Statement of Investment Principles

Introduction

This statement sets out the principles, which the Trustee of the ZF UK Pension Plan will follow in determining its investment policy for the purposes of the Plan. It has been prepared in accordance with the requirements of Section 35 of the *Pensions Act 1995 as amended* and the Occupational Pension Schemes (Investment) Regulations 2005 *as amended*. The statement is subject to periodic review by the Trustee, at least every three years and as soon as practicable following any significant changes in investment policy.

This revised statement was approved at a meeting of the Trustee Board held on 7th October 2021. The Principal Employer has been consulted. The investment principles set out in this statement will be reviewed periodically and revised as necessary. Prior to the preparation of this statement the Trustee has obtained and considered written advice from its appointed Investment Adviser, Hymans Robertson LLP, which is qualified to provide such advice.

Fund Managers

The Trustee does not take day to day investment decisions; the Board considers investment management to be a specialist activity that is most appropriately undertaken by professional managers. It has delegated responsibility for the selection and management of the Plan's assets to the following professional investment managers:

Liability Driven Investment Manager

- Legal & General Investment Management - equity and credit derivatives, interest rate and inflation hedging instruments and repurchase agreements, and cash instruments.

Credit Investment Managers

- M&G Investment Management – asset backed securities and secured loans.
- Barings – global high yield credit and private lending.
- Schroders – fixed income.
- Arcmont – private lending.

Property Managers

- CBRE Global Investors – indirect European property

Additional Voluntary Contribution (AVC) Managers

- Phoenix Life – Insured Additional Voluntary Contributions
- Clerical Medical – Insured Additional Voluntary Contributions
- Royal London – Insured Additional Voluntary Contributions
- Standard Life – Insured Additional Voluntary Contributions
- Prudential – Insured Additional Voluntary Contributions

All the above organisations are regulated by either or both of the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). They are all authorised under the Financial Services and Markets Act 2000 (as amended) to undertake investment business. The appointments are reviewed periodically.

The appointed investment managers are responsible for the day to day investment of their mandates (including the treatment of income) and are responsible for investing additional funds allocated to them or for disinvesting assets as required. In addition, they are responsible for maintaining suitably diversified portfolios.

The AVC managers are responsible for the investment of external AVC's. These were the appointed managers of legacy pension arrangements.

Investment Adviser

The Trustee has appointed an Investment Adviser, Hymans Robertson LLP, to assist it in determining and reviewing its ongoing investment policy. The Investment Adviser provides routine advice on the suitability of the Trustee's investments relative to its liabilities, and also assists the Trustee in reviewing the performance of its investment managers. This is a separate appointment to that of Hymans Robertson LLP as actuaries to the Plan.

The Board has appointed an Investment Sub-Committee (ISC), which is chaired by the Independent Trustee. The ISC comprises representatives from:

- The Trustee Board
- The Company
- The Plan Secretary

In addition, the Investment Adviser and the Company's investment advisers will be invited to attend meetings of the ISC.

The role of the ISC is to conduct in-depth research on investment strategies and to advise the Trustee on both its investment objectives and the strategies to achieve them. In addition, the ISC may exercise discretion over investment decisions that have been delegated to it by the Trustee.

The Trustee has appointed Hymans Robertson LLP to provide quantitative analysis of the Plan's assets and liabilities. The analysis is used by the ISC to monitor the performance of the Trustee's investment strategy, model the effect of proposed investment strategies and highlight risks.

Investment objectives

The Trustee's investment objectives are:

- To retain sufficient long-term, risk-controlled exposure to investment markets to help restore over time the Plan to a funding level of self-sufficiency.

- To achieve a rate of return from the assets of the Plan that is in excess of the movement in the Plan's liabilities by a combination of exposure to assets that may include:

    - Equity risk
    - Credit risk
    - Interest rate and inflation risk
    - Alternative asset classes (e.g. property, infrastructure) risk
    - Illiquidity and other market risks

- The acquisition of suitable assets of appropriate liquidity which will generate income and capital growth to meet the cost of the Plan's benefits as set out in the Plan's Trust Deed and Rules.

- To reduce the level of investment risk over time in order to lock in improvements in the Plan's funding position and to limit the risk of the assets failing to meet the liabilities over the long term.

The kind and balance of investments

The Trustee recognizes the long-term nature of its liability profile and appoints its collective managers to invest in a manner commensurate with generating long-term sustainable returns. The Trustee carry out necessary due diligence on the underlying investment decision making process, to ensure the manager makes investment decisions over an appropriate time horizon aligned with the asset class in which they invest and the Plan's objectives.

The Trustee, acting on the advice of its ISC, its Investment Adviser and the Plan's actuaries have put in place an investment structure whereby the Plan's liabilities determine the type of assets held by the Plan. This approach to investments is called 'liability driven investment' (LDI).

The central features of this strategy are as follows:

- To control the interest rate and inflation risk inherent in the Plan's liabilities by the implementation of swap contracts and repurchase agreements.

- To retain, as required, any exposure to credit markets through a combination of physical assets and derivatives.

- The controlled use of derivatives to increase the yield on the Plan's physical assets by taking credit risk.

- On an ongoing basis, approximately 50% of the Plan's physical assets are designed to support the LDI strategy, including:

    - Gilts
    - Index-linked Gilts
    - Repurchase agreements
    - Cash

- The remainder of the Plan's physical assets are a combination of:

    - Property
    - Asset backed securities
    - Secured loans
    - Global high yield credit and other fixed income
    - Private lending

In addition, the Trustee holds some cash in a liquidity fund to meet ongoing benefit and expenditure payments from the Plan. This cash will be topped up from time to time, as required. The Trustee considers the investments to be suitable to the Plan's stated objectives.

The asset allocation is monitored on a quarterly basis relative to an agreed target allocation. The Trustees have an informal threshold deviation of +/- 5% at asset class level with the exception of mandates currently being funded (such as private lending), with consideration of any rebalancing on a discretionary basis.

Risk

The Board recognises that the funding position of the Plan will be improved by a combination of investment returns and support from the Company. It, therefore, continues to take investment risk, in order to target long term outperformance relative to its liabilities.

An outline of the Board's attitude to risk is as follows:

- It considers interest and inflation risks to be so significant it has introduced an LDI strategy to limit its exposure in these areas. The investment manager responsible for implementing the LDI strategy is Legal & General Investment Management.

- The LDI investment manager is required to ensure suitable liquidity of assets for funding benefit payments and that there are sufficient assets, both in terms of liquidity and eligibility, to act as collateral for the Plan's derivatives obligations.

- The LDI assets have been so structured to manage counterparty risk to provide a level of protection against failure of any derivative counterparty. There are four main components to this counterparty risk protection:

    - Counterparties are limited to financial institutions on Legal & General Investment Management's approved panel.
    - All derivatives are marked to market, with collateral posted on a daily basis.
    - In order to manage the risk of any counterparty concentration, the underlying assets are structured to provide a measure of protection in the event of counterparty failure.
    - The ISC regularly reviews reports by Legal & General Investment Management on the risks associated with posting collateral to counterparties with a view to limiting exposures to counterparties whose credit quality may be deteriorating.

- The Board will take account of Environmental, Social and Governance issues, including climate change, when considering the appropriate investment strategy for the Plan.

- In order to further control risk, the Trustee has imposed the following restrictions:

  - Stock Lending is only permitted in circumstances where the loan is fully collateralised and the collateral meets strict acceptability requirements.
  - Constraints are placed on the use of derivatives, which may not be used for speculative purposes.
  - Certain types of investment are not permitted. These include commodities, works of art and precious metals.

Target Return on Investments

In the long term the LDI investment strategy is expected to deliver a return which either matches or exceeds the real rate of return assumed by the Plan's actuaries in assessing the funding of the Plan.

The Trustee will monitor the returns of each fund manager and asset class against an appropriate benchmark. Where appropriate, the individual benchmarks will be constructed using data provided by external index providers and will be independently verified by a recognised pension fund performance measurement company on behalf of the Trustee.

Monitoring is carried out on a quarterly basis and the Trustee considers performance over different time periods including a long-term time horizon. The Trustee seeks to understand the reason for any significant deviations away from benchmark or target.

The target returns and index benchmarks are as follows:

Manager/Asset class	Index	Target return over the index (p.a.)
Legal & General Investment Management		
LDI assets	Liability benchmark and credit benchmark	0.25%
CBRE Investors		
Property	Retail Prices Index	5%
M&G Investment Management		
Asset backed securities	SONIA	2.5%
Secured loans	SONIA	4%
Barings		
Global high yield credit	SONIA	5%
Private Lending*	SONIA	4%
Schroders		
Fixed income*	SONIA	3.5%
Arcmont		
Private Lending*	SONIA	4%

*target return for mandate set by Trustee

The target returns are goals and the investment managers do not guarantee they will be achieved.

Mandates to the Investment Managers

The Trustee has appointed each of its investment managers to deliver a specific benchmark or performance target, which overall will align to deliver the broader Plan investment strategy and long-term investment objectives. The Trustee ensures that all manager engagements have clearly defined benchmarks, objectives and management parameters. The Trustee will consider terminating the mandate if the manager fails to conform to the mandate set by the Trustee or to deliver performance in line with its objectives over the relevant time horizon.

Where appropriate, and where commercial considerations permit, the terms of the mandate and the basis on which the manager is engaged will be defined specifically for the Plan. Where such tailoring is not directly achievable, the Trustee will invest in pooled funds where the objectives of the fund and the policies of the investment manager will be evaluated by the Trustee to ensure they are appropriate for the needs of the Plan.

The Board has explicit written mandates with its investment managers. The managers are to invest the assets in accordance with the asset allocation benchmark and the Board's guidelines on risk control.

The duration of each mandate is determined by the Trustee at inception of the mandate. For segregated and open-ended investments, the Trustee generally engages managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Trustee expects the minimum duration of the appointment will be three years, this being the minimum period over which the Trustee considers performance of the mandate can be properly evaluated, although all mandates are subject to ongoing review against various financial and non-financial metrics in addition to their continued appropriateness within the investment strategy. For closed-ended investments, the Trustee expects the term of the appointment to be the lifetime of the investment.

The Trustee has expectations of the level of turnover within each mandate, based on the Trustee's knowledge of the manager, investment process and the nature of the portfolio. Whilst the Trustee expects performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustee expects managers to report at least annually on the underlying assets held within the portfolio and details of any transactions over the period. The Trustee will challenge its managers if there is a sudden change in portfolio turnover or if the level of turnover seems excessive. The Trustee will request turnover costs incurred by the asset manager over the Plan reporting year.

Investment Management Fees

The basis of fees agreed with Legal & General Investment Management in respect of the majority of the Plan assets is a fee defined as a percentage of the notional exposure plus a capped performance fee which, if applicable, varies based on excess performance and the level of assets.

The fee structure for the two private lending mandates is in two parts; a base management fee based on invested capital and a performance fee over a pre-specified hurdle.

The basis of fees agreed with the other investment managers is a percentage of the value of the portfolio controlled by the manager. This fee structure was chosen in order to compensate the manager appropriately in relation to the work undertaken on behalf of the Trustee.

The charging structures of the managers responsible for external AVC's are built into the historical group policy terms for each arrangement and are reflected in the value of individual members' AVC accounts.

Realisation of Investments

The majority of the Plan's assets are directly or indirectly invested in securities traded on major recognised investment exchanges. These investments can therefore be realised quickly, if necessary, although there would be a risk of capital loss. The Trustee's policy is that there should be sufficient investments in liquid or readily realisable assets to meet cash flow requirements, both for benefit payments and collateral calls, in the majority of foreseeable circumstances without realising the assets that cover derivatives. The Trustee's advisers monitor cash flow requirements explicitly using liquidity projections.

Statutory Funding Objective

In arriving at its investment principles account has been taken by the Trustee of the liabilities of the Plan in respect of pensioners and deferred pensioners together with the Plan's funding position. This has been done in relationship to the Plan's Statutory Funding Objective, which is that the Plan must have 'sufficient and appropriate' assets to cover the expected cost of providing members' past service benefits.

Details of the Plan's Statutory Funding Objective and its policy for securing that the objective will be met along with the Plan's funding method and actuarial assumptions are contained in the Plan's *Statement of Funding Principles*. The Plan's latest *Statement of Funding Principles was agreed* as part of its triennial actuarial valuation on 31 March 2018 and is available from the Trustee Secretary or via the Plan's website www.trwpensions.co.uk.

Responsible Investment

The Trustee recognises that the consideration of financially material factors, including ESG factors, is relevant at different stages of the investment process.

The Trustee considers strategies that provide a greater probability of delivering sustainable and predictable returns as likely to be most suitable, and this is reflected in the Trustee's approach to Responsible Investment.

The strategic asset allocation has been determined using appropriate economic and financial assumptions for different asset classes. These assumptions apply at a broad market level and are considered to implicitly reflect all financially material factors. The Trustee recognises that climate change could pose systemic risks which could in turn affect the returns achieved from the investment strategy.

The Trustee has not at this stage made explicit allowance for climate change in framing its strategic asset allocation, although this will be reviewed periodically. Instead, the Trustee does expect the active managers to take into account all financially material factors, including climate change, in the selection of assets within their portfolios and to be able to demonstrate their approach when challenged.

In appointing new active managers, the Trustee will explicitly consider the managers' ability to integrate the consideration of ESG factors within their investment process. The Trustee will also periodically review their investment managers and seek evidence that managers are meeting the Trustee's expectations.

In passive mandates, including derivative based 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 believes this approach is in line with the basis on which their current strategy has been set. The Trustee will review periodically the index benchmarks employed.

The Trustee has not imposed any constraints on the investment arrangements or managers employed relating to non-financial factors.

Stewardship & Engagement

The Trustee believes good management of companies should lead to more sustainable and predictable returns. The Plan no longer has any significant investments in company shares. In any event, the Trustee has delegated the exercise of any voting rights to the Plan's investment managers on the basis that voting rights should be exercised with the aim of preserving and enhancing long-term shareholder value. The investment managers provide reports on any votes cast to the Trustee on a quarterly basis. When appointing new managers, the Trustee will consider the managers' approach to voting and engagement.

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

As previously stated, responsibility for the day-to-day investment decisions and their execution has been delegated to investment managers, which includes consideration of the capital structure of investments and the appropriateness of any investment made. Where managers are responsible for investing in new issuance, the Trustee expects the 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 separately considers any conflicts of interest arising in the management of the Plan and its investments and will ensure that each manager has an appropriate conflicts of interest policy in place.

Custodian

The segregated assets of the Plan are held by the Trustee's appointed custodian, Bank of New York Mellon, and are under the control of the Trustee. The appointment is reviewed periodically.