

## Statement of Investment Principles

Army and Air Force Exchange Service United  
Kingdom Area Exchange  
Managed Pension Plan

*March 2022*

# Statement of Investment Principles

## Army and Air Force Exchange Service United Kingdom Area Exchange Managed Pension Plan

This document is the Statement of Investment Principles for the Army and Air Force Exchange Service United Kingdom Area Exchange Managed Pension Plan (the “Plan”). The requirement for the Trustees of the Plan to have such a Statement in place was introduced by the Pensions Act 1995. The Statement comprises the following sections and appendices:

<b>Section</b>	<b>Page</b>
<b>1</b> Introduction	1
<b>2</b> Governance	3
<b>3</b> Division of responsibilities	4
<b>4</b> Objectives and long-term policy	6
<b>5</b> Asset allocation guidelines	9
<b>6</b> Statement of Funding Principles	11
<b>7</b> Investment manager arrangements	12
<b>8</b> Risk management	13
<b>Appendix</b>	
<b>A</b> Current advisers	14
<b>B</b> Current investment manager	17

# 1 Introduction

## **Background**

- 1.1 Under the Pensions Act 1995, as amended by the Pensions Act 2004 (Pensions Act) the Trustees are required to prepare a statement of the principles governing investment decisions. This document contains that statement and describes the investment policy pursued by the Trustees of the Army and Air Force Exchange Service United Kingdom Area Exchange Managed Pension Plan (the Plan).
- 1.2 In preparing this document, the Trustees have consulted the Employer and the Trustees will consult the Employer before revising this document. The Trustees will consult the Employer on changes in investment policy. However, the ultimate power and responsibility for deciding investment policy lies solely with the Trustees.
- 1.3 In preparing this document, the Trustees have sought written advice from the Plan's investment consultants (Wilshire Associates) and consulted with the Scheme Actuary. The Trustees will review this document, in consultation with the investment consultant and Scheme Actuary, usually annually, or immediately after any significant change in investment policy.
- 1.4 In preparing this document the Trustees have had regard to the requirements of the Pensions Act and the Occupational Pension Scheme (Investment) Regulations 2005 and the Trustees will consider these requirements on any review of this document or any change in their investment policy. The Trustees will refer to this document where necessary to ensure that they exercise their powers of investment so as to give effect to the principles set out in it as far as reasonable.
- 1.5 When choosing investments, the Trustees and the investment managers (to the extent delegated) are required to regard the criteria for investment set out in the Occupational Pension Scheme (Investment) Regulations 2005 and in the principles contained in this statement.
- 1.6 This document has been drafted in the light of the Myners' Principles and specifically Myners' recommendations relating to the content of Statements of Investment Principles.

## **Plan details**

- 1.7 The Plan operates for the exclusive purpose of providing retirement benefits and death benefits to eligible participants and beneficiaries.
- 1.8 Members of the Plan are contracted-out of the State Second Pension (S2P) under the Pensions Schemes Act 1993, until contracting-out ceased on 5 April 2016

- 1.9 The Plan is registered with Her Majesty's Revenue and Customs under Chapter 2 of Part 4 of the Finance Act 2004.
- 1.10 Administration of the Plan is managed by the Trustees, who are responsible for the investment of the Plan's assets.

**Financial Services and Markets Act**

- 1.11 In accordance with the Financial Services and Markets Act 2000, the Trustees will set general investment policy, but will delegate the responsibility for selection of specific investments to an appointed investment manager, which may include an insurance company. The investment manager shall provide the skill and expertise necessary to manage the investments of the Plan competently.

## 2 Governance

- 2.1 The Trustees have ultimate responsibility for decision-making on investment matters. In order to ensure that investment decisions are taken only by persons or organisations with the skills, information and resources necessary to take them effectively, the Trustees delegate some of these responsibilities.
- 2.2 Responsibility for all day-to-day investment decisions is delegated to the Plan's investment manager(s). The Trustees are satisfied that the appointed investment manager(s) has(have) sufficient expertise and experience to carry out their role. The Trustees retain direct responsibility for other investment matters which include:
- a. Reviewing annually the content of this Statement of Investment Principles and for modifying it if deemed appropriate, in consultation with the investment consultant and Scheme Actuary.
  - b. Reviewing the investment policy following the results of each actuarial review, in consultation with the investment consultant and Scheme Actuary.
  - c. Appointing, monitoring and dismissing investment managers.
  - d. Assessing the quality of the performance and processes of the investment manager by means of regular, but not less than annual, reviews of the investment results and other information, in consultation with the investment consultant.
  - e. Consulting with the Employer before amending this Statement.
  - f. Monitoring compliance of the investment arrangements with this Statement on an ongoing basis.
- 2.3 The Trustees are satisfied that they have sufficient expertise and appropriate training to evaluate critically the advice it receives. The Trustees are also satisfied that they have an appropriate set of skills individually and collectively, and the right structures and processes, to carry out their role effectively.
- 2.4 Decisions affecting the Plan's investment strategy should be taken with appropriate advice from the Plan's investment consultant, in consultation with the Scheme Actuary. Only persons or organisations with the necessary skills, information and resources are actively involved in taking investment decisions affecting the Plan. The Trustees of the Plan draw on the skills and expertise of external providers including the investment manager, custodian, investment consultant and Scheme Actuary.

# 3 Division of responsibilities

## **Investment manger**

3.1 The investment manager's responsibilities include:

- Tracking the relevant benchmark return within an appropriate tracking error.
- Providing the Trustees with quarterly statements of the assets along with a quarterly report on actions and future intentions, and any changes to the investment processes applied to the Plan's portfolio.
- Informing the Trustees of any material changes in the internal objectives and guidelines of any pooled funds used by the Plan and managed by the investment manager or an associated company.
- Having regard to the need for diversification of investments so far as appropriate and to the suitability of investments and the criteria for investment set out in the Occupational Pension Scheme (Investment) Regulations 2005.
- Giving effect to the principles contained in the Statement as far as reasonably practicable.

## **Investment consultant**

3.2 The role of the investment consultant is to make recommendations or give advice to the Trustees in the following areas:

- The formulation of an efficient governance structure particularly in the light of the Myners Review.
- The regular updating of the Statement of Investment Principles.
- The development of a clear investment strategy for the Plan, involving the use of the asset-liability modelling process.
- The construction of a strategic asset allocation benchmark given the liabilities of the Plan and the risk and return objectives of the Trustees.
- The construction of an overall investment management structure that meets the objectives of the Trustees.
- The selection and appointment of appropriate investment managers.
- Current views of the investment manager employed by the Plan.
- Potential new areas or tools of investment such as hedge funds, currency hedging, and liability driven investments.
- Commentary on the investment performance and risk taken by the manager as appropriate.

- Trustee education.
- General advice in respect of the Plan's investment activities.

### **Scheme Actuary**

3.3 The Scheme Actuary's responsibilities include:

- Liaising with the investment consultant on the suitability of the Plan's investment strategy given the financial characteristics of the Plan.
- Assessing the technical provisions of the Plan and advising on the appropriate response to any shortfall, with regard to scheme specific funding requirements.
- Performing the triennial (or more frequently, as required) valuations of the Plan and advising on the appropriate contribution levels for the future.

Fees are calculated on a project-based basis, often with reference to the time spent on a particular assignment multiplied by the relevant charge-out rates applying to staff who provided the services in question.

# 4 Objectives and long-term policy

## **Objectives**

- 4.1 The Trustees have the following investment objectives:
- a. The acquisition of suitable assets of appropriate liquidity which will generate income and capital growth to meet, together with new contributions from members and the Employer, the cost of current and future benefits which the Plan provides.
  - b. To limit the risk of the assets failing to meet the liabilities over the long term.
  - c. To minimise the long term costs of the Plan by maximising the return on the assets whilst having regard to the objective shown under **b**.

## **Policy**

- 4.2 The Trustees Policy is to seek to achieve the objectives through investing in a suitable mixture of real and monetary assets. They recognise that the returns on real assets, while expected to be greater over the long term than those on monetary assets, are likely to be more volatile. A mixture across asset classes should nevertheless provide the level of returns required by the Plan to meet its liabilities at an acceptable level of risk for the Trustees and an acceptable level of cost to the Employer.
- 4.3 The Trustees have undertaken an asset and liability modelling exercise (ALM) with the assistance of Wilshire Associates, the investment consultant, in April 2019. Following which, the Trustees have selected an asset allocation benchmark which reflects the Plan's liabilities. The Trustees consider that an asset allocation policy for the Plan which corresponds to this benchmark will ensure that the assets of the Plan include suitable investments, that those assets are appropriately diversified and that there is a reasonable expectation of meeting the objectives in 4.1.

## **Rates of Return**

- 4.4 In setting the Plan's asset allocation policy, the Trustees have regard to the historical rates of return earned on the various classes of assets available for investment.

- 4.5 The following table outlines the expected return and volatility for all asset classes, as of December 31, 2018, taken from Wilshire's 2018 Asset Class Risk and Return Assumptions which were used in the last asset allocation exercise undertaken by the Plan.

	U.K. Stocks	Global ex U.K. Stocks (GBP)	Global ex U.K. Stocks (h)	Global Stocks (GBP)	Global Stocks (h)	U.K. Long Duration Gilts (15+ yrs)	U.K. Inflation Linked Gilts
Expected Return	7.50	7.75	7.60	7.75	7.60	1.70	1.65
Expected Risk	17.00	17.30	16.35	17.15	16.25	11.00	8.00
<i>Correlations</i>							
U.K. Stocks	1.00						
Global ex U.K. Stocks (GBP)	0.84	1.00					
Global ex U.K. Stocks (h)	0.85	0.97	1.00				
Global Stocks (GBP)	0.85	0.99	0.97	1.00			
Global Stocks (h)	0.86	0.97	0.99	0.97	1.00		
U.K. Long Duration Gilts (15+ yrs)	0.19	0.05	0.03	0.06	0.04	1.00	
U.K. Inflation Linked Gilts	-0.05	0.03	0.00	0.02	-0.01	0.45	1.00

The following table outlines the expected return and volatility for all asset classes, as of December 31, 2021, taken from Wilshire's 2021 Asset Class Risk and Return Assumptions.

	U.K. Stocks	Global ex U.K. Stocks (GBP)	Global ex U.K. Stocks (h)	Global Stocks (GBP)	Global Stocks (h)	U.K. Long Duration Gilts (15+ yrs)	U.K. Inflation Linked Gilts
Expected Return	5.50	5.75	5.60	5.75	5.60	1.10	1.15
Expected Risk	17.00	17.35	16.50	17.25	16.45	10.00	8.00
<i>Correlations</i>							
U.K. Stocks	1.00						
Global ex U.K. Stocks (GBP)	0.84	1.00					
Global ex U.K. Stocks (h)	0.85	0.97	1.00				
Global Stocks (GBP)	0.85	0.99	0.97	1.00			
Global Stocks (h)	0.86	0.97	0.99	0.97	1.00		
U.K. Long Duration Gilts (15+ yrs)	0.19	0.05	0.03	0.06	0.04	1.00	
U.K. Inflation Linked Gilts	-0.05	0.03	0.00	0.02	-0.01	0.45	1.00

#### **Additional Voluntary Contributions (AVCs)**

- 4.6 The Plan provides a facility for members to pay AVCs into the Plan to enhance their benefits at retirement. An AVC is a member only contribution held on a money purchase basis to provide an additional benefit to that being accrued under the main section of the Plan. Members are offered a range of funds in which to invest their AVC payments. The Trustees' objective is to provide a range of funds which will provide a suitable long-term return for members, consistent with members' reasonable expectations.
- 4.7 The Trustees consider that a With Profits insurance policy meets the requirements for diversification between real and monetary assets and, because of the smoothing of

bonuses and the guaranteed value of the account, is appropriate for all members' AVC payments.

4.8 The range of funds offered includes:

- Aviva With-Profit Fund
- Aviva Balanced Managed Fund
- Aviva Defensive Managed Fund

### **Financially Material Considerations**

4.9 The Trustees' policy is to invest the Plan's assets on a passive basis. The Trustees cannot therefore directly influence the selection, retention and realisation of investments to take account of climate, social, environmental or ethical considerations.

4.10 However, it is the Trustees' policy to give discretion to the investment manager to pursue a policy of voting activity and engagement with companies. The extent to which climate, social, environmental, or ethical considerations are taken into account in this voting and engagement policy is left to the discretion of the investment manager.

### **Non-Financial Matters**

4.11 Non-financial matters are not taken into account in the selection, retention and realisation of investments.

### **Stewardship**

4.12 The Trustees' policy is to invest the Plan's assets in pooled arrangements. The responsibility for the exercising of rights (including voting rights) attaching to the underlying investments within pooled funds is delegated to the investment manager.

4.13 The Trustees are satisfied that the investment manager has an explicit strategy elucidating the circumstances in which they will intervene in a company, the approach they will use in doing so and how they will measure the effectiveness of this strategy.

# 5 Asset allocation guidelines

## Asset allocation

- 5.1 The Trustees believe that the following Plan-specific asset allocation is appropriate for the Plan. The Plan may hold funds in the following asset classes and will normally fall within the specified limits:

<b>Asset Classes</b>	<b>Minimum %</b>	<b>Benchmark %</b>	<b>Maximum %</b>
Global Stock (GBP)	5.0	10.0	15.0
Global Stock (Hedged)	5.0	10.0	15.0
U.K. Long Duration Gilts (15+ Yrs)	35.0	40.0	45.0
U.K. Inflation Linked Gilts	35.0	40.0	45.0
Cash	0.0	0.0	10.0

- 5.2 Asset categories not included above may only be used following a revision of these restrictions which specifically permits their inclusion. The Trustees may not borrow money or otherwise leverage the portfolio.

## Diversification

- 5.3 The Plan's strategic asset allocation (detailed in 5.1) is designed to ensure that the Plan's investments are adequately diversified by asset class. The use of index-tracking pooled funds ensures that at the stock selection level, the Plan's investments are adequately diversified.

## Suitability

- 5.4 The Trustees have taken advice from the investment consultant and the Scheme Actuary to ensure that the benchmark and the ranges specified above are suitable for the Plan given its liability profile. The Trustees will continue to monitor, and take advice on, the various assets held on an ongoing basis.

## Liquidity

- 5.5 The Trustees, together with the Plan's administrators, will ensure that they hold sufficient cash to meet the likely benefit outgo from time to time. The Trustees' policy is that there should be sufficient investments in liquid or readily realisable assets to meet unexpected cashflow requirements in the majority of foreseeable circumstances so that realisation of assets will not disrupt the Plan's overall investment policy, where possible.

## 6 Statement of Funding Principles

- 6.1 The Pensions Act requires that the Trustees maintain a Statement of Funding Principles, stating the methods and assumptions used in calculating the amount required to make provision for the Plan's liabilities, and the manner and period in which any shortfall will be remedied. The Trustees will consult the Scheme Actuary and the Employer when deciding upon the appropriate response to any shortfall.
- 6.2 The Trustees consider that the investment policy described in this Statement is consistent with the Statement of Funding Principles and the Trustees' obligations under the Scheme Specific Funding Requirement. In addition, the Trustees will review this investment policy in the light of actuarial valuations and certificates and schedules of contributions produced in order to comply with the Pensions Act and subsequent relevant legislation.

# 7 Investment manager arrangements

- 7.1 The Trustees considered the use of both passive and active investment management when reviewing the Plan's strategy. The resultant use of a single passive manager for equities and bonds was determined following consideration of the relative levels of risk involved, set against the efficiency, liquidity, and level of transaction costs likely to prevail within each market. In addition, the Trustees considered the impact of the investment manager fees on future expected returns net of fees.

## Manager structure

The Plan's assets are currently managed by BlackRock Investment Management. The composite portfolio will be composed as follows, with further details in Appendix B (note Aquila is the insurance wrapped index product offered by BlackRock as required by the HMRC defined benefits regulations for commingled funds):

<b>Asset</b>	<b>Benchmark Allocation (%)</b>	<b>Ranges (%)</b>
<b>Total Equities</b>	<b>20.00</b>	<b>+/- 1.50</b>
Aquila Life MSCI World Index Fund	8.85	+/- 1.50
Aquila Life Currency Hedged MSCI World Index Fund	8.85	+/- 1.50
iShares Emerging Markets Index Fund (IE) Aggregate	2.30	+/- 1.50
<b>Total Fixed Income</b>	<b>80.00</b>	<b>+/- 1.50</b>
Aquila Life Over 25 Years Gilt Index Fund	40.0	+/- 1.50
Aquila Life All Stocks UK Index-Linked Gilt Index Fund	40.0	+/- 1.50

The Trustees policy is to obtain ongoing advice on whether the BlackRock funds continue to be satisfactory as required by the Pensions Act.

## Performance objectives

- 7.2 Whilst the Trustees are not involved in the investment manager's day to day method of operation and therefore cannot directly influence attainment of the performance target, they will assess performance and review BlackRock's appointment on an annual basis.

A measurable objective has been developed for BlackRock consistent with the achievement of the Plan's longer-term objectives which is to produce a return which is close to the benchmark return set out in 5.1.

- 7.3 BlackRock should achieve the objective in the majority of periods under consideration. It is not expected that BlackRock will achieve this target in every period. However, the manager should demonstrate that the skill that they exercise on the portfolio is consistent with this target given the levels of risks adopted.

**Manager monitoring and the Trustee's policy**

- 7.4 Alignment between investment managers' management of the Plan's assets and the Trustees' policies and objectives are fundamental part of the appointment process of a new manager. Before investing, the Trustees will seek to understand the manager's approach to sustainable investing (including engagement). When investing in a pooled investment vehicle, the Trustees will ensure the investment objectives and guidelines of the vehicle are consistent with its own objectives.

To maintain alignment, managers are provided with the most recent version of the Plan's Statement of Investment Principles.

The Trustees appoint the investment managers with an expectation of a long-term partnership, which encourages active ownership of Plan's assets. When assessing a manager's performance, the focus is on medium to longer-term financial outcomes, and the Trustees would not expect to terminate a manager's appointment based purely on short-term performance. However, a manager's appointment could be terminated within a shorter timeframe due to other factors such as a significant change in business structure or the investment team.

Further, should the Trustees' monitoring process reveal that a manager is not taking into account medium to longer-term financial outcomes, or that a manager's portfolio is not aligned with the Trustees' policies, the Trustees will engage with the managers further to encourage alignment. This monitoring process includes specific consideration of the social, environmental, or ethical characteristics of the portfolio and manager's engagement activities. If, following engagement, it is the view of the Trustees that the degree of alignment remains unsatisfactory, the managers will be terminated and replaced.

For avoidance of doubt, the Trustees do not consider a manager's non-financial performance in its assessment/monitoring. This is because the Trustees do not take into account non-financial matters when determining the selection, retention, and realization of investments.

Managers are paid an ad valorem fee, in line with normal market practice, for a given scope of services which includes consideration of whether the Trustees' policies have been or will be followed (including in relation to long-term factors and engagement).

The Trustees review the costs incurred in managing the Plan's assets regularly, which includes the costs associated with portfolio turnover (these are the cost incurred as a result of buying, selling, lending or borrowing investments). In assessing the appropriateness of the portfolio turnover costs of an individual manager, the Trustees will have regard to the actual portfolio turnover and how this compares with the expected turnover range for that mandate.

The Trustees' policy is to invest the Plan's assets in pooled index-tracking funds. For most of the Plan's investments, the Trustees expect the investment managers to invest with a medium to long-term horizon, and to use their engagement activity to drive improved performance over these periods.

The Trustees understand that the investment manager takes into account the key principles of activism as endorsed by the Institutional Shareholder's Committee. Furthermore, the Trustees expect the investment manager to engage with companies (and other relevant person including, but not limited to, investments managers, and issuers/other holders of debt and equity) o things including capital structure of investee companies, actual and potential conflicts, performance, strategy, risks, corporate governance, and socials, environmental and ethical issues concerning Trustees' investments. The Trustees believe such engagement will protect and enhance the long-term values of its investments.

# 8 Risk management

8.1 The Trustees recognise a number of risks involved in the investment of the assets of the Plan:

- *Solvency risk and mismatching risk*
  - are measured through a qualitative and quantitative assessment of the expected development of the liabilities relative to the current and alternative investment policies.
  - are managed through the choice of the benchmark set out in Section 5.1 and through ongoing triennial actuarial valuations.
- *Manager risk:*
  - is measured by the expected deviation of the prospective risk and return, as set out in the performance objective set out in Section 7.3 and relative to the investment policy.
  - is managed by the ongoing monitoring of the actual deviation of returns relative to the objective and factors supporting the investment manager's investment process.
- *Concentration risk:*
  - is measured by the exposure to any single asset class or investment
  - is managed by maintaining a diversified portfolio across geographic regions and a variety of asset types
- *Liquidity risk:*
  - is measured by the level of cashflow required by the Plan over a specified period.
  - is managed by the Plan's administrators monitoring the level of cash held in order to limit the impact of the cash flow requirements on the investment policy, as set out in Section 5.5.
- *Political risk:*
  - is measured by the level of concentration of any one market leading to the risk of an adverse influence on investment values arising from political intervention.
  - is managed by the diversification of the assets across many countries.
- *Sponsor risk (Final Salary section):*
  - is measured by the level of ability and willingness of the Employer to support the continuation of the Plan and to make good any current or future deficit.

- is managed by assessing the interaction between the Plan and the Employer's business, as measured by a number of factors, including the creditworthiness of the Employer and the size of the pension liability relative to a number of metrics reflecting the financial strength of the Employer.
- *Currency risk:*
  - is measured by the movement of the currencies in which the Plan has exposure to through overseas investments.
  - is managed by investing 50% of the overseas developed equities in currency hedged funds.

8.2 The Trustees continue to monitor these risks.

# A Current advisers

<b>Scheme Actuary:</b>	Willis Towers Watson
<b>Investment consultant:</b>	Wilshire Associates, Inc.
<b>Investment manager:</b>	
<b>Passive equities and bonds:</b>	BlackRock Investment Management
<b>Administrator:</b>	Scottish Widows
<b>Solicitors:</b>	Slaughter and May
<b>Scheme auditors:</b>	Grant Thornton

# B Current investment manager

The Plan's assets are currently invested across a range of BlackRock pooled funds.

## BlackRock Investment Management

### Global Equity Index

Benchmark: MSCI All Country World Index

Objective: The aim of the Equity portfolio (the "Equity Sub-Portfolio") is to invest in passive world equities. This will be through a combination of hedged and unhedged assets

Charge:

Name of Fund	Manager's Fee (% p.a.)
Aquila Life MSCI World Index Fund	0.18
Aquila Life Currency Hedged MSCI World Index Fund	0.21
iShares Emerging Markets Index Fund (IE) Aggregate	0.15

### Gilt Denominated Fixed Income

Benchmark: UK Inflation Linked Gilt Index/Long Duration All Gilts Index

Objective: The Fund aims to track the sterling total return of the benchmark to within +/- 0.50% p.a. for two years in three.

Charges:

Name of Fund	Manager's Fee (% p.a.)
Aquila Life All Stocks UK Index-Linked Gilt Index Fund	0.08
Aquila Life Over 25 Years Gilt Index Fund	0.08