Statement of Investment Principles – Smiths Industries Pension Scheme

Introduction

This Statement of Investment Principles (“SIP”) has been prepared by the Trustee of the Smiths Industries Pension Scheme ("the Scheme") to comply with the requirements of the Pensions Act 1995, as amended by the Pensions Act 2004, and The Occupational Pension Schemes (Investment) Regulations 2005 (“the Investment Regulations”) and subsequent Regulations.

Effective Date

This SIP is effective from 10 October 2023.

1. Strategy

Investment Objectives

The Trustee's objective is to invest the assets of the Scheme prudently to ensure that the benefits promised to members are provided. The overall aim is to reach and maintain a position where sufficient assets are held to cover all liabilities plus an additional reserve for unforeseen events such as improvements in life expectancy and to have a contribution rate which the Sponsoring Company, Smiths Group plc ("Smiths Group"), can afford.

The investment strategy agreed between the Trustee and Smiths Group targets an expected return over the liabilities (as valued by gilt yields) with the intention of achieving a fully funded position (based on expected returns) within agreed timescales. In choosing the investment strategy the Trustee recognises the level of risk compared to the liabilities that accompanies the outperformance target. A Pension Risk Management Framework (“PRMF”) exists to ensure that both the level of risk and outperformance target are monitored by the Trustee on a regular basis and calls to action for funding, risk, hedging and liquidity are easily identified.

Allocation of Assets

The Trustee invests the Scheme’s assets in a portfolio of physical assets (the Physical Portfolio), and liability matching assets (the Liability Matching Portfolio)

The **Physical Portfolio** (currently c.52% of assets) has the objective of outperforming the liabilities by investing in a suitably diversified range of assets which together are expected to reduce investment volatility, consisting of corporate bonds and other credit alternatives, and property.

The **Liability Matching Portfolio** (currently c.48% of assets) has the objective of using a liability driven investment strategy to provide a hedge against a portion of the interest rate and inflation risks associated with the non-insured liabilities, by investing predominantly in a range of UK government bonds alongside other financial instruments such as gilt repos, interest rate and inflation swaps. In addition, the LDI manager takes into consideration the GBP denominated corporate bonds managed in the Scheme's Buy & Maintain corporate bond portfolio when constructing the hedge.

The portfolio also includes bulk annuity arrangements, insuring the benefits for a cross section of the Scheme's pensioner liabilities, as part of the Liability Matching Portfolio. The Trustee monitors the bulk annuity market in order that it can take advantage of future opportunities if appropriate.

This structure is expected to provide an appropriate risk and return profile, with suitable interest rate and inflation hedging characteristics, consistent with less volatile and improving funding levels.

The Trustee and Smiths Group have agreed to reduce investment risk over time in a phased manner and in the event that the funding level improves ahead of expectation. Such reductions will be achieved by reducing the allocation to return seeking assets and increasing the level of liability hedging provided by the Liability Matching Portfolio.

Risks

The Scheme is exposed to a number of different investment risks. These include risks relating to:

- Funding – i.e. that the Scheme has insufficient assets to cover 100% of the accrued liabilities
- Mismatching – arising from a difference in the sensitivity of asset and liability values to financial and demographic factors
- Cash flows – arising from a shortfall of liquid assets relative to the Scheme's immediate liabilities
- Investment managers – arising from a failure to meet target returns
- Diversification – an inadequate spread of investments and sources of return
- Covenant – the possibility of failure of the Scheme’s sponsor
- Counterparty – arising from the failure of a third party to fulfil its obligations under a financial (e.g. derivative or bulk annuity) contract entered into with the Scheme
- Operations – fraud, poor advice or negligence.

These risks are reduced by careful structuring of the Scheme’s funding and investment management arrangements and through the contracts with the investment managers. The Trustee closely monitors these risks using the PRMF and receives formal quarterly reports on funding, cash flows, investment managers (including performance) and diversification. Counterparty risk is reduced by limiting the exposure to any one counterparty together with the use of a collateral mechanism for derivative positions that is calculated daily.

Operational risk is reduced as far as possible by due diligence on the appointment and review of investment managers, annuity providers and advisers, and by contracts of engagement.

2. Implementation

Physical Portfolio Assets as at June 2023

Investment Manager/Insurer (mandate)	Objective
Insight Investment (Buy and Maintain segregated USD, Euro and GBP denominated bonds)	To invest in a diversified portfolio of USD, Euro and GBP denominated corporate bonds which has an improved risk adjusted return profile compared with an index-tracking bond portfolio with a similar maturity profile.
Colliers Capital UK Ltd (Active UK property)	To outperform the IPD Annual Index over a market cycle (3-5 years).
24AM VONTOBEL (Multi-class credit)	The manager does not have a formal objective. However, the Scheme's Investment Adviser recommends the following as a comparator: SONIA +4.0 - 5.0% p.a. with a volatility similar to a portfolio equally split between European high yield and European leveraged loans over a rolling 3-year period.
CQS (Multi-class credit)	To target a net return of 6-8% per annum over the cycle, with single digit volatility.
M&G (Multi-asset credit)	To target a total return of one month Sonia / Euribor +3 to 5% gross of fees p.a. over a cycle.

Liability Matching Portfolio Assets as at June 2023

Investment Manager/Insurer (mandate)	Objective
BlackRock Investment Management (UK) Limited (segregated Liability Driven Investment Portfolio)	To manage a liability driven investment solution, taking into account the Scheme's Sterling corporate bond investments, to broadly match the inflation and interest rate sensitivity of a portion of the Scheme's liabilities.
BlackRock Investment Management (UK) Limited (overseas rates and currency portfolio)	To hedge currency and non-GBP interest rate exposure arising from non-GBP corporate bonds in the Insight portfolio.
Pension Insurance Corporation plc, Canada Life Ltd and Prudential Assurance Company Ltd (Member Annuities)	To provide cashflows to the Scheme which cover a cross section of the Scheme's pensioner liabilities.

Choosing investments

In general, individual investment managers have discretion in the timing of the purchase and sale of investments and in considerations relating to the liquidity of those investments. Additional realisations may be required to ensure that the Scheme's benefit outgoings and other expenditure can be met.

The Trustee, and investment managers (to the extent delegated), will use the criteria set out in the Occupational Pension Schemes (Investment) Regulations 2005, when selecting investments on behalf of the Scheme.

3. General

Additional Voluntary Contributions (AVCs)

AVCs and money purchase members are invested in policies with Prudential, Legal & General, Phoenix Life and Santander.

Direct Investments

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. Assets directly held by the Trustee, including policies of assurance such as AVCs, will be regularly reviewed to ensure that they continue to be appropriate, and written advice will be obtained from the Investment Adviser. The Trustee will use the criteria set out in the Occupational Pension Schemes (Investment) Regulations 2005 when selecting direct investments.

Responsible Investment

Environmental, Social and Governance issues may be financially material to the investment portfolio over the Scheme’s time horizon. The Trustee considers the long-term financial interests of the Scheme to be paramount, and, where appropriate and practical:

- expects investment managers to consider financially material environmental (including climate change risks), social and governance issues in investment decision making
- expects investment managers to practise good stewardship which includes engaging with issuers of debt or equity on financially material environmental, social or governance issues.

Non-financial matters, including ethical views of beneficiaries and members, are not ordinarily taken into account in the selection, retention and realisation of investments.

The Investment Adviser carries out research on environmental, social and governance (“ESG”) integration as a key element of fund manager selection and monitoring as follows:

- Preferred List Process: each time a rated manager is selected or reviewed, ESG integration is one of the key selection factors considered by the Investment Adviser’s manager research team.
- Annual survey: rated managers are surveyed annually to ensure any changes to the ESG integration process are captured (e.g. data sources, reporting lines, etc).

- PRI reporting: The Investment Adviser requests PRI Assessment scores from all managers for funds in which clients are invested on an annual basis.

Climate-related Investment Beliefs Statement

The Trustee believes that climate change is likely to be a financial risk that will affect all of the Scheme's investments to some degree, as well as the Scheme's liabilities and covenant. The Trustee integrates the monitoring of climate risk metrics into its wider risk management framework and considers these when making investment decisions. To aid the Trustee's assessment of the resilience of the Scheme against climate-related risks, climate scenario analysis is performed in relation to the Scheme's assets, liabilities, and covenant by the Trustee's advisers. This analysis will be performed triennially; interim updates may be performed, for example if there are material changes to the Scheme's strategy or if there are significant changes to the methodology and industry practice relating to the analysis. To this end, the Trustee will consider annually whether a refresh of the analysis is required. The Trustee also receives annual reporting on the Scheme's climate risk metrics from its Investment Adviser.

The Trustee believes that climate change – and efforts to mitigate it – will likely create investment opportunities that the Trustee should do its best to take advantage of, where it is appropriate as part of the Trustee's wider strategic objectives and the Trustee's fiduciary responsibilities.

The Trustee believes that it is appropriate in the context of its fiduciary duty to seek to align the Scheme's investment strategy with achieving the goals of the Paris Agreement. These goals include limiting global temperature increases to well below 2°C – ideally 1.5°C – by the end of this century, relative to pre-industrial levels. The Trustee considers this aim in the context of the Scheme's wider investment objectives.

The Trustee expects that market participants will be slow to react to climate change and therefore takes a proactive approach to integrating climate considerations into their investment decisions. The Trustee also expects the Scheme's investment managers to take a proactive approach to managing climate-related risks and opportunities where this is possible and appropriate. To aid the Trustee's monitoring of managers' approaches, the Trustee meets with at least one of its managers quarterly and receives advice from its Investment Adviser.

The Trustee believes that climate-related risks and opportunities need to be considered alongside and balanced against other relevant investment risks and considerations when evaluating investments. The Trustee therefore acknowledges that it may not always be able to minimise climate-related risk if doing so would be to the detriment of wider strategic objectives.

Whilst the Trustee has overall responsibility for all investment decisions of the Scheme, certain responsibilities regarding climate policy and strategy are delegated to the Scheme's Investment Committee ("IC"). This includes overseeing the implementation of the Responsible Investment policy, including the assessment of climate-related risks and opportunities. IC meetings take place quarterly, after which the IC reports any meaningful items to the Trustee for consideration or sign-off.

Stewardship and Engagement Policy

The Trustee believes that effective stewardship is part of its fiduciary duty to act in the best financial interests of members.

The Trustee understands good stewardship to be the responsible allocation, management, and oversight of capital to create long-term value for members, leading to sustainable benefits for the economy, the environment and society. The Trustee aims to use its influence as an owner of assets to ensure that as far as possible best practices are reflected in terms of ESG factors, and investment managers are held to account for the effective use of their influence as owners of assets.

Direct engagement with underlying companies (as well as other relevant persons) in respect of shares and debt is carried out by the Scheme’s investment managers. This includes monitoring and engaging with issuers of debt or equity on financially material issues concerning strategy, capital structure, management of actual or potential conflicts of interest, risks, environmental impact, social considerations and corporate governance. Where relevant, the Trustee expects its managers to use voting rights to effect the best possible sustainable long-term outcomes.

The Trustee expects all its investment managers to practise good stewardship. When selecting new managers, the Trustee's Investment Adviser assesses the ability of each investment manager to engage with underlying companies to promote the long-term success of the investments. In addition, the Trustee believes its investment managers should sign up to industry-wide climate initiatives where possible and sensible to do so.

Where the Trustee chooses managers that align with its beliefs on stewardship, there are instances where the Trustee has less direct influence over the managers’ policies on the exercise of investment rights (for example, where assets are held in pooled funds, due to the collective nature of these investments). The Trustee monitors and discloses the voting behaviour carried out on its behalf. If the Trustee deems this behavior inadequate, it will engage with the relevant manager and seek to better align the behaviour of the manager with the Trustee’s policy.

The Trustee has a preference for ‘engagement’ rather than ‘exclusion’ as a method of incorporating climate change risks into an effective risk management framework. However, this preference is kept under review and may be updated in the future should circumstances change. The Trustee believes that engagement (including the exercise of voting rights) is an effective means of helping to manage the Scheme’s ESG (including climate change) risks. However, its efficacy can be limited, and other actions should be considered alongside engagement. The Trustee may look to disinvest from companies or asset managers that are inadequately managing their ESG or climate-related risks if attempts to engage with these parties to address this are not successful, subject to legal advice on any Trustee divestment decision or framework, and provided this is in line with the fiduciary duty of the Trustee. The Trustee expects its investment managers to independently consider whether exclusion or engagement is more appropriate within their investment process.

When selecting, monitoring and de-selecting asset managers, engagement is factored into the decision-making process to the appropriate level for the specific asset class in question. The Trustee requires its Investment Adviser to monitor the policies of the Scheme’s investment managers and report annually on how the managers have acted in accordance with the Trustees' policy on stewardship and engagement. In addition, the Trustee meets directly with each of its investment managers regularly and – where relevant and appropriate – questions the manager on their activities with respect to stewardship and engagement. The Trustee will disclose any highlights as part of these reviews annually in its implementation statement.

Our key areas of focus

To best channel stewardship efforts, the Trustee is first focusing on a single key theme. This theme was selected by assessing its relevance to the Scheme and its members, the financially material risks it poses, and the maturity and development of thinking within the industry that allows for ease of integration into the Trustee's approach. The key theme is:

- **Climate Change** – this represents a material risk to societies, economies and, by extension, the Scheme's investments. The Trustee has also set a target to aim to reach a net zero strategy by 2050 in a way that is consistent with the scheme's wider investment strategy, and an interim target of a 50% reduction in the emissions intensity (as measured by the carbon footprint) of the Scheme's buy & maintain corporate bond mandate by 2030 compared to a 2022 baseline. A focus on climate change will help the Trustee to manage climate change risks, to achieve its net-zero target and aid real-economy decarbonisation.

Adopting one theme is an appropriate starting point and the Trustee may explore adopting additional theme(s) in the future.

Voting: expectations

Where the Scheme holds equity investments in companies, the Trustee (or managers acting on their behalf) has the right to vote at the shareholder meetings of these companies. The defined benefit section of the Scheme does not hold an equity portfolio; however, its managers can invest in credit assets that can be converted into equity in certain circumstances. Once these assets have been converted, they have voting rights attached to them – this is typically how the Scheme may have voting rights in relation to the assets it holds. Assets of this sort comprise a negligible portion of the Scheme's overall investments.

As the votes pertain to the Scheme's non-equity managers, the Trustee deems all votes to be significant.

Custody and Accounting

The Trustee employs Northern Trust Company ("Northern Trust") as the Scheme's global custodian. Northern Trust provides safekeeping of the Scheme's liability driven investment and bond assets and performs administrative duties, including performance measurement and certain accounting functions on behalf of the Scheme.

Custody for the Multi Asset Credit pooled funds managed by M&G, 24AM, and CQS are arranged by the managers themselves and no direct custody relationship with the Scheme exists.

Policies of assurance are held by the Trustee and deeds relating to direct UK property assets are held by Edwin Coe LLP.

Asset Manager Policy

For segregated arrangements, the terms of the long-term relationship between the Trustee and its managers are set out in separate Investment Management Agreements ("IMAs"). These document the Trustee's expectations of their managers, alongside the investment guidelines they are required to operate under.

The investment guidelines are based on the policies set out in this SIP. When the SIP is updated, it is promptly shared with the relevant managers and the investment guidelines are updated (as required) following any changes, ensuring the managers always invest in line with the Trustee's policies.

For pooled arrangements, the Scheme's investments are managed according to standardised fund terms, which are reviewed by the Scheme's legal and Investment Advisers at the point of investment to ensure that they are aligned with the Scheme's long-term investment strategy and market best practice. These terms are reviewed at the point of investment and following any material changes notified by the manager.

When relevant, the Trustee requires its investment managers to invest with a medium to long-term time horizon, and use any rights associated with the investment to drive better long-term outcomes. For some asset classes, the Trustee does not expect the respective asset managers to make decisions based on maximising long-term performance. These may include investments that provide risk reduction through diversification or through hedging, consistent with the Trustee's strategic asset allocation.

The Trustee appoints its investment managers with an expectation of a long-term partnership, which encourages active ownership of the Scheme's assets. When assessing a manager's performance, the focus is on longer-term outcomes and is assessed over a medium to longer-term timeframe, subject to a minimum of three years.

The Trustee would not expect to terminate a manager's appointment based purely on short-term performance. However, a manager's appointment could be terminated within a shorter timeframe than three years due to other factors such as a significant change in business structure or the investment team.

Managers are paid an ad valorem fee for a defined set of services. The Trustee reviews the fees annually to confirm they are in line with market practices, notably when the Trustee expects the manager to take an active ownership approach and consider long-term ESG factors. The Trustee reviews the portfolio transaction costs and managers' portfolio turnover ranges, where the data is disclosed and available. The Trustee will then determine whether the costs incurred were within reasonable expectations.

Investment Adviser

Redington Limited has been appointed as Investment Adviser. It has the knowledge and experience required under the Pensions Act 1995.

Review of SIP

This SIP will be reviewed at least every three years or immediately following a change of investment policy. Written advice on any changes will be taken from the Investment Adviser and Smiths Group will also be consulted.