Statement of Investment Principles

Civil Service Additional Voluntary Contributions - closed schemes

Prepared by the Government Actuary's Department for the Cabinet Office on 28 September 2023

Contents

1. Introduction

1.1 This Statement has been prepared by the Cabinet Office in its capacity as the Appointee responsible for the discharge of all duties relating to the statutory Civil Service Additional Voluntary Contributions (AVC) Scheme. This Statement is in respect of the Civil Service AVC scheme policies that are closed to new members and closed to further contributions in respect of accruing investments. The Civil Service AVC arrangement that is open to contributions uses a commercial master trust and the Trustees of that master trust have their own Statement of Investment Principles. This Statement sets down the principles which govern the decisions about the investments that enable the Scheme to meet the requirements of:

- The Pensions Act 1995, as amended by the Pensions Act 2004;
- The Occupational Pension Schemes (Investment) Regulations 2005 as amended by the Occupational Pension Schemes (Investment) (Amendment) Regulations 2010 and the Occupational Pension Schemes (Charges and Governance) Regulations 2015;

and

- incorporates changes as required by The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018.

1.2 This Statement has been designed to cover the fundamental aspects of investment policy, which are not expected to differ greatly from one year to the next. The Cabinet Office has obtained advice on the content of this Statement from the Government Actuary's Department and its legal advisors. This statement has been prepared with regard to guidance from the Pensions Regulator on the investment of defined contribution and AVC assets.

1.3 This statement will be reviewed at least every 3 years or if there is a significant change in any of the areas covered by this statement.

1.4 The Cabinet Office will ensure that investments are made in line with rule 4.1 (a), of the Civil Service AVC rules[1].

[1] Civil Service Additional Voluntary Contribution Scheme (civilservicepensionscheme.org.uk)

2. Investment policy

2.1 The Cabinet Office is responsible for ensuring that the value of members' savings grows over the longer term by making available a diversified range of funds. This acknowledges that members will have different attitudes to risk and different aims for accessing their AVCs, therefore, whilst seeking good member outcomes net of fees, it also considers the level of risk that is appropriate based on the anticipated needs of the membership of the schemes.

2.2 The AVC scheme policies are well established and closed to new members. They are not receiving any contributions, except in respect of life assurance premiums. In 2018 a consolidation exercise was undertaken whereby a bulk transfer of members took place out of these legacy AVCs into a master trust arrangement. Members had the right to opt out, and members using with profits funds and with protected life cover plans were not moved. As such, the Cabinet Office maintains a proportionate approach to reviewing these legacy AVC Scheme policies where there are limited courses of action in terms of changing providers. The Cabinet Office looks to work with the incumbent provider to remediate and improve.

2.3 The Cabinet Office monitors the appropriateness of the investment arrangements with the AVC scheme policies through quarterly reporting and an annual review with the support of their adviser, the Government Actuary's Department. Should any changes be considered to these arrangements, the Cabinet Office would consult with the Scheme employers.

2.4 The AVC schemes are permitted to invest in a wide range of assets including equities, bonds, cash, property and alternatives through the fund range provided. There is not considered to be a default investment strategy for these legacy AVCs as may be considered in the context of defaults used for trust-based defined contribution schemes that are open to new contributions.

2.5 The size of the Scheme's assets is sufficient to allow a widely diversified portfolio of investments which is achieved through each of the providers. The members choose their own investments in the legacy AVC policies, so it is up to them to decide the level of diversification they want.

2.6 The legacy AVC policies all use pooled funds to implement their investments. As such it is the investment company operating each pooled fund that sets the investment criteria that then determines the investment strategy and how it is implemented, the Cabinet Office cannot decide or amend these criteria. However, the Cabinet Office can take account of the stated investment objectives and ranges of permitted investments of the products when reviewing the ongoing suitability of these AVC policies.

3. Risks

3.1 Risks in a defined contribution AVC scheme lies with the members. The Cabinet Office has considered a number of risks when designing and providing suitable investment choices to members. The main investment risks affecting members are:

Risk	Mitigation
Inflation risk – this is the risk that the investment returns do not outstrip the rate of inflation, leading to insufficient funds at retirement.	The Cabinet Office ensures funds are available that are expected to provide a long term real rate of return.
Mismatching risk - this is the risk that the value of assets held, particularly in the period before retirement savings are accessed, are significantly lower than is expected for the intended purpose.	Members have a range of asset classes available to tailor to their intended purpose. The Cabinet Office monitors the choice of investments to ensure that members have a range of fund types to suit their changing preferences for risk and return.
Manager risk - this is the risk that the investment managers do not achieve their performance objectives.	The Cabinet Office monitors this risk and each AVC provider also has their own fund governance framework for identifying periods of poor performance and instigating further mitigations.
Concentration risk - a large proportion of the Scheme assets are invested in a single asset class or investment.	The investment manager is expected to manage properly diversified portfolios and to spread assets across a number of individual shares and securities.
Loss of investment – the risk of loss of investment by the investment manager or custodian. This could include losses beyond those caused by market movements.	The Cabinet Office uses regulated providers and regularly reviews their ongoing solvency and internal processes.
Market risk – this is the risk that markets in which the funds are invested underperform.	Cabinet Office understands that markets can perform better or worse than expected and manages this risk by ensuring a sufficiently diverse pool of investments is available
Investment beliefs – the investment options provided do not align with the beliefs of members and may result in that member not saving for their retirement or having to use funds that do not satisfactorily align with their beliefs.	Cabinet Office will consider comments from members with respect to fund choices made available. Where feasible, best practice from Cabinet Office's experience with other AVC and DC schemes will be applied to their legacy AVCs.

Climate risk – the physical and transition risks of climate change may be detrimental to the return on assets.	The Cabinet Office will consider the governance arrangements of the providers to ensure that climate change is a consideration. Where feasible, best practice from Cabinet Office's experience with other AVC and DC schemes will be applied to their legacy AVCs.

3.2 The Cabinet Office has regard to the relative investment return, net of fees, and risk that each asset class is expected to provide. The Cabinet Office takes advice from professional advisors they have deemed to be appropriately qualified. However, the day to day selection of investments is delegated to each fund's investment manager.

3.3 The Cabinet Office recognises the need to distinguish between nominal and real returns and to make appropriate allowance for inflation when making decisions and comparisons.

5. Day-to-day management

5.1 The Cabinet Office has delegated the day-to-day management of the investments to their respective investment managers, Scottish Widows, Standard Life and Utmost Life, who take decisions regarding the underlying assets to buy and sell.

5.2 In making their decisions regarding investments, the investment managers are expected to:

- exercise their investment powers in a way that is consistent with the governing documentation of their pooled investment vehicles and the stated objectives of their funds. Where appropriate, this will include having regard to the suitability and diversification of the investments chosen;
- allocate the assets, where appropriate, in a suitable balance between different categories of investment and between individual investments within each category;
- carry out all the day-to-day functions relating to the management of the fund;
- have regard to the liquidity of an investment before deciding to make an investment of that kind. In particular considering the liquidity in the context of:
  - the fund's likely need for cash in the short and longer term
  - the income generated from such an investment; and
  - the prospects for liquidity in the future;
- decide whether it is appropriate to retain or realise individual investments under their management; and
- exercise rights (including voting rights), attached to the investments, in the best interests of the members and in accordance with their stated socially responsible and ethical investment policies.

5.3 The Cabinet Office will receive regular written reports as required from the fund managers and advisers. These reports will summarise the recent performance of each fund and advise on future market expectations and investment prospects.

5.4 The Cabinet Office will consider each fund's investment policy and review performance at regular intervals. Review of each fund will include:

- comparing the investment return to the benchmark return set out in the fund's explanatory documentation;
- reviewing at agreed intervals the investment policy and any specific policies agreed by the Cabinet Office to meet particular needs; and
- reviewing the reports of the fund managers on their management of the funds.
- Consider portfolio turnover costs, as it will impact the performance of investments.

5.5 Review of the investment performance will consider both longer term returns and short term returns for example the return over the quarter, one year, three years and potentially longer periods. Should periods of underperformance be identified, the Cabinet Office will engage with its advisers and the provider and consider options for appropriate courses of action.

6. Financially and non-financially material considerations and stewardship

6.1 The Cabinet Office, with their investment advisor, has considered the financial materiality of environmental, social and governance (ESG) issues within their member options. The Cabinet Office views ESG issues within an investment context as financially material, however, the Cabinet Office appreciates that taking ESG into account within an investment strategy process will yield different returns and/or risks for different asset classes. The Cabinet Office's view on ESG integration within each asset class is outlined below:

- Passive equities – the Cabinet Office believes that when investing passively in equity index tracker funds, there is little that the manager can do within the investment process selecting stocks. However, positive engagement on ESG issues can lead to improved risk-adjusted returns.
- Passive gilts and cash – the Cabinet Office does not believe there is scope for ESG issues to improve risk-adjusted returns within the Scheme's passive gilt and cash holdings.
- Corporate bonds – the Cabinet Office believes that ESG issues will be financially material to the risk-adjusted returns achieved by the schemes' corporate bond managers given ESG factors can be informative with regard to risk adjusted returns. However, in respect of passive corporate bond funds, the managers cannot actively select issues based on ESG criteria but acknowledge stewardship potential, covered in the next section.
- Multi-asset funds – the Cabinet Office believes that ESG issues will be financially material to the risk-adjusted returns given these funds can be actively managed. The process for incorporating ESG issues should be consistent with, and proportionate to, the rest of the investment process.

6.2 The Cabinet Office believes that ESG issues will be more important for members who are further from retirement, as the financial materiality of such issues will have a greater impact over their longer timeframe. Therefore, this will be considered as part of periodic investment reviews.

6.3 The Cabinet Office will take advice on ESG when reviewing investments.

Stewardship

6.4 Stewardship encompasses the exercise of rights (including voting rights) attaching to the schemes' investments, and the engagement by and with investment managers.

6.5 Responsibility for stewardship activities attaching to the Scheme's investments is delegated to the investment managers. Managers are expected to exercise voting powers and use engagement activity with the objective of preserving and enhancing long term shareholder value. The Cabinet Office will periodically review engagement activity undertaken by their investment managers to ensure that the policies outlined above are being met.

Engagement activities

6.6 The Cabinet Office acknowledges the importance of ESG within their investment framework. When delegating investment decision making to their investment managers they provide their investment managers with a benchmark they expect the investment managers to either follow or outperform. The investment manager has discretion over where in an investee company’s capital structure it invests (subject to the restrictions of the mandate), whether directly or as an asset within a pooled fund.

Non-financial matters

6.7 The Cabinet Office considers that it is important to ensure that a suitable range of funds are offered for members who wish to express their personal beliefs in their pension saving and review these provisions from time to time.

Policy on arrangements with asset managers

6.8 The Cabinet Office completes an annual review where they assess the continuing relevance of the strategy in the context of the AVC schemes’ membership.

7. Controls and review

7.1 The Cabinet Office will review this Statement at least every three years. This Statement replaces any previous statements. Copies of this Statement will be made available to scheme employers, the investment managers and public sector auditors upon request.