

## **Statement of Investment Principles**

### **The Church of England Funded Pensions Scheme (CEFPS) 2023**

#### **I. Introduction**

This Statement of Investment Principles (“SIP”, or “Statement”) sets out how the assets of the Church of England Funded Pensions Scheme (referred to as the “CEFPS” or the “Scheme” in the rest of this document) are invested. It has been prepared by the Church of England Pensions Board (referred to as the “Board” or “Trustee” in the rest of this document), which is the corporate trustee of the Scheme, with advice from its investment consultant.

The Church of England Funded Pensions Scheme is an occupational pension scheme, set up under trust, for the benefit of clergy and licensed lay workers in the Church of England.

The costs of the CEFPS’s benefits are met by the various church bodies and other organisations that participate on behalf of their employees and office holders. Contributions are paid to the Board as Trustee of the CEFPS by those participating organisations. The contribution rate is set by the Board on the basis of advice provided by the Scheme Actuary and is reviewed at least every three years.

The Trustee monitors the covenant of the Scheme’s sponsors in order to assess their ability to support the Scheme. The Trustee believes the Scheme’s sponsors are willing and able to underwrite its liabilities.

The legal details of the CEFPS are contained in the Trust Deed and Rules and subsequent amendments, copies of which are available from the Trustee.

For practical reasons, the Scheme’s sponsors have delegated their rights to consultation on a number of issues, including the content of this statement, to the Trustee. The Trustee engages with the sponsors regularly and is happy to receive feedback and suggestions on this and any other matter.

The Trustee will review this Statement every year and without delay after any significant change in investment policy or, if required, following a formal investment strategy review.

Any change to this Statement will only be made after having obtained and considered the written advice of someone who the Trustee reasonably believes to be qualified by their ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of pension scheme investments.

The Trustee receives written advice from its Investment Consultant on any investments prior to them being implemented. The Statement complies with the requirements of the Pensions Act 1995 (as amended) and the Occupational Pension Schemes (Investment) Regulations 2005 (as amended).

## 2. Objectives

The Trustee is responsible for the stewardship of the Scheme's assets. It has three main objectives, which are to ensure that:

- (1) All beneficiaries receive the benefits to which they are entitled under the Rules of the Scheme.
- (2) There are sufficient assets to meet the Scheme's liabilities as they fall due, and
- (3) Through the process of meeting the Scheme's liabilities that the Scheme's investments do not work against beneficiaries' interests and the world into which they will retire.

The Trustee has an objective for the Scheme to be fully funded on a basis that reflects the asset holdings that the Scheme is expected to hold as a Scheme open to new entrants in the long term. The Trustee also monitors the Scheme's funding position on a low dependency basis, in-line with the Pension Regulator's guidance.

## 3. Investment Policy

The Trustee is responsible for how the Scheme's assets are invested. It takes advice from the Investment Consultant and the Scheme Actuary where appropriate, and it is supported by an in-house investment team. The Trustee has established an Investment Committee, which has relevant professional investment experience through a mix of members of the Board and co-opted members.

Ethical and responsible investment considerations are central to the Trustee's work. They reflect the Christian identity and the values of the Board and the beneficiaries of the CEFPS, and they inform its aim of achieving a long-term sustainable return on the Scheme's investments.

The main Board determines investment strategy for the Scheme, which is reflected in the split in the Scheme's assets between those invested for growth (return seeking assets) and investments that seek to match the liabilities for pensions already in payment.

The Investment Committee selects the asset classes for investment, appoints managers for them, monitors the managers' performance, and removes them when necessary. It also directs the Scheme's cash flows between asset classes and investment mandates.

Day to day investment decisions are delegated to external investment managers. They are appropriately qualified, and their activities are defined by legally binding agreements.

## 4. Investment Beliefs

The Trustee has developed a set of investment beliefs, which underpin how the investments are made. The beliefs are set out in Appendix I to this statement. Environmental Social and Governance ("ESG") considerations are central to the Trustee's investment beliefs.

## 5. Investment Management

The Board operates a common investment fund, The Church of England Investment Fund for Pensions, (or "CEIFP"), comprising a Public Equity Pool, Diversified Growth Pool, Diversified

Income Pool, Listed Credit Pool and Liquidity Pool (together “the pools”). The common investment fund allows the Board’s pension schemes, including the CEFPS, to pool their assets for greater efficiency and diversification than they would be able to achieve if investing on their own. The investment powers of the common investment fund are set out in the Schedule of Regulations of the CEIFP’s Trust Deed and are in accordance with the investment powers of the Board as set out in the Church of England Pensions Measure 2018 (as amended).<sup>1</sup>

The CEIFP accounts for all the return seeking investments of the CEFPS and some of its liability matching assets. The Scheme may from time to time have assets that are invested outside the common investment fund. In particular, so called Liability Driven Investment (“LDI”) assets are held to back pensions in payment and to hedge against inflation and changes in interest rates (largely via Gilts and Gilt repurchase agreements (repos), with inflation and interest rate swaps also permitted).

The Scheme’s LDI portfolio contains derivative instruments (inflation and interest rate swaps and Gilt repos) which involve the use of leverage. As a result, small changes in underlying conditions can produce larger changes in the value of the LDI portfolio relative to the amount invested. These leveraged investments require collateral, and the collateral requirements increase when the LDI portfolio incurs losses (typically due to rising interest rates or falling inflation rates) and vice versa. The investment team and Trustee regularly monitors availability of collateral to ensure it is sufficient.

The Scheme’s investment managers are listed in the Scheme’s Annual Report, which also carries information on investment performance, asset allocation and the main investment decisions taken during the year. The Scheme’s Annual Report is published on the Church of England website.

The in-house investment team regularly meets with each of the Scheme’s investment managers to discuss performance and other related matters (including climate change and other ESG topics) and reports its findings to the Trustee. As part of this process, the investment team will challenge decisions that appear inconsistent with the Scheme’s stated objectives and/or policies.

Portfolio turnover costs and manager fees are monitored by the investment team, in absolute terms and relative to what might be reasonably expected given the underlying asset class and investment style of each investment manager and reported to the Trustee periodically.

As the Trustee is a long-term investor, it does not expect to make investment manager changes on a frequent basis.

Where the Scheme invests in an open-ended vehicle, or segregated mandate, with an investment manager the Trustee expects to retain them unless:

- There is a change to the overall strategy that no longer requires exposure to that asset class or manager; or
- The investment manager has been reviewed and the Trustee has decided to terminate the mandate.

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<sup>1</sup> The amended Measure is published on the government website: <https://www.legislation.gov.uk/ukcm/2018/9/contents>

A review of a manager's appointment may be triggered by one or a combination of the non-exhaustive scenarios below:

- Sustained periods of under-performance;
- Change in the portfolio manager or team responsible;
- Change in underlying objectives or process of the investment manager;
- Concern over their ability to meet operational or ESG considerations, or
- Significant change to the Investment Consultant's rating of the manager.

For holdings in closed-ended vehicles, the Scheme would expect to be invested for the lifetime of the strategy (which is disclosed to the Trustee at point of investment), although secondary market sales could be considered under certain circumstances.

The Trustee reviews the performance of the investment managers on a regular basis versus agreed benchmarks and targets, over multiple periods, with an emphasis on the long term. This includes how the investment managers make decisions based on assessments about medium to long-term financial and non-financial performance of an issuer of debt or equity, as well as engage with issuers of debt and equity in order to improve performance in the medium to long-term.

The investment managers are aware that their continued appointment is based on their success in delivering the mandate for which they have been appointed to manage. If the Trustee is dissatisfied, then it will look to replace the manager.

Investment managers are appointed based on their capabilities and the perceived likelihood of them meeting the Trustee's return and risk expectations. The manager selection process is designed to ensure that appointments are consistent with the Board's ESG policies. As part of this, the Trustee undertakes due diligence ahead of investing to ensure it is aware of the:

- Underlying assets held and how the investment manager will allocate between them;
- Risks associated with the underlying mix of assets and the steps the investment manager takes to mitigate them;
- Expected return targeted by the investment manager and details around realisation of the investment; and the
- Impact of financial and non-financial factors, including those outlined in the Ethical and Responsible Investment section of this Statement, on the investment over the long-term (and including how those matters are taken into account in the selection, retention and realisations of investments).

Should an investment manager make changes to any of these factors, the Trustee will assess the impact and (where no longer aligned) consider what action to take.

The Trustee seeks input from its investment consultant for their forward-looking assessment of the investment managers' abilities to meet their performance objectives over a full market cycle and an assessment of how environmental, social and governance factors are integrated into their investment processes. In addition, the investment team maintains its own independent ESG ratings for the appointed investment managers. These views assist the Trustee in its ongoing monitoring of the investment managers and are considered when making selection and retention decisions.

Where the Trustee invests via a pooled vehicle (rather than a segregated mandate), it accepts that it has limited ability to specify the investment guidelines, risk profile or return targets of an investment manager. Despite this, the Trustee believes that pooled vehicles can be identified that are aligned with its policies.

Investment management fees are charged as a proportion of the value of assets being managed and, in some instances, include an element based on investment performance. The fees are set on appointment and reviewed regularly thereafter. The Trustee takes advice to ensure the fees are appropriate.

## **6. Types of Investment**

The common investment fund, the CEIFF, is well diversified in terms of the assets it holds and the range of investment managers employed to manage those assets. The asset classes invested in by the CEFPS, and the managers of them, are listed on the Board's website.

The Trustee takes advice from its Investment Consultant to ensure that the asset classes invested in by the Scheme are appropriate for it.

The split between the pools is determined by the characteristics of the Scheme, in particular its demographic profile, the spread of time over which its liabilities fall due, its long-term funding target, strength of sponsor covenant and the appetite for risk of the Trustee and the Scheme's sponsors.

The Trustee aims to achieve a balance between growth assets and assets that have liability matching characteristics, such that a proportion of the Scheme's inflation and interest rate risk (relative to the self-sufficiency liabilities measured on a gilts + 0.5% p.a. basis) is hedged by the Scheme's LDI portfolio. The proportions of inflation and interest rate risk being hedged are reviewed by the Trustee from time to time. The alignment of the hedges with their targets is monitored daily by the Scheme's LDI manager and the manager provides regular reports to the investment team and Trustee.

The Scheme may use synthetic instruments in a segregated fund (or via a pooled fund) to reduce risk or to improve operational efficiency.

The Scheme's allocation to specific assets is shown in its Annual Report.

## **7. Realisation of Investments**

The Trustee considers, because the Scheme is open to new entrants, it has a longer investment time horizon and therefore a greater appetite for illiquid investments than most pension schemes. However, the Trustee ensures it always holds sufficient highly liquid assets that can be sold at short notice, should the need arise.

The Scheme is a non-contributory defined benefit scheme, with the pension promises entirely funded by the Responsible Bodies. As such, the Trustee does not directly consider the views of beneficiaries with regard to the selection, retention and realisation of investments. However, its Investment Beliefs reflect the Christian identity and values of the Scheme's beneficiaries and

these are central to how the Scheme is invested. The Trustee receives Advice from the Ethical Investment Advisory Group (“EIAG”)<sup>2</sup> on Christian ethics and responsible investment, which the Trustee draws upon to determine its investment policies.

## **8. Ethical and Responsible Investment**

The Trustee recognises that the beneficiaries and the sponsors of the Scheme are part of the Church of England and that the Scheme’s investments should reflect that as far as possible, without compromising its objectives.

The Trustee wishes to fully exercise its responsibilities as an asset owner, and in respect of the relevant voting assets (equities) held within the Scheme, the Trustee maintains full discretion over voting activity.

The Trustee recognises climate change as a major financial, social and ethical risk, and one that has potential to impact gravely on the financial well-being of the members of its schemes, as well as their quality of life in retirement.

The Trustee receives advice on the ethical implication of investments from the EIAG, which informs the Board’s investment policies.

The Trustee also values engagement with companies over responsible and ethical investment issues, and it considers engagement as a more effective means of exercising its stewardship responsibilities than disinvestment in many situations. Company engagement is carried out and monitored for effective change by the Board’s investment team. The Trustee regularly reviews the engagement and corporate governance activities of the investment team. The Trustee also produces an annual Stewardship Report summarising its activities, which is available on the Board’s website.

The investment team produces a list of restricted investments, and maintains a list of excluded companies based on the Board’s ethical investment screens that reflect the ethical policies approved by the Trustee. Investment managers appointed by the Trustee are instructed to exclude these investments from their portfolios.

The Trustee expects companies in which the Scheme invests to demonstrate responsible employment and corporate governance practices; to be conscientious with regard to environmental performance and human rights; and to deal fairly with customers and suppliers and act with sensitivity to the communities in which they operate. When appointing its investment managers, the Trustee takes into consideration how they incorporate analysis of companies’ performance on ESG issues into their stock selection.

The ‘Statement of Ethical Investment’ recommended by the EIAG, which has been adopted by the Trustee, is adapted from time to time and can be found on the EIAG’s website.

Before an investment is made in a pooled vehicle, where the Trustee cannot directly influence the selection of individual investments, the Trustee will satisfy itself that the proportion of restricted investments in the pooled fund is not material.

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<sup>2</sup> See the Church of England website for further details on the work of the EIAG.

The Trustee intends that the Scheme should vote at all company meetings held by its investee companies. This is administered by the in-house team using a platform provided by Institutional Shareholder Services (“ISS”), with input from the EIAG, and a responsible proxy voting template developed with reference to other members of the Church Investors Group. The Trustee takes its own voting decisions and is not bound by any other investor in doing so.

The Scheme, via the Church of England Pensions Board, is a signatory to the UNPRI and the Financial Reporting Council’s UK Stewardship Code 2020. It is also a member of the IIGCC (Institutional Investors Group on Climate Change), a co-founder of the Transition Pathway Initiative (TPI), and a member of a number of other collective engagement initiatives detailed in the Trustee’s Stewardship Report.

## **9. Risk**

The Trustee recognises that it is possible to select investments for the Scheme that are similar to its estimated liability cash flows. However, in order to meet the Scheme’s objectives within a level of contributions that its sponsors have indicated they are able and willing to make, the Trustee has agreed to take investment risk. This seeks to target a greater return than the matching assets would provide, whilst maintaining a prudent approach to meeting the Scheme’s liabilities.

The primary risk upon which the Trustee focuses is that arising through a mismatch between the Scheme’s assets and its liabilities. The Trustee recognises that whilst increasing investment risk increases potential return over the longer term, it also increases the risk of a shortfall in return relative to that required to cover the Scheme’s liabilities, as well as producing more short-term volatility in the Scheme’s funding position.

To address this set of risks, the Trustee adopted an Asset Led Funding (ALF) approach for the Scheme with effect from the 31 December 2018 actuarial valuation and maintained an ALF approach for the 31 December 2021 actuarial valuation. This approach references the expected return (including yield profile) and risk characteristics of the expected long-term investment portfolio when estimating the Scheme’s future liabilities. This should reduce the volatility of the Scheme’s funding level and ensure greater stability in contributions to the Scheme. The Trustee believes the ALF approach is more appropriate to the profile of the Scheme’s liabilities and the covenant of its sponsors than an approach that references Gilt yields.

Whilst taking investment risk may lead to volatility in the funding levels of the Scheme, the Trustee feels that this risk is acceptable in view of the potential benefits of the expected extra return. The additional return should work through ultimately to greater security for the members of the Scheme and lower costs for its sponsors over the long term.

The Trustee considers a wide range of specific risks, including, but not limited to, those set out in Appendix 2 to this statement (which includes a range of financial and non-financial risks). Some of these risks are more quantifiable than others, but the Trustee has tried to allow for the relative importance and magnitude of each one.

The Trustee will from time-to-time use derivatives to manage risk and for efficient portfolio management. These will primarily be in the risk areas of currency, inflation, interest rates and

longevity, and within the allocation to equities for efficient portfolio management purposes.

### **10. Additional Voluntary Contributions (AVCs)**

The investment options for additional voluntary contributions (“AVCs”) are set out on the Board’s website.

The Trustee’s policy is to:

- Make a range of options available that gives a broad choice of investments funds to members, including an ethical investment option;
- Make options available which, under normal circumstances, should prove easy to buy and sell;
- Reduce risk and cost to members, by offering passively managed fund options wherever possible; and
- Regularly review the arrangements offered to AVC members to ensure they are fit for purpose.

Signed:

Clive Mather, Chair

Date: 28th September 2023