

# THE PARAGON PENSION PLAN

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## AVC STATEMENT OF INVESTMENT PRINCIPLES

### **The Paragon Pension Plan Defined Contribution and Additional Voluntary Contribution section Statement of Investment Principles**

#### **1. Introduction and scope**

- 1.1 The purpose of this Statement of Investment Principles ("the DC and AVC SIP") is to document the principles and policies governing decisions about the investment of the assets of the Paragon Pension Plan ("the Plan") Defined Contribution and Additional Voluntary Contribution arrangements ("DC and AVCs"). This statement has been prepared by the Trustee of the Plan ("the Trustee") and is separate to the Statement of Investment Principles relating to the Defined Benefit assets of the Plan.
- 1.2 This Statement: -
  - 1.2.1 Has been drawn up in accordance with the requirements of Section 35 of the Pensions Act 1995 (as amended by the Pension Act 2004 and the Occupational Pension Plans (Investment) Regulations 2005) (the Act)
  - 1.2.2 Complies with the applicable legislation and underlying regulations.
  - 1.2.3 Has been designed to take into consideration the recommendations made by the Myners Review of Institutional Investment.
  - 1.2.4 Has an effective date of 30 September 2020.
  - 1.2.5 Is available to the members of the Plan on request and is published on a publicly available website.

#### **2. Decision Making Structure and Governance**

- 2.1 Overall investment policy falls into two parts:
  - 2.1.1 The *strategic management* of the assets is fundamentally the responsibility of the Trustee, acting on expert advice, and is driven by the investment objectives set out below. The Trustee reviews the investment policy on a regular basis, although it is not expected to change frequently. Details are set out in Sections 3 and 4
  - 2.1.2 The *implementation* of the investment policy occurs through the day to day management of the DC and AVC assets which is delegated to the Trustee's selected investment managers ("the DC and AVC Managers"). Details are outlined in section 5 with full details in the Implementation section below.

#### **3. Strategic Management**

- 3.1 Investment objectives
  - 3.1.1 The Trustee's primary objective for the Plan DC and AVCs is to provide a range of investments that are suitable for meeting members' long and short-term investment objectives, based on the Trustee's consideration of members' needs. Members' circumstances are taken into account, including the range of members' likely attitudes to risk and term to retirement.
- 3.2 Process for choosing investments
  - 3.2.1 In order to enable members to avoid inappropriate risk a range of asset classes is provided.

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- 3.2.2 The Trustee recognises that decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. It also recognises that where the Trustee takes investment decisions, it must have sufficient expertise and appropriate training to be able to evaluate critically any advice it takes.
- 3.2.3 The Pensions Act 1995 distinguishes between investments where the management is delegated to a fund manager with a written contract and those where a product is purchased directly, e.g. the purchase of an insurance policy or units in a pooled vehicle. The latter are known as **direct investments, which include the Plan's DC and AVCs.**
- 3.2.4 The Trustee policy is to review their direct investments and to obtain written advice about them at regular intervals (normally at least triennially). When deciding whether or not to make any new direct investments the Trustee will obtain written advice and consider whether future decisions about those investments should be delegated to the fund managers.
- 3.2.5 The written advice will consider the issues set out in the Occupational Pension Schemes (Investment) Regulations 2005 and the principles contained in this statement. The regulations require all investments to be considered by the Trustee (or, to the extent delegated, by the fund managers) against the following criteria:
- The best interests of the members and beneficiaries
  - Security
  - Quality
  - Liquidity
  - Profitability
  - Nature and duration of liabilities
  - Tradability on regulated markets
  - Diversification
  - Use of derivatives
- 3.2.6 The Trustee's investment adviser has the knowledge and experience required under the Pensions Act 1995.
- 3.2.7 Day to day selection of stocks is delegated to fund managers appointed by the Trustee. The Trustee takes professional advice when formally reviewing managers or funds offered to members. This advice will be taken at least every three years.
- 3.2.8 The Trustee expects the fund managers to manage the assets delegated to them under the terms of their respective contracts and to give effect to the principles in this statement so far as is reasonably practicable.
- 3.2.9 The Trustee has appointed Prudential as the manager of the DC and AVC assets. Prudential provides safekeeping for the Plan's assets and performs administrative duties, such as the collection of interest and dividends and dealing with corporate actions.
- 4. Investment Risk Measurement and Management**
- 4.1 The Trustee recognises that members take the investment risk. The Trustee takes account of this in the selection and monitoring of investment managers and the choice of funds offered to members.

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### 5. Asset Allocation Strategy

- 5.1 The Trustee recognises that the key source of financial risk (in relation to meeting its objectives) normally arises from asset choice. The Trustee therefore retains responsibility for the asset choice available to members and takes expert advice as required from its professional advisers.
- 5.2 A full range of available asset classes has been considered. This includes consideration of so called "alternative" asset classes (namely illiquid infrastructure, private equity, and hedge funds). It is the view of the Trustee's advisers that these alternative assets are not currently suitable for investment by members for their DC and AVC assets.
- 5.3 The Trustee also considers the following sources of risk:
- 5.3.1 Inflation risk – the absolute return on investments, and hence the value of a member's DC and AVC pension savings within the Plan may be diminished by inflation. To help mitigate this risk, a range of funds is offered including growth funds which aim to provide real growth (in excess of inflation) over the long term.
  - 5.3.2 Volatility risk. The risk of significant short-term fluctuations in the value of members' DC and AVC pension savings within the Plan and can significantly impact member outcomes as members approach retirement.
  - 5.3.3 Credit Risk. The risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation. The credit risk the Plan and members are exposed to arises from both holdings in the underlying funds, and from investment through an investment platform.
  - 5.3.4 Geared or speculative investments using derivatives. The Trustee has not invested in funds that are geared or make largely speculative use of derivatives.
  - 5.3.5 Market Risk. The Plan and members are subject to currency, interest rate and other price risk associated with the underlying investments. These risks can impact the valuations of the funds. The Trustee has selected a sufficient range of funds to be available to allow members to suitably diversify their investments to manage these risks. This is also considered when setting the Lifestyle strategies. Further, the Trustee closely monitors the performance of the funds and receives formal reports from the investment adviser giving views on their continuing appropriateness, and that of the underlying fund managers.
  - 5.3.6 Liquidity Risk. Being forced to sell investments to pay benefits in unfavourable financial market conditions or being unable to sell investments to meet a request from a member. The Trustee has invested in unitised pooled funds which are easily redeemable, although trading may be temporarily suspended under certain conditions, for example when there is some uncertainty around the valuations of underlying properties within the fund.
  - 5.3.7 Diversification Risk. The Trustee has chosen funds that are constructed from well diversified portfolios of assets to reduce the stock specific risk faced by the Plan and members.
  - 5.3.8 Manager risk - The failure of the fund managers to meet their objectives. This risk is considered by the Trustee and its advisers both upon the initial appointment of the fund manager and on an ongoing basis thereafter.

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- 5.3.9 Operational risk - The risk of fraud, poor advice or acts of negligence. The Trustee has sought to minimise such risk by ensuring that all advisers and third-party service providers are suitably qualified and experienced.
- 5.3.10 Default option risk. The risk of the default option being unsuitable for the requirements of some members. The Trustee has provided alternative fund options in addition to the default and has communicated to members the need to review their own requirements and circumstances before making any investment decisions.
- 5.3.11 Conversion or "annuity rate" risk. The risk that relative market movements in the years just prior to retirement lead to a substantial reduction in benefits secured.

### 6. Custody

- 6.1 Investment in pooled funds gives the Trustee a right to the cash value of the units rather than to the underlying assets. The managers of the pooled fund are responsible for the appointment and monitoring of the custodian of the fund's assets. The custodians are independent of the employer.

### 7. Expected Returns on Assets

- 7.1 Over the long-term the Trustee's expectations are:
  - 7.1.1 For units representing real assets (UK and overseas equities, property), to achieve a return which keep pace with the increase in national average earnings over the same period. The Trustee considers short-term volatility in price behaviour is acceptable, given the general expectation that over the long-term these types of asset will outperform the other major asset classes.
  - 7.1.2 For units representing monetary assets (fixed bonds), to achieve a long-term rate of return that is lower than returns on growth assets.
  - 7.1.3 For units representing cash, to protect the capital value of the investment and achieve a rate of return in line with money market interest rates.
- 7.2 Returns achieved by the fund managers are assessed against performance benchmarks by the Trustee in consultation with its advisers and fund managers.

### 8. Realisation of Investment/Liquidity

- 8.1 The Trustee recognises that there is a risk of holding assets that cannot easily be realised should the need arise. The majority of assets held on behalf of members are realisable at short notice.

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### 9. Financially Material Considerations - Social, Environmental or Ethical

- 9.1 In setting the Plan's investment strategy, the Trustee's primary concern is to act in the best financial interests of the Plan and its beneficiaries, seeking the best return that is consistent with a prudent and appropriate level of risk. This includes the risk that environmental, social and governance factors including climate change negatively impact the value of investments held if not understood and evaluated properly.
- 9.2 The Trustee considers this risk by taking advice from their investment adviser when setting the Plan's investment strategy, when selecting managers and when monitoring their performance.

### 10. Stewardship – Voting and Engagement

- 10.1 As part of its delegated responsibilities, the Trustee expects the Plan's investment managers to:
- 10.1.1 Where appropriate, engage with investee companies with the aim to protect and enhance the value of assets; and
  - 10.1.2 exercise the Trustee's voting rights in relation to the Plan's assets.
- 10.2 The Trustee regularly reviews the continuing suitability of the appointed managers and takes advice from the investment adviser with regard to any changes. This advice includes consideration of broader stewardship matters and the exercise of voting rights by the appointed managers. If an incumbent manager is found to be falling short of the standards the Trustee has set out in its policy, the Trustee will first look to engage with the manager and seek a more sustainable position but may look to replace the manager.
- 10.3 The Trustee reviews the stewardship activities of its investment managers on an annual basis, covering both engagement and voting actions. From 2021, this will be accessible to members via the Implementation Statement. As part of this Statement, the Trustee will expect investment managers to provide aggregate voting information at a fund level and voting rationale for significant votes (defined as where votes were cast against management or where voting differed from the standard voting policy of the investment manager).
- 10.4 The Trustee will engage with its investment managers as necessary for more information, to ensure that robust active ownership behaviours, reflective of their active ownership policies, are being actioned.
- 10.5 It is the expectation of the Trustee that the Plan's investment managers will actively monitor environmental, social and governance risks within the investment, providing transparency on engagement and voting actions with respect to mitigating these risks as appropriate.
- 10.6 From time to time, the Trustee may engage with their investment managers on matters concerning an issuer of debt or equity, including their performance, strategy, risks, social and environmental impact and corporate governance, the capital structure, and management of actual or potential conflicts of interest. Ordinarily, the Trustee would not engage directly with an issuer of debt or equity or other stakeholders about these matters, and delegates this authority to the investment managers.

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### 11. Members' Views and Non-Financial Factors

- 11.1 In setting and implementing the Plan's investment strategy the Trustee does not explicitly take into account the views of Plan members and beneficiaries in relation to ethical considerations, social and environmental impact, or present and future quality of life matters (defined as "non-financial factors").

### 12. Arrangements with asset managers

- 12.1 As the Plan predominantly invests in pooled funds, the Trustee has limited direct influence on the investment holdings, processes and policies in place. However, the Trustee will encourage managers to improve their practices where possible, while acknowledging that in practice the managers may face limitations in fully aligning their strategy and decisions to the (potentially conflicting) policies of all their pooled fund investors.
- 12.2 The Trustee monitors the Plan's investments to consider the extent to which the investment strategy and decisions of the investment managers are aligned with the Trustee's policies. This includes monitoring the extent to which managers:
- 12.2.1 make decisions based on assessments about medium- to long-term financial performance of an issuer of debt or equity; and
  - 12.2.2 engage with issuers of debt or equity to improve their performance in the medium- to long-term.
- 12.3 The Trustee is supported in this monitoring activity by its advisers.
- 12.4 The Trustee receives at least annual reports and regular verbal updates from the advisers covering various items including underlying fund performance and any major changes to processes or personnel. The Trustee focuses on longer-term performance when considering the ongoing suitability of the investments in relation to the Plan's objectives.
- 12.5 Before appointment of a new investment manager, the Trustee and its advisers endeavour to review the governing documentation associated with the investment and consider the extent to which it aligns with the Trustee's policies. Where necessary, the Trustee will seek to express its expectations to the investment managers to try to achieve greater alignment.
- 12.6 Where investment managers are considered to make decisions that are not in line with the Trustee's policies, expectations, or the other considerations set out above, the Trustee will typically first engage with the manager but could ultimately replace the manager where this is deemed necessary.
- 12.7 There is typically no set duration for arrangements with managers, although the continued appointment for all managers will be reviewed periodically, and at least every three years.
- 12.8 The Trustee does not regularly monitor investment managers against non-financial criteria of the investments made on its behalf unless this is a stated aim of the underlying investment.

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### 13. Cost transparency

- 13.1 The Trustee recognises the importance of monitoring the level of investment costs incurred in the management of members' assets and the impact these can have on the value of these assets.
- 13.2 It is the Trustee's view that long term performance, net of fees, is the most important metric on which to evaluate the investment managers.
- 13.3 Investment managers are remunerated by the deduction of set percentages of assets under management, with the exception of the With Profits fund. This is in-line with market practice and avoids a short-term approach to investment performance that may be the result of any performance-related fees. The Trustee therefore believes it is important to understand all the different costs and charges, which are paid by members (through a deduction from the unit price). These include:
- 13.3.1 explicit charges, such as the annual management charge, and additional expenses that are disclosed by investment managers as part of the Total Expense Ratio ('TER');
- 13.3.2 implicit charges, such as the portfolio turnover costs (transaction costs) borne within a fund. The Trustee defines portfolio turnover costs as the costs incurred in buying and selling underlying securities held within the fund's portfolio. These are incurred on an ongoing basis and are implicit within the performance of each fund.
- 13.4 The platform provider is also remunerated as a set percentage of the assets under management. This reflects the costs associated with administration, hosting of funds and direct communications.
- 13.5 The Trustee collects annual cost transparency reports as part of the value for members assessment. This allows the Trustee to understand exactly what members are paying. These costs, along with the estimated impact on representative members, are made publicly available within the annual Chair's Statement.
- 13.6 No specific ranges are set for acceptable costs and charges, particularly in relation to portfolio turnover costs. However, the Trustee expects its advisers to highlight if these costs and charges appear unreasonable when they are collected as part of the annual Chair's Statement exercise.
- 13.7 The Trustee is aware of the importance of monitoring its investment managers' total costs and the impact these costs can have on the overall value of members' assets.

### Portfolio Turnover

- 13.8 The Trustee accepts that transaction costs will be incurred to drive investment returns and that the level of these costs varies across asset classes and by investment manager style within an asset class. In both cases, a reasonable level of transaction costs is acceptable providing it is consistent with the asset class characteristics and investment manager's style and historic trends. Where the Trustee's monitoring identifies a lack of consistency the mandate will be reviewed.
- 13.9 Targeted portfolio turnover is defined as the expected frequency with which each underlying investment managers' fund holdings change over a year. The Plan's investment adviser monitors this on behalf of the Trustee as part of the investment manager monitoring they provide to the Trustee and flags to the Trustee where there are concerns.

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### 14. Consultations Made

- 14.1 As required by the Act, the Trustee has consulted with the sponsoring employer, Paragon Banking Group plc ("the Company") to seek the views of the Company on the DC and AVC SIP. The Trustee is under no obligation to adhere to the Company's comments.

### 15. Timing of Periodic Review

- 15.1 The Trustee will review this Statement of Investment Principles (SIP) at least every three years and following any significant change in investment policy or Plan circumstances.
- 15.2 The Trustee will take investment advice and consult with the Company over any changes to the SIP.

### 16. Implementation

- 16.1 The DC and AVCs are invested in an insurance policy issued by Prudential. Investment in the insurance contracts is under the control of the Trustee and it is the Trustee's policy to review the investments and to obtain written advice about them periodically.
- 16.2 Prudential is authorised by the Prudential Regulation Authority ('PRA') and regulated by the Financial Conduct Authority ('FCA') and the PRA.
- 16.3 Prudential offer a With Profits Fund and a range of unit-linked funds. The Trustee decides the range of funds offered to members, but has no influence on the investment aims of each fund or how the investment managers choose the underlying investments within the fund, as the assets are pooled with many other investors to obtain economies of scale. Nevertheless, notwithstanding how the assets are managed, the Trustee has taken investment advice regarding the suitability of the relevant investment vehicles.
- 16.5 The fund range offered to members, including the objectives and fund charges, is set out in the appendix:

**Adopted by the Trustees on:**

**Date** .....



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#### Appendix A: Current DC and AVC fund details

Fund name	Fund objective	Annual Fee Scale (Total Expense Ratio)
Prudential Dynamic Global Equity Passive	The fund aims to deliver long term (more than five years) growth by investing in underlying funds, offered by M&G plc and/or external fund managers, that track UK and overseas equities. The regional asset allocation is actively managed against an internal benchmark set by the M&G Treasury & Investment Office	0.64
BlackRock Aquila Over 15 Years UK Gilt Index	This fund invests in UK government fixed income securities (gilts) that have a maturity period of 15 years or longer. The fund aims to achieve a return consistent with the FTSE UK Gilts Over 15 Years Index, which is widely regarded as the benchmark for UK pension fund investment in the longer dated end of the UK gilt market.	0.72
Prudential Cash	This fund invests via the M&G PP Cash Fund in both secured (reverse repurchase agreements) and unsecured interest-bearing deposits, as well as short-term UK Government bonds and Certificates of Deposit. This fund aims to outperform its benchmark, the London Interbank LIBID 7 Day Deposit rate, before charges on a rolling three-year basis.	0.55
Prudential Discretionary	This fund invests via the M&G PP Discretionary Fund in a range of assets, holding a mix of UK and overseas company shares, bonds, property, cash plus listed alternative assets through other M&G PP funds or direct holdings. It is actively managed against an internal benchmark asset allocation set by the Prudential Portfolio Management Group.	0.78
Prudential UK Equity	This fund invests via the M&G PP UK Equity Fund in the shares of UK companies and aims to outperform its benchmark, the FTSE All-Share Index, by 0.75%-1.0% a year (before charges) on a rolling three-year basis.	0.76
Prudential Fixed Interest	This fund invests via M&G PP Fixed Interest Fund mainly in UK government gilts. The fund can also invest in overseas government bonds and corporate bonds issued by UK and overseas companies and institutions. Exposure to short-term exchange rate movements from any overseas holdings is mitigated by hedging. It aims to outperform its benchmark, the FTSE Actuaries UK Conventional Gilts All Stocks Index, by 0.75% a year (before charges) on a rolling three-year basis.	0.76
Prudential Global Equity	This fund invests via the M&G PP Global Equity Fund in 60% UK equity and 40% mix of overseas company shares. It aims to outperform its benchmark, 60% FTSE All-Share Index and 40% an internal composite benchmark asset allocation set by the Prudential Portfolio Management Group, by 1.0% a year (before charges) on a rolling three-year basis.	0.76

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Prudential Index-Linked	This fund invests via the M&G PP Index-Linked Fund mainly in UK Government index-linked gilts, typically with over five years to maturity. The fund can also invest in corporate bonds, overseas government bonds and fixed interest gilts. Exposure to short term exchange rate movements from any overseas holdings is mitigated by hedging. It aims to outperform its benchmark, the FTSE Actuaries UK Index-Linked Gilts Over 5 Years Index, by 0.75% a year (before charges) on a rolling three-year basis.	0.76
Prudential Index-Linked Passive	This fund invests via the M&G PP Index-Linked Passive Fund in UK Government index-linked gilts with over five years to maturity. The fund aims to track the performance of the FTSE Actuaries UK Index-Linked Gilts Over 5 Years Index as closely as possible.	0.66
Prudential International Equity	This fund invests via the M&G PP International Equity Fund in the shares of overseas companies. It aims to outperform its benchmark, an internal composite benchmark asset allocation set by the Prudential Portfolio Management by 1.0% a year (before charges) on a rolling three-year basis.	0.76
Prudential UK Property	This fund invests via the M&G PP UK Property Fund and the M&G UK Property Fund ("UKPF"), solely in UK property assets, including the retail, office, industrial and alternative sectors. The underlying fund aims to outperform its benchmark, the MSCI/AREF UK Quarterly Property Fund Index by 1.05% per year (gross of annual management charges) over rolling 3-year periods.	1.28
Prudential With Profits Cash Accumulation	The fund invests in fixed and variable interest investments, shares, property, cash and more complex financial instruments. The fund works in a different way to other unit-linked funds in that the manager smooths the returns to minimise volatility and offer minimum fund guarantees at retirement or in the event of death before retirement. The returns are fairly shared out by a system of bonuses and market value reductions.	0.8 (estimated)