

# **STATEMENT OF INVESTMENT PRINCIPLES – AUGUST 2020**

## **HAWKER PACIFIC AEROSPACE PENSION PLAN**

### **1. Introduction**

Lufthansa UK Pension Trustee Limited (the “Trustee”), as sole corporate Trustee of the Hawker Pacific Aerospace Pension Plan (the “Plan”), has drawn up this Statement of Investment Principles (the “Statement”) to comply with the requirements of the Pensions Act 1995 and associated legislation including the Occupational Pension Schemes (Investment) Regulations 2005 (as amended).. The Statement sets out the principles that underlie the Trustee decisions about the investment of the Plan’s assets.

In preparing this Statement, the Trustee has consulted the Principal Employer, Lufthansa Technik Landing Gear Services UK Limited, as sponsor of the Plan (the “Sponsor”) and has taken the Sponsor’s views into account in setting the objectives and strategy. The Trustee’s will continue to consult the Sponsor whenever the Statement is reviewed.

Overall investment policy falls into two parts; the strategic management of the assets, which is fundamentally the responsibility of the Trustee, and the day-to-day management of the assets, which is delegated to professional investment managers.

The Trustee will review this Statement at least once every three years to ensure that it continues to represent the principles employed to invest the Plan’s assets. This Statement will also be updated if there are relevant, material changes to the Plan and/or the Sponsor. The asset allocation of the Plan will be changed by the Trustee as and when it is appropriate to do so within the principles set out in this Statement.

### **2. Plan Governance**

The Trustee’s investment responsibilities are governed by the Plan’s Trust Deed. The Trustee is accountable for the investment of the Plan’s assets, including the setting of appropriate investment objectives and establishment of a long term investment strategy. The Trustee has appointed a firm of professional investment consultants to provide investment advice to the Trustee.

The implementation of the strategy determined by the Trustee has been delegated to the Lufthansa Group UK Investment Sub-Committee (the “ISC”).

The ISC’s role is to assist the Trustee in addressing the investment issues relating to the Plan, and to ensure that the management of the Plan’s assets is consistent with this Statement and any other guidelines set by the Trustee. The ISC was created in order both to ensure that investment matters receive a sufficient degree of attention and to achieve economies of scale across a number of Lufthansa Group UK pension schemes. A copy of the Terms of Reference of the ISC is available on request from the Plan administrators.

Decisions relating to the day-to-day management of the Plan’s assets are delegated to Mercer who act as a discretionary investment manager. In this capacity, and subject to guidelines agreed with

the Trustee, the Plan's assets are invested in multi-client collective investment schemes ("Mercer Funds") managed by a management company (Mercer Global Investments Management Limited ("MGIM")). MGIM has appointed Mercer Global Investments Europe Limited ("MGIE") as investment manager of the Mercer Funds. In practice, MGIE delegates the discretionary investment management for the Mercer Funds to third party investment managers based in countries such as Ireland, UK and USA and those sub-investment managers will manage either a sub-fund or certain segments of a sub-fund.

The Trustee has taken steps to satisfy itself that Mercer and MGIE have the appropriate knowledge and experience for managing the Plan's investments and is carrying out its work competently.

The safe custody of the Plan's assets is delegated to professional custodians via the use of pooled vehicles.

### **3. Investment Policy**

#### **3.1. Investment Objectives**

The Trustee's investment objectives guide the strategic management of the assets. These objectives aim to control the various risks to which the Plan is exposed.

The Trustee's primary objective is to ensure that the assets of the Plan are sufficient to meet the obligations to beneficiaries. It has been agreed to target full funding on a gilts + 0.5% p.a. liability valuation basis by 2026 or earlier, which was chosen as a prudent low risk funding target

Once this target has been achieved, the Trustee expects to be in a position where:

- The likelihood of future cash calls on the Sponsor are significantly reduced
- The dependency on the covenant of the Sponsor will be reduced
- The risk in the investment portfolio will be reduced and managed more closely in line with liabilities

The Trustee has decided to adopt a set of funding level triggers to de-risk the Plan's assets relative to liabilities as the funding level improves. The funding target may be updated from time to time following appropriate consultation with the Sponsor. Non-financial considerations are discussed in section 7.

The objectives set out above and the risks and other factors referenced in this Statement are those that the Trustee determine to be financially material considerations in relation to the Plan. Non-financial considerations are discussed in section 7.

#### **3.2. Investment Strategy**

The Trustee has put into place a de-risking framework to achieve the Plan's long-term funding objectives. This comprises a number of funding level triggers, which reference a 'required return' to achieve the long-term funding objectives. The required returns provide guidance on when to de-risk the Plan's assets in terms of the switch from growth to matching assets. The Trustees have also implemented a downside monitoring trigger, which if breached will result in discussion around whether any further action is required in response to a deterioration of the funding position. Full

details on the Plan's funding level triggers for de-risking are outlined in the Plan's Investment Policy Implementation Document.

### 3.3. Investment Structure

Due to the de-risking framework in place, the Plan's strategic allocation will change over time. The strategic split of the Plan assets as at 31 July 2020 is set out below. The IPID summarises the strategy currently in place.

#### Plan Strategic Allocation as at 31 July 2020

Asset Class	Strategic Allocation (%)
Multi-Asset Credit	5.0
Absolute Return Fixed Income	10.0
Corporate Bonds/Tailored Credit	43.5
Liability Driven Investment ("LDI")	41.5
<b>Total</b>	<b>100.0</b>

### 3.4 Risk

There are various risks to which any pension scheme is exposed. The Trustee's policy on risk management over the Plan's anticipated lifetime is as follows:

*Mismatch risk* – The Trustee invests in growth fixed income asset classes (multi-asset credit and absolute return fixed income) which are expected to demonstrate volatility when compared to the development of the Plan's liabilities. The Trustee's target is for the Plan to be 95% hedged with regards to interest rates and inflation on a gilts flat basis, thereby somewhat, but not fully mitigating the impact of the liabilities reacting differently to changes in interest rates and inflation relative to the Plan's assets. Furthermore, it is acknowledged, that while a pro-rata hedge of liabilities is targeted, there will be a degree of mismatch risk arising from differences in the profile of the hedging assets relative to the liabilities, due to the practicalities of hedging and lack of availability of hedging assets at all tenors. To manage this risk, the Trustee is provided with monthly updates on the funding position and quarterly updates on the investment strategy, which will provide information on the Plan's assets relative to the liabilities.

*Manager risk* – The risk that the day to day management of the assets will not achieve the rate of investment return expected by the Trustee. The Trustee monitors the MGIE funds' and underlying managers' performances on a regular basis, and compares the investment returns with the appropriate performance objectives to ensure continuing acceptable performance. The Trustee recognises that the use of active management involves additional risk. However, the Trustee believes that in some asset classes this risk is outweighed by the potential gains from successful active management.

*Liquidity risk* – The pooled funds through which the Trustee invests makes due allowance of the need for liquidity of the Plan's assets.

*Concentration risk* – The Trustee has adopted a strategy that ensures that the risk of an adverse influence on investment values from the poor performance of a small number of individual investments is reduced by diversification of the assets;

- by asset class (corporate bonds, government bonds, etc.)
- by region (UK, overseas, etc.)

*Currency risk* – At the total asset portfolio level, the Trustee ensures that at least 75% of the Plan's assets are in sterling. There will be a limited amount of foreign currency exposure via the absolute return fixed income and multi-asset credit funds.

*Counterparty risk* – Derivatives will be employed in the Plan's liability hedging mandate for the purposes of efficient portfolio management. These derivatives are likely to be traded directly with other counterparties, which gives rise to counterparty risk, namely the risk that the counterparty is unable to honour their commitment at the maturity of the derivative contract. The underlying managers mitigate this risk by restricting their trading to 'high quality' counterparties (i.e. those with the lowest chance of defaulting), trading across a number of high quality counterparties, and by ensuring margin is posted by these counterparties (to lower the risk of default).

*Collateral adequacy risk* – As derivative instruments are used to hedge the Plan's liabilities, leverage will be employed in the liability hedging mandate. Using leverage means small changes in underlying conditions can produce larger changes in the value of the Plan's investment than if only physical assets were held (i.e. there is an implied 'lever effect'). Collateral adequacy is therefore the risk that underlying conditions negatively impact the Plan to the extent that additional assets will need to be used to support the use of derivatives. The underlying managers monitor this risk on an ongoing basis and will inform MGIE should additional collateral be required for the Plan's liability hedging mandate.

*ESG risk* - The Trustee recognises that environmental, social and corporate governance (ESG) concerns, including climate change, have a financially material impact on return. Section 7 sets out how these risks are managed.

*Sponsor risk* – This is assessed as the level of ability and degree of willingness of the Sponsor to support the continuation of the Plan and to make good any current or future deficit. It is managed by assessing the interaction between the Plan and the Sponsor's business, as measured by a number of factors, including the creditworthiness of the Sponsor and the size of the pension liability relative to the Sponsor.

The following risks are also recognised by the Trustee:

- The risk of a deterioration in the value of the Plan's assets;
- The risk of changes in the value and profile of the liabilities in relation to the value and profile of the assets;
- The risk that the assets will not achieve the rate of investment return expected by the Trustee. This could lead to a higher than expected cost to the Sponsor;
- Associated with the above, the risk of volatility in the level of Sponsor contributions and the implications of this to the Sponsor and the security of members' benefits.

The Trustee will continue to monitor and consider these risks as part of any investment discussions.

#### **4. Cashflow and Rebalancing Policy**

Following suitable advice from the investment consultant, the Trustee has put into place a regular cash flow management policy for the Plan's administrators to follow. MGIE will use its discretion on where to source disinvestments and invest monies as and when they are required. Disinvestments and investments will be made in accordance with the Plan's strategic asset allocation as outlined above.

If there is to be a deviation from this policy, Mercer will contact the Trustee and seek its approval.

#### **5. Buying and Selling Investments**

The Trustee on behalf of the Plan hold shares in the Mercer Funds. In its capacity as investment manager to the Mercer Funds, MGIE, and the underlying third party asset managers appointed by MGIE, within parameters stipulated in the relevant appointment documentation, have discretion in the timing of the realisation of investments and in considerations relating to the liquidity of those investments.

The Trustee has delegated the responsibility for buying and selling investments to MGIE (in its capacity as investment manager of the Mercer Funds) and the underlying third party asset managers appointed by MGIE within parameters stipulated in the relevant appointment documentation. The day to day activities that they carry out are governed by the Plan's Investment Management Agreement. This will be reviewed from time to time to ensure that the operating instructions, guidelines and restrictions remain appropriate.

#### **6. Monitoring the Investment Managers**

Every quarter a performance report will be produced presenting the performance of both the overall MGIE fund and underlying sub-funds. Changes and/or developments at the underlying investment managers will also be reported as part of this quarterly report.

#### **7. Responsible Investment and Corporate Governance**

The Trustee believe that good stewardship and environmental, social and governance ("ESG") issues may have a material impact on investment returns. The Trustee has given the investment managers full discretion when evaluating ESG issues and in exercising rights and stewardship obligations attached to the Plan's investments.

As noted above, the Trustee has appointed Mercer to act as discretionary investment managers in respect of the Plan's assets and such are invested in a range of Mercer Funds managed by MGIE. Asset managers appointed to manage the Mercer Funds are expected to evaluate ESG factors, including climate change considerations. Similarly, the Plan's voting rights are exercised by its investment managers in accordance with their own corporate governance policies, and managers are expected to take account of current best practice including the UK Corporate Governance Code and the UK Stewardship Code.

The Trustee increasingly considers how ESG, climate change and stewardship is integrated within Mercer's and MGIE's investment processes and those of the underlying asset managers in the monitoring process. Mercer and MGIE are expected to provide reporting to the Trustee on a regular basis, at least annually, on ESG integration progress, stewardship monitoring results, and climate-

related metrics such as carbon footprinting for equities and/or climate scenario analysis for diversified portfolios.

Member views are not taken into account in the selection, retention and realisation of investments, but members have a variety of methods by which they can make views known to the Trustee. This position is reviewed periodically.

The Trustee has not set any investment restrictions in relation to particular Mercer Funds.

#### **8. Trustee policies with respect to arrangements with, and evaluation of the performance and remuneration of, asset managers and portfolio turnover costs**

When engaging Mercer as discretionary investment manager to implement the Trustees' investment strategy outlined in section 3.2, the Trustee is concerned that, as appropriate and to the extent applicable, Mercer is incentivised to align its strategy and decisions with the profile and duration of the liabilities of the Plan, in particular, long-term liabilities.

As Mercer manages the Plan's assets by way of investment in Mercer Funds, which are multi-client collective investment schemes, the Trustee accepts that they do not have the ability to determine the risk profile and return targets of specific Mercer Funds but the Trustee expects Mercer to manage the assets in a manner that is consistent with the Trustees' overall investment strategy as outlined in section 3.2. The Trustee has taken steps to satisfy themselves that Mercer has the appropriate knowledge and experience to do so and keeps Mercer's performance under ongoing review.

Should Mercer fail to align its investment strategies and decisions with the Trustee's policies, it is open to the Trustee to disinvest some or all of the assets invested managed by Mercer, to seek to renegotiate commercial terms or to terminate Mercer's appointment.

To evaluate performance, the Trustee receives, and considers, investment performance reports produced on a quarterly basis, which presents performance information and commentary in respect of the Plan's funding level and the Mercer Funds in which the Trustee is invested. Such reports have information covering fund performance for the previous three months, one-year, three years and since inception as applicable. The Trustee reviews the absolute performance and relative performance against a portfolio's and underlying investment manager's benchmark (over the relevant time period) on a net of fees basis. The Trustee's focus is on the medium to long-term financial and non-financial performance of Mercer and the Mercer Funds.

Neither Mercer or MGIE make investment decisions based on their assessment about the performance of an issuer of debt or equity. Instead, assessments of the medium to long-term financial and non-financial performance of an issuer are made by the underlying third party asset managers appointed by MGIE to manage assets within the Mercer Funds. Those managers are in a position to engage directly with such issuers in order to improve their performance in the medium to long term. The Trustee is, however, able to consider Mercer's and MGIE's assessment of how each underlying third party asset manager embeds ESG into their investment process and how the manager's responsible investment philosophy aligns with the Trustees' own responsible investment policy. This includes the asset managers' policies on voting and engagement.

Section 7 provides further details of the steps taken, and information available, to review the decisions made by managers, including voting history and the engagement activities of managers

to identify decisions that appear out of line with a Mercer Fund's investment objectives or the objectives/policies of the Plan.

The asset managers are incentivised as they will be aware that their continued appointment by MGIE will be based on their success in meeting MGIE's expectations. If MGIE is dissatisfied then it will, where appropriate, seek to replace the manager.

The Trustee is a long-term investor and are not looking to change their investment arrangements on an unduly frequent basis. However, the Trustee does keep those arrangements under review, including the continued engagement of Mercer using, among other things, the reporting described above.

The Trustee monitors, and evaluates, the fees it pays for asset management services on an ongoing basis taking into account the progress made in achieving its investment strategy objectives as outlined in section 3.1. Mercer's, and MGIE's, fees are based on a percentage of the value of the Plan's assets under management which covers the design and annual review of the de-risking strategy, and investment management of the assets. In addition, the underlying third party asset managers of the Mercer Funds also charge fees based on a percentage of the value of the assets under management. In some instances, some of the underlying managers may also be entitled to charge fees based on their performance.

MGIE reviews the fees payable to third party asset managers managing assets invested in the Mercer Funds on a regular basis with any negotiated fee savings passed directly to the Plan. Mercer's, MGIE's, and the third party asset managers', fees are outlined in a quarterly investment strategy report prepared for the Trustee, excluding performance-related fees and other expenses involved in the Mercer Funds not directly related with the management fee.

Details of all costs and expenses are included in the Mercer Funds' Supplements, the Report & Accounts and within the Plan's annualized, MiFID II compliant Personalised Cost & Charges statement. The Plan's Personalised Cost & Charges statement also include details of the transaction costs associated with investment in the Mercer Funds.

The Trustee does not have an explicit targeted portfolio turnover range, given the de-risking mandate, but rebalancing ranges have been designed to avoid unnecessary transaction costs being incurred by unduly frequent rebalancing. Performance is reviewed net of portfolio turnover costs, with the review of portfolio turnover of the underlying investment managers undertaken by MGIE.

## **9. Additional Voluntary Contributions ("AVC's")**

Members' AVCs are governed under the Trust Deed and Rules of the Plan. These AVC's are separately invested in insurance policies held by the Trustee with Utmost Life Life and Legal & General. With effect from 31 October 2011 the AVC facility closed to new entrants. The Legal & General AVC facility has remained open for those members who were actively contributing as at Plan closure, but no new contributors are permitted. The Trustee will review the AVC arrangements from time to time.

#### **10. Compliance with this Statement**

The Trustee will monitor compliance with this Statement on a regular basis and at least once every three years. The Statement will be reviewed in response to any material change to any aspects of the Plan, its liabilities, finances and the attitude to risk of the Trustee and Sponsor which they judge to have a bearing on the stated policy.

Signed for and on behalf of the Lufthansa UK Pension Trustee Limited A/C as Trustee to the Hawker Pacific Aerospace Pension Plan

Olaf Behn

Clive Grimley

Signed

Signed

29 September 2020  
Date

29 September 2020  
Date