deviation from performance and risk targets or approach to portfolio management is likely to result in the fund being formally reviewed.

### **Portfolio turnover**

The Trustee does not expect investment managers to take excessive short-term risk and will monitor the investment manager's performance against the benchmarks and objectives on a short, medium and long terms basis.

For passively managed funds the turnover of holdings is driven by changes in the index a fund seeks to track and hence is outside the control of the investment manager.

Whilst the Trustee expect performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustee will ask investment managers to report on at least an annual basis on the underlying assets held within fund with details of any transactions and turnover costs incurred over the Scheme's reporting year.

Where a fund has significantly under or outperformed its benchmark, the Trustee will seek to ascertain where necessary whether higher or lower than normal turnover has been a contributory factor. The Trustee will challenge the investment manager if there is a sudden change in portfolio turnover or if the level of turnover seems excessive.

### **Portfolio duration**

The Trustee recognises the long-term nature of defined contribution pension investments and chooses funds which are expected to deliver sustainable returns over the Scheme members' investment horizon.

The Trustee expects that each fund will be used for at least three years, this being the period over which performance of the fund can be appropriately evaluated and the costs of change amortised, although all funds are subject to ongoing review against various financial and non-financial metrics in addition to their continued appropriateness within the investment strategy.

### **Security of assets**

The Scheme holds unitised insurance policies issued by BlackRock Life Limited which is a UK authorised and regulated insurance company. The Scheme is therefore a policyholder of BLL on behalf of members. BLL is subject to UK Company Law and Insurance Regulation.

### **Realisation of investments**

The Trustee expects that it will normally be able to sell the funds within a reasonable timescale. As all funds are invested in liquid assets the risk of there being any restrictions imposed on the timing of sales and purchases of funds are limited.

Nevertheless, the Trustee recognises that most members' pension pots have a long investment timeframe, during which assets which are less easily traded can be managed to deliver good long-term returns while avoiding the impact of liquidity issues at retirement.

### **Balance of investments**

The Trustee reviews the nature of the Scheme's investment options on a regular basis, with particular reference to suitability and diversification. The Trustee considers written advice from a suitably qualified person when

determining the appropriateness of each investment manager and fund for the Scheme, particularly in relation to diversification, risk, expected return and liquidity.

Overall, the Trustee's intention is that the Scheme's investment options:

- Provide a balance of investments; and
- Are appropriate for managing the risks typically faced by members.

### **Stewardship**

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

### **Members' financial interests**

The Trustee expects that the investment platform provider and fund managers will have the members' financial interests as their first priority when choosing investments.

### **Conflicts of interest**

When appointing investment managers', the Trustee will seek to establish that the investment manager has an appropriate conflicts of interest policy in place.

When given notice the Trustee will consider the impact of any conflicts of interest arising in the management of the funds used by the Scheme.

Responsibility for investment decisions has been delegated to the investment managers which includes consideration of the capital structure of investments and the appropriateness of any investment made. Where managers are investing in new issuance, the Trustee expects the investment 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 consider any conflicts of interest arising in the management of the funds used by the Scheme and that investment manager has an appropriate conflicts of interest policy in place.

### **Voting and engagement**

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

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 investment managers are expected to exercise the voting rights attached to individual investments in accordance with their own house policy.

The Trustee will periodically review the voting and engagement policies of the fund managers.

While the Trustee is not in a position to engage directly, the Trustee 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 will request, where appropriate and practicable, that the investment manager notifies the Trustee of any issue on which it may be beneficial for the Trustee to undertake further engagement. The Trustee seek to review engagement activity undertaken by the fund managers as part of its broader monitoring activity.

### Monitoring

The Trustee reviews the fund managers' voting activity in conjunction with their investment adviser and use this information as a basis for discussion with fund managers. Where the Trustee deems it appropriate, any issues of concern will be raised with the manager for further explanation.

### Non-financial factors

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.

Fund managers are otherwise only expected to take non-financial factors into account when these do not conflict with the financial interests of members and the Scheme's investment objectives.

### For the record

The Trustee obtains and consider proper advice from suitably experienced and qualified persons when choosing investments and preparing the Statement of Investment Principles.

Funds are chosen by the Trustee to give an expected level of return with an appropriate level of investment risk which meets the objectives of each default arrangement and other investment options.

The funds invested in by the Scheme are unitised insurance policies issued by BlackRock Life Limited ("BLL"), which is a UK authorised and regulated insurance company.. The funds may invest in quoted and unquoted securities traded in regulated UK and overseas markets:

- Equities (company shares);
- Fixed interest and index-linked bonds issued by governments and companies;
- Cash and other short-term interest-bearing deposits;
- Commercial and residential property;
- Illiquid assets including infrastructure, forestry, private equity and private debt;
- Commodities through collective investment vehicles; and
- Derivatives to facilitate changes in where funds are invested or to help control investment risks.

Funds provided through a life insurance company must comply with the Financial Conduct Authority ("FCA") "Permitted Links" rules, which place limits on the degree of leverage a fund can use. Fund managers using other fund vehicles subject to the European "UCITS IV" and the FCA's "Non-UCITS" regulations have to meet requirements on the security and concentrations of assets. Exchange Traded Funds may be used directly or indirectly to gain access to less easily traded and illiquid asset classes.

Subject to the funds' benchmarks and guidelines, the fund managers are given full discretion over the choice of securities and, for multi-asset funds, choice of asset classes. Fund managers are expected to maintain well-diversified and suitably liquid portfolios of investments.

The Trustee considers that these types of investments are suitable for the Scheme. The Trustee is satisfied that the funds used by the Scheme provide adequate diversification both within and across different asset classes.