Building Societies Association
Pension and Assurance (No.3) Scheme

Statement of Investment Principles

1. **Introduction**

1.1 **Purpose of the Statement**

The Trustee of the Building Societies Association Pension and Assurance (No. 3) Scheme ("the Scheme") have drawn up this Statement of Investment Principles ("the Statement"). In doing so, they comply with the requirements of the Pensions Act 1995 as amended (the Act) and fulfil the spirit of the Code of Best Practice for Institutional Investment (the "Myners Code").

1.2 **Advice**

The Trustee has obtained written advice on the content of this Statement from Mercer Ltd, the Investment Consultant appointed by the Trustee ("the Investment Consultant"). The Investment Consultant provides strategic and other investment advice as agreed with the Trustee from time to time.

1.3 **Consultation**

The Trustee in preparing this Statement have also consulted the Building Societies Association, the sponsoring employer of the Scheme, in particular on the Trustee's investment objectives and strategy. The Trustee has taken advice from the Investment Consultant. However, the Trustee has made all the decisions taken in drawing up this Statement.

1.4 **Investment Powers**

The investment powers of the Trustee is set out in the Trust Deed and Rules of the Scheme. This Statement relates to and is consistent with those powers. Neither the Statement nor the Trust Deed restricts the Trustee's investment powers by requiring the consent of the sponsoring employer.

2. Overall Policy, Investment Objectives and Risk

Overall investment policy falls into two parts. The strategic management of the assets is fundamentally the responsibility of the Trustee acting on advice from the Investment Consultant, and is driven by their investment objectives as set out below. The remaining elements of policy are part of the day-to-day management of the assets, which is delegated to a professional investment manager.

2.1 Investment Objectives

The Scheme is a Defined Benefit Scheme with a Defined Contribution underpin. The Trustee's objectives are:

- To ensure that obligations to the beneficiaries of the Scheme are met.
- To meet the Statutory Funding Objective ("SFO").
- To achieve a level of return that is sufficient to improve the confidence over which members' benefits can be funded from assets of the Scheme with no long-term reliance on the sponsoring employer. Such return target shall be set relative to the objective of achieving 105% funding as measured on a solvency liability basis, which is more prudent than the SFO basis, and designed, by the Scheme Actuary, to broadly reflect prevailing annuity pricing; the "long-term funding objective". The Trustee shall seek to take investment risk commensurate with their return target whilst also considering opportunities to reduce risk where appropriate, including such activities as a de-risking trigger framework, or a buy-in or buyout of the Scheme's liabilities.
- That the Scheme returns should match as closely as possible the returns of the benchmark indices set out below in section 2.3, except in Corporate Bonds where a modest degree of outperformance is expected over time.
- To have regard to the maturity profile of the Scheme, and to reduce the level of investment risk as afforded by the level of funding in the Scheme and as the proportion of current pensioners increases in the Scheme's liabilities.

2.2 Risk

The Trustee pays close regard to the risks that may arise through a mismatch between the Scheme's assets and its liabilities, and the risk that may arise from the lack of diversification of investments. Subject to satisfying the risk from a mismatch of assets and liabilities, the Trustee believes that the asset allocation policy in place provides an adequately diversified distribution of assets.

The Trustee takes into account the following risks arising from the asset classes in which the Scheme invests:

- *Interest rate risk* exists to the extent that the change in the present value of the Scheme's projected liability cashflows differs to the change in the value of the Scheme's assets as market expectations of future interest rates change.

- *Inflation risk* exists to the extent that the change in the present value of the Scheme's projected liability cashflows differs to the change in the value of the Scheme's assets as market expectations of future inflation rates change.

- *Credit risk* is the aggregation of credit spread risk and default risk which reflects the possibility that the payments due under a bond might not be made by the issuer and acknowledges that the present value of future expected payments is connected to the credit spread upon which those payments are discounted.

- *Currency risk* will arise 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.

- *Market risk* concerns the stability of the market value of assets such as equities, where the prevailing market price may be particularly affected by short term sentiment and is not certain until the point of sale.

- *Regulatory risk* arises from investing in a market environment where the regulatory regime may change. This may be compounded by *political risk* in those environments subject to unstable regimes.

- *Liquidity risk* arises from holding assets that are not readily marketable and realisable.

- *Concentration risk* arises for example when a high proportion of the Scheme's assets are invested in a particular asset class, region in securities, whether debt or equity, of the same or related issuers.

Given the Trustee's long-term investment horizon, the Trustee believe that a degree of liquidity risk is acceptable because they expect to be rewarded for assuming it. Thus, a small proportion of the Scheme's assets may be invested in illiquid investments such as property. The remainder will be invested in assets that are readily realisable at short notice.

The Trustee does not expect to be rewarded for assuming concentration risk, and will adopt overall investment arrangements that are intended to provide an appropriate spread of assets by type and spread of individual securities within each asset class.

The Trustee will also consider the balance between active and passive management, in asset classes where passive management is a practicable option. In determining this balance, the Trustee will consider whether active management offers sufficient potential to outperform to justify the additional risks and fees compared with passive management. The risks the Trustee will take into account include:

- *Active risk* in that the combination of assets held by an active manager will differ from the benchmark and may give rise to underperformance relative to passive management.

- *Tracking error risk* in that a passive manager may not have the skills to track the benchmark index within an appropriate degree of accuracy.

- *Manager selection risk* due to the potential for selecting (or failing to de-select in a timely manner- after taking account of the managers performance objectives) an active manager that fails to generate sufficient return in excess of the benchmark to justify the active risk taken and the higher fees charged than for passive management.

2.3 Investment Strategy

The Trustee sets the target asset allocation with the aim of generating sufficient investment returns to satisfy the Scheme's long-term funding objective.

Asset Class	Central allocation %	Allowed ranges %	Benchmark Index	Tracking Error / Performance Target
Total equities	**12.50**	**10.5 – 14.5**		
UK Equities	6.25	5.25 – 7.25	FTSE All-Share	+/- 0.25% p.a. for two years in three
North America – GBP Currency Hedged	1.5	1.0 – 2.0	FTSE AW Developed North America – GBP Hedged	+/- 0.50% p.a. for two years in three
Europe (ex UK) – GBP Currency Hedged	1.5	1.0 – 2.0	FTSE AW Developed Europe (ex UK) – GBP Hedged	+/- 0.50% p.a. for two years in three
Japan – GBP Currency Hedged	0.75	0.25 – 1.25	FTSE AW Japan – GBP Hedged	+/- 0.50% p.a. for two years in three
Asia Pacific (ex Japan) – GBP Currency Hedged	1.25	0.75 – 1.75	FTSE AW Developed Asia Pacific (ex Japan) – GBP Hedged	+/- 0.75% p.a. for two years in three
Emerging Markets	1.25	0.75 – 1.75	FTSE AW All Emerging	+/- 1.50% p.a. for two years in three
Total bonds	**87.5**	**84.5 –90.5**		
Index-Linked Gilts	31.0	29.0 – 33.0	FTSEA Index-Linked (Over 15 Year)	+/- 0.25% p.a. for two years in three
Conventional Gilts	6.5	5.5 – 7.5	2060 Conventional Gilt	+/- 0.25% p.a. for two years in three
	12.5	10.5 – 14.5	FTSE Actuaries UK Conventional Gilts All Stocks Index	+/- 0.25% p.a. for two years in three
Corporate Bonds (Actively managed)	37.5	35.5 – 39.5	Markit iBoxx £ Non-Gilts Over 10 Year	+ 1.5% p.a. / 0.75% p.a. over rolling three year periods.
Total	**100.0**			

The Trustee recognises that the allocation of assets has been taken with a view to meeting the long-term liabilities of the Scheme and that the chosen strategy is a major determinant of the overall return on the Scheme's assets and the level of investment risk taken.

The Trustee decided to hedge the Scheme's foreign currency exposure resulting from overseas equity assets in order to eliminate currency risk. The exception to this is the investment in Emerging Markets equity, where the foreign currency exposure remains unhedged.

To assist in governing the Scheme's progression along their journey plan, the Trustee has developed a de-risking framework, which allows for a change in investment strategy subject to pre-agreed funding level metrics being achieved.

The investment strategy may deviate from the table above, if de-risking steps are taken in line with the funding level based framework as described below.

- A "flight path" funding level monitoring process is in place (see Appendix) that will help to identify potential de-risking opportunities, as and when the funding level approaches the long-term funding target.

- Assets will be transitioned in such a way that the resulting new asset portfolio will have a lower level of risk and expected return.

3. Day To Day Management of the Assets

3.1 Main Assets

For the purpose of this statement the Scheme assets are split into 'main assets' and 'other assets', which are dealt with in section 3.2 below. The Trustee invests the main assets of the Scheme solely in a collection of pooled fund investments operated by Legal & General Investment Management ("L&G") under the terms of a policy of insurance with the Trustee. The Trustee is satisfied that the spread of assets by type and the investment manager's policy on investing in individual securities within each type provides adequate diversification of investments.

3.1.1 Investment Restrictions

The Scheme invests in pooled vehicles. Prohibited investments within each pooled vehicle are determined by the respective pooled vehicles' governing documents. Overall restrictions and limitations on the use of these funds by the Scheme are set out in the policy document.

3.1.2 Investment Performance Benchmark

The target for L&G is to match as closely as possible the return of the benchmark indices in each of the various asset classes set out in the table in Section 2.3, except in Corporate Bonds where a modest degree of outperformance is expected over time.

3.1.3 Manager Fees

Investment management fees paid to L&G are based on the market value of assets under management. The following fee arrangement has been agreed between the Trustee and L&G.

Asset	Fees % p.a.	
UK Equities	First £10m	0.10
	Next £10m	0.075
North American Equities – Currency Hedged	First £1m	0.225
	Next £1.5m	0.20
	Next £7.5m	0.175
European (ex UK) Equities – Currency Hedged	First £1m	0.275
	Next £1.5m	0.25
	Next £7.5m	0.225
Japanese Equities – Currency Hedged	First £1m	0.25
	Next £1.5m	0.225
	Next £7.5m	0.20
Asia Pacific (ex Japan) Equities – Currency Hedged	First £1m	0.30
	Next £1.5m	0.275
	Next £7.5m	0.25
Emerging Market Equities	First £2.5m	0.60
	Balance	0.45
Index-Linked Gilts	First £5m	0.10
	Next £5m	0.075
Conventional Gilts	First £5m	0.10
	Next £5m	0.075
Corporate Bonds	All assets	0.20

In addition the Trustee pays L&G a flat fee of £1,500 p.a. for monitoring and maintaining the Scheme's asset distribution within the agreed ranges around the central benchmark.

3.1.4 Investment Consultant Fees

Mercer's investment consulting fees are either based on fixed quotes for particular projects or, more normally, are on a time cost basis.

The Investment Consultant provides advice to the Trustee but does not have responsibility for decision making in any area. The role encompasses, but is not limited to, the following areas:

- Assistance in helping the Trustee formulate investment objectives
- Advice on investment strategy
- Advice on devising an appropriate investment management structure
- Assistance in selecting and monitoring of investment managers

3.2 Other Assets

Assets in respect of members' ongoing Additional Voluntary Contributions (AVCs) are held with Aviva (formerly Friends Life). All their funds (and guest funds) were available to members, prior to 31 December 2009, except the With Profit fund. The Aviva arrangement closed to new contributions with effect from 31 December 2009.

AVC assets in respect of some members who contributed prior to 1 January 2005 are held with the Prudential. The Prudential arrangement closed to new contributions with effect from 31 December 2009.

In addition cash balances are held in a Trustee bank account. From time to time the Trustee may also invest cash balances temporarily in the L&G cash fund.

3.3 Realisation of Investments

In general L&G have discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments.

3.4 Monitoring the Investment Manager

The Trustee retains Mercer as investment consultants to provide assistance in monitoring the Scheme's investment arrangements.

In addition the Trustee meets with L&G annually to discuss performance, activity and other issues as appropriate, and monitor the manager quarterly through receiving quarterly performance reports, which contains performance information over 3 months, 1 year, 3 years, 5 years and since inception. The Trustee reviews the absolute performance, relative performance against a suitable index used as the benchmark, and against the manager's stated target performance (over the relevant time period) on a net of fees basis. The Trustee's focus is on long-term performance but the Trustee may review a manager's appointment if:

- There are sustained periods of underperformance;
- There is a change in the portfolio manager;
- There is a change in the underlying objectives of the Investment Manager;
- There is a significant change to the Investment Consultant's rating of the manager.

The investment manager for the majority of the existing funds, is remunerated by way of a fee calculated as a percentage of assets under management. For the Scheme's actively managed fund, the manager is incentivised via performance related targets and associated higher levels of remuneration. Where such fees apply, a hurdle rate structure is in place to mitigate the possibility of the Trustee paying additional fees during periods of long-term underperformance.

3.5 Aligning Manager Appointments with Investment Strategy

Investment Managers are appointed based on their capabilities and, therefore, their perceived likelihood of achieving the expected return and risk characteristics required for the asset class they are selected to manage.

As part of this, to maintain alignment of the investment manager's investment strategy and decisions with the Trustee's own policies, the Trustee undertakes due diligence ahead of investing to ensure it is aware of the:

- risks associated with the underlying mix of assets;
- expected return targeted and details around realisation of the investment; and
- impact of financial and non-financial factors, including but not limited to ESG factors and climate change, on their long term investment decision making process.

The Trustee will review an appointment if the investment objective for a manager's fund changes to ensure it remains appropriate and consistent with the Trustee's wider investment objectives.

Where the Trustee invests in pooled investment vehicles they accept that they have no ability to specify the risk profile and return targets of the manager, but appropriate mandates can be selected to align with the overall investment strategy.

3.6 Manager Turnover

The Trustee is a long-term investor and is not looking to change the investment arrangements on a frequent basis. For open-ended funds, there is no set duration for the manager appointments. The Trustee will therefore retain an investment manager unless:

- There is a strategic change to the overall strategy that no longer requires exposure to that asset class or manager;
- The manager appointed has been reviewed and the Trustee has decided to terminate the mandate.

Monitoring is undertaken on a regular basis. The manager is aware that their continued appointment is based on their success in delivering the mandate for which they have been appointed to manage. If the Trustee is dissatisfied, then they may look to replace the manager.

3.7 Portfolio Turnover Costs

The Trustee does not currently monitor portfolio turnover costs directly, however returns are quoted net of fees and investment performance implicitly reflects the costs of portfolio turnover.

The Trustee also receives MiFID II reporting from their investment manager however it does not currently analyse this information in detail. The Trustee will continue to monitor industry improvements concerning the reporting of portfolio turnover costs. In future, the Trustee may ask managers to report on portfolio turnover cost. They may assess this by comparing portfolio turnover across the same asset class, on a year-on-year basis for the same manager fund, or relative to the manager's specific portfolio turnover range in the investment guidelines or prospectus.

4. Socially Responsible Investment and Corporate Governance

The Trustee believes that good stewardship and environmental, social and governance ("ESG") issues may have a material impact on investment returns. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration.

The Trustee has given the investment managers full discretion when evaluating ESG issues and in exercising rights and stewardship obligations attached to the Scheme's investments. Similarly, the Scheme's voting rights are exercised by its investment managers in accordance with their own corporate governance policies, and taking account of current best practice including the UK Corporate Governance Code and the UK Stewardship Code.

The Trustee also considers the investment consultant's assessment of how the manager embeds ESG into their investment process for each of the underlying investment mandates and how the manager's responsible investment philosophy aligns with the Trustee's views. This includes the investment manager's policy on voting and engagement.

The Trustee considers how ESG is integrated within investment processes when monitoring existing investment managers. It is accepted that pooled investments will be governed by the individual policies of the investment managers. These policies are reviewed as part of the appointment of new managers.

Equity managers who are registered with the appropriate UK regulators (currently the Financial Conduct Authority (FCA) or Prudential Regulation Authority (PRA)) are expected to report on their adherence to the UK Stewardship Code on an annual basis.

The Trustee does not currently have a policy of taking into account "non-financial matters" when considering the selection, retention and realisation of assets. For this purpose "non-financial matters" means 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.

5. Review of this Statement

The Trustee will review this Statement on a periodic basis and also in response to any material changes to any aspects of the Scheme, its liabilities, finances and attitude to risk of the Trustee and sponsoring employer, which they judge to have a bearing on the stated investment policy. Any such review will again be based on expert investment advice and will be in consultation with the sponsoring employer.

May 2021 (Previous version dated August 2020)

Appendix – Flight Path

The strategy is kept under regular review and may be de-risked subject to the process described below.

- A "flight path" funding level monitoring process is in place to identify de-risking opportunities to enable gradual de-risking as the funding level approaches the pre-defined long-term funding target.

- The flight path will have funding level based triggers.

- The liability value under the funding level triggers will be determined using assumptions defined by the Scheme Actuary consistent with the solvency basis.

- The return target and therefore the target asset mix has been calibrated, as at 31 December 2020, in order to deliver a 65% probability of achieving the long term funding objective by 30 June 2024.

The following triggers are valid until 31 December 2021 Thereafter, the trigger levels are subject to change and will be reviewed periodically.

		Trigger 1	**Trigger 2**
Required funding level		103%	104%
Strategic Asset Allocation (%)	Equities	12.5	-
	Corporate Bonds	37.5	37.5
	Gilts	50.0	62.5
Expected return under trigger strategy (margin over gilts % p.a.)		+1.0%	+0.5%

Figures may not sum due to rounding

The split between fixed and index-linked gilts is to be periodically updated with the intention of broadly matching the interest rate and inflation exposures of the Scheme's liabilities.