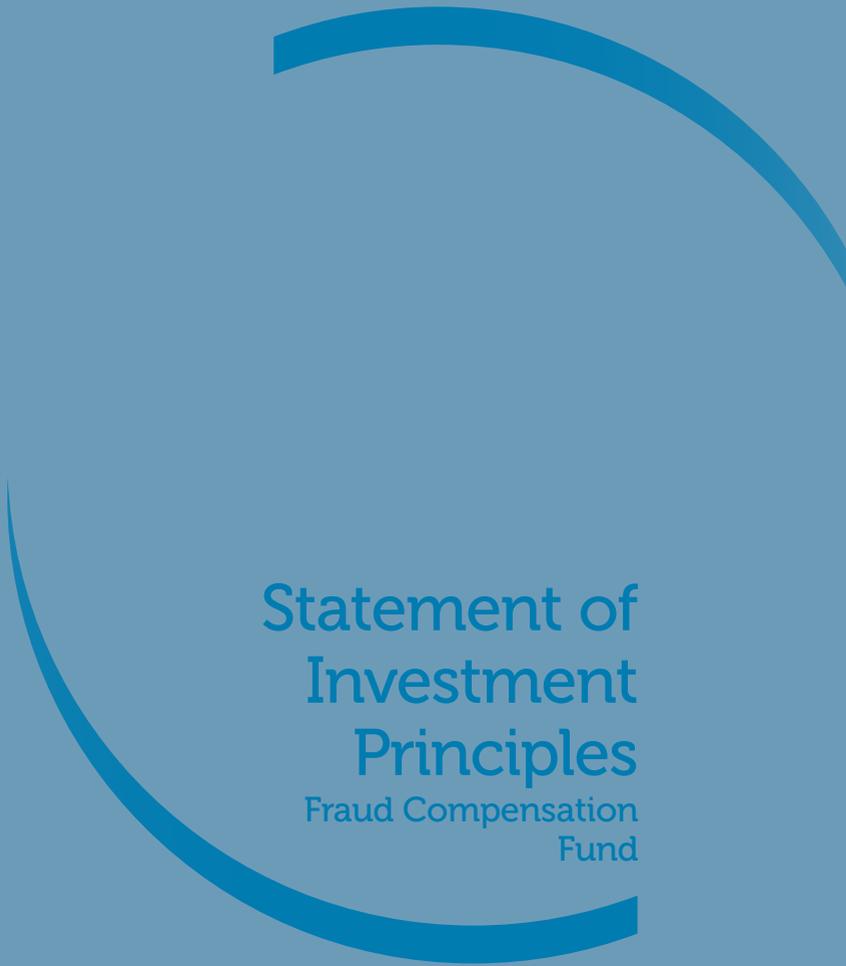




Pension
Protection
Fund

Protecting
people's futures



Statement of
Investment
Principles
Fraud Compensation
Fund

September 2020

This Statement of Investment Principles is produced to meet the requirements of the Pensions Act 2004 and to reflect industry best practice for institutional investment decision making. The Board also complies with the requirements to maintain and take advice on the Statement and with the disclosure requirements.

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1. Introduction

- 1.1** The Board of the Pension Protection Fund (“the PPF”) has prepared this Statement of Investment Principles (“the Statement”) in accordance with Section 114 of the Pensions Act 2004 (“the Act”) and the Pension Protection Fund (Statement of Investment Principles) Regulations 2005 (“the Regulations”).
- 1.2** This written statement outlines the principles and policies governing determinations about investments made by or on behalf of the PPF in the management of the assets of the Fraud Compensation Fund (“the Fund”). This Statement also takes account of industry best practice for institutional investment decision making.
- 1.3** This Statement will be reviewed annually or when there is, or the PPF anticipates that there might be, a significant change in relation to any matter contained in this Statement or to any of the matters which this Statement is required to cover by the Regulations.
- 1.4** This Statement is specifically concerned with the investment of:
- any property and rights transferred following dissolution of the Pensions Compensation Board which the PPF designates as assets of the Fund;
 - the accumulated fraud compensation levy contributions paid into the Fund;
 - interim payments;
 - fraud compensation payments;
 - fraud compensation transfer payments; and
 - money required for the repayment of, and payment of interest on interim payments.
- 1.5** This Statement will be published.

2. Governance of the Fraud Compensation Fund

2.1. Investment powers and compliance with the Pensions Act 2004

2.1.1. Section 113 of the Act provides that the PPF may invest for the purpose of the prudent management of its financial affairs. When exercising its power to invest, the PPF will consider the interests of members of occupational pension schemes in relation to whom a fraud compensation levy applies and the effect on the level of any levy and the interests of persons affected by the rate of such levy.

2.1.2. The PPF Board (“the Board”) is responsible for the governance and investment of the Fund’s assets. The Board is satisfied that it has sufficient expertise, information, and resources to carry out its role effectively. Several members of the Board have significant working experience in the investment industry.

2.1.3. In preparing this Statement, the Board has obtained and considered the written advice of individual specialists employed by the PPF, and its independent investment advisor (Redington). The Board is satisfied that those individuals have the appropriate knowledge and experience for providing advice

on the preparation or, as the case may be, revision of the Statement. The advice considers the matters prescribed under Section 114 of the Act and the Pension Protection Fund (Statement of Investment Principles) Regulations 2005. Actuarial advice relating to the assets and liabilities of the Fund is sought from the PPF’s Chief Actuary.

2.2. Investment Committee and Asset and Liability Committee

2.2.1. The funding strategy, which comprises a funding objective and a defined appetite for investment risk, are the responsibility of the PPF.

2.2.2. The PPF has established an Investment Committee to set an appropriate mix of assets consistent with the PPF’s funding objective and appetite for risk, and provide oversight of its implementation. The Investment Committee is accountable to the Board.

2.2.3. The initial investment strategy for the Fund is the responsibility of the PPF, acting on the recommendation of the Investment Committee and is driven by the PPF’s investment objective as set out in Section 3. The strategic management of the Fund’s assets is delegated to the Investment Committee. The Investment Committee has

2. Governance of the Fraud Compensation Fund

continued

delegated authority from the Board to implement and generally ensure adherence to the strategic investment policy. The Investment Committee also has responsibility for the allocation of the Fund's assets held between the various available fund managers' funds and accounts.

2.2.4. The Chief Executive has also established an executive committee, the Asset and Liability Committee ("ALCO"), to oversee the day to day investment activities of the Fund.

2.3. Day to day fund management

2.3.1. The day to day fund management of the assets is performed by both external professional fund managers (each of whom is authorised and regulated by the Financial Conduct Authority or a similar local regulatory authority as required) and the Chief Investment Officer, with authority to delegate

to an in-house team of investment professionals, appointed in accordance with Section 113 of the Act. The Investment Committee satisfies itself that the appointed external and in-house fund managers have the appropriate knowledge and experience to carry out their role in accordance with Section 113(6) of the Act. More detail is contained in Section 6.1.

2.3.2. The Investment Committee approves the framework for, and oversees the appointment, monitoring, funding, termination and performance of, the professional fund managers. ALCO is responsible for confirmation of the selection and funding of managers and monitoring performance.

3. Strategic Management of the Fund's Assets and investment objective

- 3.1 The PPF's primary investment objective is to have sufficient funds to pay compensation under the Act to members of eligible occupational pension schemes where the scheme assets have been reduced as a result of an offence involving dishonesty.
- 3.2 This objective is to be met by the Fund achieving a balance between protecting and securing the compensation payments for actual and potential members of eligible schemes whilst setting a fair and proportionate levy.

4. Risk measurement and management

- 4.1** The PPF will assess and consider the following risks on an ongoing basis:
- **Cash flow risk**
The risk of a shortfall of liquid assets relative to the immediate liabilities. The Board and its advisers will manage the Fund's cash flows taking into account the timing of future payments and may borrow over the short term, in order to minimise the probability that this shortfall occurs.
 - **Fund manager risk**
The failure by the fund managers to achieve a rate of investment return consistent with the investment objectives of their funds. This issue has been considered by the PPF on the initial appointment of the fund managers. This risk is mitigated through a robust manager selection and monitoring process.
 - **Environmental, Social and Governance (ESG) risk**
This is the risk that material issues or events related to environmental, social or governance concerns can have a significant impact on the long-term performance of assets. For example, climate-related risks (such as policy risks, physical risks or transition risks) are perceived to be systemic in nature, with the potential to impact businesses, markets and economies globally in a number of ways. ESG risk is mitigated through a responsible investment framework that integrates ESG considerations, including performing due diligence during the manager selection process and ongoing monitoring of portfolios against contractual ESG requirements.
- These risks are monitored on a periodic basis by the Investment Committee.

5. Investment Strategy

- 5.1.** The PPF regards the selection of asset classes as the decision which has most influence on its ability to achieve its investment objectives.
- 5.2. Establishing the strategic asset allocation**
- 5.2.1.** The strategic asset allocation is set by taking into account the nature and timing of both actual and potential future liabilities. The nature and timing of these liabilities are driven by acts of fraud or misappropriation of assets. These events are by their very nature, unknowable in advance and are driven by idiosyncratic factors and any liability arising from a claim is short term in nature. Therefore, the strategic asset allocation includes cash, deposits and other money market instruments.
- 5.2.2.** The PPF has considered manager risk and therefore will hold the assets with at least two fund managers, as required by Section 113(4) of the Pensions Act 2004.
- 5.2.3.** The liabilities of the PPF will change periodically as a result of the PPF accepting the legal obligation to pay compensation to occupational pension schemes.
- 5.2.4.** This asset allocation strategy is believed to be appropriate to meet the investment objectives set out in 3.1 above, whilst mitigating the investment risks set out in 4 above.
- 5.2.5.** The strategy will be reviewed annually by the Investment Committee. An earlier review may be conducted in the event of any significant change in capital markets, the liabilities of the Fund, or in governing legislation.
- 5.3. Rebalancing policy and cash flow**
- 5.3.1.** All assets are to be invested in cash, deposits or other money market instruments.
- 5.3.2.** The PPF is satisfied that the spread of assets, the fund managers' policies on investing in individual securities and the PPFs investment guidelines to fund managers provide adequate diversification of investments. The PPF is also satisfied that the mandates awarded to the fund managers mean that the majority of assets held will be readily realisable to provide cash to meet payments by the Fund.
- 5.3.3.** To assist with cash flow management the PPF also has the power to undertake borrowing, with a ceiling of £25m.

6. Day to day investment management of the assets

6.1. Fund management

- 6.1.1. For the management of the portfolios, the PPF employs the services of investment experts as its external and internal fund managers and has specified investment guidelines to control the level of day to day decision making. The fund managers make their investment decisions independently of the PPF. The external fund managers are selected by a competitive tender process.
- 6.1.2. The external fund managers are selected by a competitive tender process. As part of this selection, due diligence is performed to ensure that each fund manager has sufficient expertise and experience to carry out their role. This includes an operational due diligence assessment of the manager's operational infrastructure, processes and controls supporting the management of the PPF's investment. As part of the procurement process, fund managers are expected to comply with the PPF's ESG requirements (see Section 8) as a minimum and, furthermore, managers are evaluated on the strength of their responsible investment practices.
- 6.1.3. Fund managers' activities are defined and constrained by detailed agreements, to ensure that each fund manager is fully aware of the PPF's particular objectives, time horizons and expectations. This is to align the fund managers' investment approach with that of PPFs, and to ensure that each manager is appropriately incentivised to meet these requirements.
- 6.1.4. Where appropriate, manager agreements will explicitly incorporate the PPF's ESG requirements on issues relating to responsible investment, such as integration of material ESG considerations into assessments of issuers; stewardship practices including engagement and voting activities; exclusions; and reporting.
- 6.1.5. On an ongoing basis, the PPF conducts regular manager monitoring and holds review meetings with each of the managers, to review performance against set objectives and discuss portfolio positioning and future outlook. The PPF's manager monitoring includes periodic reviews of each manager's operational processes and controls. Managers are also required to report against the PPF's ESG

requirements, and are expected to update their responsible investment approach in line with best practice.

6.1.6. The fund managers are set a specific benchmark and performance objective by the PPF. Fund manager performance and risks are monitored by ALCO. Material or unexpected deviations may result in a formal review.

6.2. Investment performance benchmark

6.2.1. The investment performance benchmark reflects the strategic asset allocation as follows:

Asset Class	Cash
Weight	100%
Benchmark	SONIA

6.2.2. The PPF's expected return on investments is broadly equivalent to the return on the benchmark.

6.3. Fund manager fees

6.3.1. The PPF will pay such fees and expenses as are negotiated with external fund managers from the Fund in accordance with the Pension Protection Fund (Payment to meet Investment Costs) Regulations 2005.

6.3.2. The fund managers are currently remunerated by an ad valorem fee based on the level of assets under management.

6.3.3. The costs of management and transactions will be reviewed from time to time, and if appropriate, renegotiated. Where relevant, appropriate levels of turnover may be determined and monitored to ensure they remain within the PPF's expectations for that particular mandate.

7. Day to day custody of the assets

- 7.1. Custodians provide safekeeping for assets and perform the associated administrative duties e.g. trade settlement, dividend collection, corporate actions, tax reclamation and proxy voting. For the pooled fund investments in which the Fund invests, each investment manager is responsible for the appointment of custodians.

8. Responsible investment and corporate governance

- 8.1** The PPF's primary concern, in setting its investment strategy, is to act in the best financial interests of the Fund and its beneficiaries, seeking the best return that is consistent with a prudent and appropriate level of risk. The Fund's investments consist of cash and cash instruments.
- 8.2** The PPF believes that in order to fulfil this commitment and to protect and enhance the value of the Fund's investments, it must act as a responsible and vigilant asset owner and market participant.
- 8.3** The PPF further believes that environmental, social and governance (ESG) factors can have an impact on the performance of its investments, and that the management of ESG risks and exploitation of ESG opportunities, particularly for a portfolio-wide issue like climate change, can add value to its portfolio.
- 8.4** The PPF defines ESG factors as the interaction of its investments with:
- the physical environment (environmental);
 - communities, workforces, wider society and economies (social);
 - the governance structures of the organisations and markets it invests in, as well as of its agents (governance, including corporate governance).
- 8.5** The PPF is a signatory to the UN-supported Principles for Responsible Investment (PRI), a set of best practice principles on responsible investment. The Board intends to use these Principles as a benchmark with which to guide its own approach to responsible investment, and in doing so, will seek to apply responsible investment practices across all the assets in which it invests.
- 8.6** The PPF will integrate the consideration of material ESG and climate-related issues across all asset classes and markets in which it invests. The PPF expects its fund managers, where appropriate, to have integrated material ESG factors, including climate-related risks, as part of their investment analysis and decision-making process. Appropriate weight will be given to ESG policies, processes, stewardship activities and reporting in the appointment of fund managers. The PPF will engage with and hold fund managers to account in this regard as part of its regular monitoring process.

8. Responsible investment and corporate governance continued

- 8.7.** The PPF will also demonstrate appropriate stewardship activities through responsible allocation, engagement, and monitoring of its fund managers, investee companies and other agents. In particular the PPF, or its agents on its behalf, will exercise its ownership rights, including access to company management and voting rights on matters including capital structure, risk, strategy, performance, social and environmental issues (including climate change) and corporate governance, in order to safeguard sustainable returns. Where there is a potential for any conflicts of interest, the PPF expects its external agents to identify and manage any conflicts in accordance with Principle 3 of the FRC's UK Stewardship Code, putting the best interests of clients and beneficiaries first.
- 8.8.** The PPF expects its fund managers, where appropriate, to have integrated ESG factors as part of their investment analysis and decision-making process. Appropriate weight will be given to ESG factors in the appointment of fund managers. The PPF will hold fund managers to account in this regard as part of its regular monitoring process.
- 8.9.** In line with its commitment to transparency, the PPF will report to its stakeholders on its responsible investment activities.

9. Compliance with this statement

- 9.1** The Investment Committee will monitor compliance with this Statement annually. The Investment team and Compliance team will obtain written confirmation from both the external and in-house fund managers that they have complied with this Statement as supplied to them and will advise the fund managers promptly and in writing of any material change to this Statement.
- 9.2.** The National Audit Office will audit and monitor compliance as part of its annual review of the Fund's accounts and statement of internal control.

Annex 1

Investment guidelines and benchmarks

Benchmark 100% SONIA

Allowable investments

- Cash
- Deposit account
- Money market account
- Cash and money market funds

Annex 2

Governance structure

The Board is responsible for:

- Setting structures and processes for carrying out its role
- Setting the investment framework, including objectives and an acceptable investment risk appetite within that framework
 - Securing that this Statement is reviewed and, if necessary, revised, at prescribed intervals, and obtaining and considering the written advice of the investment adviser, the Fund's actuary and legal adviser and modifying it if deemed appropriate
- Initial appointment of fund managers
- Establishing an initial investment strategy
- Reviewing the content of this Statement
- Providing oversight of the Investment Committee

The Investment Committee is responsible for:

- Developing the Fraud Compensation Fund's investment principles and strategy under section 188 of the Pensions Act 2004
- Approving revisions to the Fraud Compensation Fund's Statement of Investment Principles or recommending changes, where these are material, to the Board
- Developing and maintaining the Fund's RI principles
- Developing and overseeing the overall approach to investment risk management, including appropriate delegations and periodic reviews within the framework agreed by the Risk and Audit Committee.
- Overseeing the implementation of the risk within the framework set by the Risk and Audit Committee and investment strategies. Maintaining and engaging in a forward looking review of strategic risks and opportunities.
- Approval of the framework and oversight of the appointment, retirement and contractual review of the fund managers (as defined in section 113(5) of the Act) including the assessment of appropriate knowledge and experience under section 113 (6) of the Act
- Approval of the framework for the appointment, retirement and contractual review of any investment advisers appointed under section 114 of the Act and regulation 3 of the Pension Protection Fund (Statement of Investment Principles) Regulations 2005 SI 2005/675.
- Approving and overseeing the framework for the appointment, retirement and contractual review of the custodian to the Fund
- General oversight of the investment performance

Annex 2

continued

Governance structure continued

The Asset and Liability Committee is responsible for:

- Monitoring the implementation of the investment strategy and this Statement
- Confirmation of the appointment, funding, termination (for reasons other than redemption or divestment) and contractual review of the fund managers (as defined in Section 113(5) of the Act) including the assessment of appropriate knowledge and experience under Section 113(6) of the Act
- Confirmation of the appointment, retirement and contractual review of any investment advisers
- Confirmation of the appointment, retirement and contractual review of the custodian to the Fund
- Reviewing on a monthly basis the investment managers' investment Performance and compliance with investment mandates and short term strategies
- Monitoring the performance of the custodian to the Fund
- Recommending to the Investment Committee changes to asset allocation, fund mandates and fund managers

The investment team is responsible for:

- Advising on all aspects of the investment of the Fund assets including implementation of strategy
- Providing updates on the fund managers and their likelihood of achieving the performance objectives
- Advising on this Statement
- Providing training in investment matters to the Board

The fund managers are responsible for:

- Discretionary management of the portfolio, including implementation (within guidelines given by the Investment Committee) of changes in the asset mix and selecting securities within each asset class
- Providing the PPF with quarterly statements of the assets together with a quarterly report on actions and future intentions, and any changes to the processes applied to their portfolio
- Informing the PPF of any changes in the internal objectives and guidelines of any pooled funds used by the Fund as soon as practicable
- The safekeeping of the assets within the pooled funds in which the Fund invests
- Investing income paid to the Fund in a timely manner
 - Reconciling the manager's record of assets held with those of the Custodian

The investment advisers are responsible for:

- Advising on this Statement
- Providing training in investment matters to the Board

The custodian is responsible for:

- The safekeeping of all the directly held assets of the Fund
- Undertaking all appropriate administration relating to the held assets of the Fund
- Processing all income with respect to the Fund in a timely manner
- Processing all tax reclaims in a timely manner
- Investing cash in a suitable low risk manner consistent with the provision set out in the investment management agreements as agreed by the PPF
- Reconciling records of assets held with those of the managers



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