

July 2023

GROUP STATEMENT OF INVESTMENT PRINCIPLES (SIP)



National Grid Electricity Group of the ESPS
Statement of Investment Principles

1. INTRODUCTION

This Statement of Investment Principles ("SIP") sets out the principles governing decisions about the investment of the assets of the National Grid Electricity Group of the Electricity Supply Pension Scheme (ESPS) ("the Group"). The SIP is issued by the Trustee of the Group ("National Grid Electricity Trustee Company Limited") to comply with Section 35 of the Pensions Act 1995 (the Act) & 2004, the Occupational Pension Schemes (Investment) Regulations 2005 and to reflect the Government's Voluntary Code of Conduct for Institutional Investment in the UK. The Group Trustee complies with the requirements to maintain and take advice on the SIP and with the disclosure requirements.

The SIP gives a broad overview of the principles governing investment decisions by the Group Trustee. For more detailed information on the Group's current investment arrangements, please refer to the appropriate schedules within the Investment Policy Implementation Document ("IPID") which is a supplemental document to this SIP.

2. INVESTMENT OBJECTIVES

The Group Trustee aims to invest the assets of the Group prudently to ensure that the benefits promised to members are provided. In setting the investment strategy, the Group Trustee first considered the lowest risk asset allocation that it could adopt in relation to the Group's liabilities. The asset allocation strategy it has selected is designed to achieve a higher return than the lowest risk strategy while maintaining a prudent approach to meeting the Group's liabilities. The sponsoring employer is regularly consulted in regard to the approach adopted.

The Group Trustee has, independently of the sponsoring employer, set the following objective for the Group:

To set an investment strategy which targets a funding level of 100% on a low dependency basis within a reasonable time period as determined by the Group Trustee.

3. INVESTMENT STRATEGY

The Group Trustee invests the assets with regard to the actuarial characteristics of the Group, in particular the strength of the funding position and the liability profile. In setting the investment strategy, the Group Trustee bases its decisions on its investment beliefs. These are outlined within the Group's Investment Beliefs document, which should be referred to as a supplement to this SIP.

The Group Trustee recognises the potential volatility in equity and other "growth asset" returns, particularly relative to the Group's liabilities, and the risk that the fund managers do not achieve the targets set. The investment strategy is reviewed on a regular basis.

When choosing the Group's planned asset allocation strategy the Group Trustee considered written advice from its Investment Adviser and, in doing so, addressed the following:

- The need to consider a full range of asset classes
- The risks and rewards of a range of alternative asset allocation strategies
- The suitability of each asset class
- The need for appropriate diversification

In addition, the Group Trustee also consulted with the sponsoring employer when setting this strategy.

4. RISK

The Group Trustee recognises that the key risk to the Group is that it has insufficient assets to make provisions for 100% of its liabilities ("funding risk"). The Group Trustee has identified a number of risks which have the potential to cause a deterioration in the Group's funding level and therefore contribute to funding risk. These are as follows:

- The risk of a significant difference in the sensitivity of asset and liability values to changes in financial and demographic factors ("mismatching risk"). These risks include but are not limited to:
 - Market risk: the risk of a large fall in equity or other investment markets;
 - Interest rate risk: the risk that interest rate changes increase the funding and discontinuance value of the liabilities by a greater amount than they improve the value of the assets;
 - Inflation risk: the risk that asset values do not keep pace with or exceed inflation;
 - Longevity risk: the risk that mortality improvements increase the cost of benefits more than currently anticipated.
 - ESG Risks: Environmental, Social and Governance factors are deemed to be potentially financially material to the value of the Group's asset and liabilities

The Group Trustee and its advisers considered this mismatching risk when setting the investment strategy.

- The risk of a shortfall of liquid assets relative to the Group's immediate liabilities ("cash flow risk"). The Group Trustee will manage the Group's cash flows taking into account the timing of future payments in order to minimise the probability that this occurs.
- The failure by the fund managers to achieve the rate of investment return assumed by the Group Trustee ("manager risk"). This risk is considered by the Group Trustee and its advisers both upon the initial appointment of the fund managers and on an ongoing basis thereafter.
- The failure to spread investment risk ("risk of lack of diversification"). The Group Trustee and its advisers considered this risk when setting the Group's investment strategy and have also mandated to each of the fund managers employed that a suitably diversified portfolio of assets should be maintained at all times.
- The possibility of failure of the Group's sponsoring employer ("covenant risk"). The Group Trustee and its advisers considered this risk when setting the investment strategy and consulted with the sponsoring employer as to the suitability of the proposed strategy. The Group Trustee also considers the sponsoring employer's covenant on a regular basis.
- The risk of fraud, poor advice or acts of negligence ("operational risk"). The Group Trustee has sought to minimise such risk by ensuring that all advisers and third party service providers are suitably qualified and experienced and that suitable liability and compensation clauses are included in all contracts for professional services received.

Due to the complex and interrelated nature of these risks, the Group Trustee considers these risks in a combination of qualitative and quantitative manners on an ongoing basis and as part of each formal investment strategy review (normally triennially). However, the Group Trustee does recognise that it is beneficial to use quantitative measures where available to help evaluate and mitigate these risks. Some of these risks may also be modelled explicitly during the course of such reviews.

Having set an investment objective which relates directly to the Group's liabilities and implemented it using a range of fund managers, the Group Trustee's policy is to monitor, where possible, these risks periodically. In order to do so, the Group Trustee receives quarterly reports showing:

- Actual funding level
- Risk metrics
- Performance versus the Group's investment objective
- Performance of individual fund managers versus their respective benchmarks
- Any significant issues with the fund managers that may impact their ability to meet the performance targets set by the Group Trustee

The Group Trustee looks for opportunities to improve the efficiency of the Group's portfolio and/or remove risk, including interest rate and inflation risk, as and when this makes sense from a strategic perspective, given the long-term objective in place. Any such de-risking only takes place after consultation with the sponsoring employer.

5. IMPLEMENTATION

The Group Trustee is responsible for investment of the Group's assets. The Group Trustee takes some decisions itself and delegates others. When deciding which decisions to take and which to delegate, the Group Trustee takes into account whether it has the appropriate training and expert advice in order to make an informed decision.

As part of its investment business plan the Group Trustee receives ongoing training and undertakes from time to time a "needs analysis" to determine the specific training requirements for each individual Trustee Director.

An Investment Committee has been established to assist the Group Trustee and to apply appropriate focus to the more complex areas of investment strategy and to monitor the continued effectiveness of the appointed fund managers and advisers. The Group Trustee appoints members of the Investment Committee, which has clearly defined terms of reference and levels of delegated authority.

The Group Trustee is responsible for the investment of the Group's assets, but obtains written advice as appropriate from an Investment Adviser who is reasonably believed by the Group Trustee to be qualified for this purpose. Such advice has been obtained in preparing this Statement of Investment Principles. The Investment Adviser is authorised and regulated by the Financial Conduct Authority

The Group Trustee has delegated all day-to-day decisions about the investments that fall within each mandate, including the realisation of investments, to the relevant fund manager through a written contract.

When choosing investments, the Group Trustee and the fund managers (to the extent delegated) are required to have regard to the criteria for investment set out in the Occupational Pension Schemes (Investment) Regulations 2005 (regulation 4).

The Group Trustee regularly monitors the Group's investments to consider the extent to which the investment strategy and decisions of the fund managers are aligned with the Group Trustee's policies. This includes monitoring the extent to which fund managers:

- make decisions based on assessments about medium- to long-term financial and non-financial performance of an issuer of debt or equity. (The Group Trustee has elected not to take into account non-financial matters and would not wish any consideration given to this by fund managers to be detrimental to the financial performance of the portfolio);
- engage with issuers of debt or equity in order to improve their performance in the medium- to long-term.

The Group Trustee is supported in this monitoring activity by their Investment Adviser.

The Group Trustee receives regular reports and verbal updates from the Group's Investment Adviser on various items including the investment strategy, performance, and longer-term positioning of the portfolio. The Group Trustee focuses on longer-term performance when considering the ongoing suitability of the investment strategy in relation to the Group's objectives and assesses the fund managers over 3-year periods.

Before appointment of a new fund manager, the Group Trustee will review the governing documentation associated with the investment, seeking advice from a legal and investment perspective where appropriate, and consider the extent to which it aligns with the Group Trustee's policies. Where possible, the Group Trustee will seek to amend that documentation so that there is more alignment. Where it is not possible to make changes to the governing documentation, for example if the Group invests in a collective vehicle, then the Group Trustee will express their expectations to the fund managers by other means (such as through a side letter, in writing, or

verbally at trustee meetings).

The Group Trustee believes that having appropriate governing documentation, setting clear expectations to the fund managers by other means (where necessary), and regular monitoring of fund managers' performance and investment strategy, is in most cases sufficient to incentivise the managers to make decisions that align with the Group Trustee's policies – including, inter alia, that those decisions are based on assessments of medium- and long-term financial performance.

The duration of agreements with individual fund managers is dependent on the nature of the asset class and is kept under regular review, in accordance with the principles contained in this SIP.

The Group Trustee believes that voting rights should be exercised in the interests of investors by each fund manager to which such responsibilities are delegated. It is expected that such fund managers will exercise their voting rights according to sections 6 and 7 of this SIP, where the Group Trustee's beliefs around Responsible Investment are detailed.

Electricity Pensions Trustee Limited ('EPTL') in its capacity as the Scheme Trustee of the ESPS has appointed Bank of New York Mellon as custodian with regard to the day to day control and safekeeping of the Scheme's (and the Group's) assets. Bank of New York Mellon is independent of the Group's sponsoring employer and other relevant employers.

6. GOVERNANCE

The Group Trustee has established the following decision-making delegation structure:

Group Trustee

The Group Trustee has delegated authority to the Investment Committee to manage the Group's investments, but retains the power in relation to the following areas:

- Setting structures and processes for carrying out its role.
- Appointing the Investment Committee.
- Considering recommendations from the Investment Committee.
- Selection of and monitoring planned investment strategy, including:
 - Strategic direction;
 - Investment Risk;
 - Strategic asset allocation and parameters.
- Selecting direct investments.
- Maintaining the Group's Statement of investment Principles.

Investment Committee

Details of the responsibilities and powers delegated to the Investment Committee are documented in the Terms of Reference for the Investment Committee as updated from time to time.

Fund Managers

- Operate within the terms of their written contracts.
- Select individual investments with regard to their suitability and diversification characteristics.
- Exercise voting rights attaching to their investments

Investment Adviser

- Advise on all aspects of the investment of the Group assets, including implementation.

- Advise on this Statement of Investment Principles.
- Provide required training to the Investment Committee/Group Trustee.
- Advise the Group Trustee on ESG matters with relevance to the Group, including the impact of climate change, and the Group Trustee's implementation of their agreed Responsible Investment policy.

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.

The Group Trustee's policy is to review its direct investments and to obtain written advice about them at regular intervals. These include vehicles available for members' AVCs. When deciding whether or not to make any new direct investments the Group Trustee will obtain written advice and consider whether future decisions about those investments should be delegated to the fund manager(s).

The written advice will consider the issues set out in the Occupational Pension Schemes (Investment) Regulations 2005 and the principles contained in this SIP. The regulations require all investments to be considered by the Group Trustee (or, to the extent delegated, by the fund managers) against the following criteria:

- The best interests of the members and beneficiaries
- Security
- Quality
- Liquidity
- Profitability
- Nature and duration of liabilities
- Tradability on regulated markets
- Diversification
- Use of derivatives

The Group Trustee's Investment Adviser has the knowledge and experience required under the Pensions Act 1995.

The Group Trustee expects fund managers to manage the assets delegated to them under the terms of their respective contracts and to give effect to the principles in this statement so far as is reasonably practicable.

7. CASHFLOW POLICY

The Group Trustee maintains a separate cashflow policy which is updated regularly and reviewed at least annually. This policy formally documents the cashflow management procedure for the Group and states that a working cash balance should be monitored/maintained, equal to around 3 months of net benefit outgo. This is monitored by the Group's investment advisor who provides monthly assets updates and quarterly cashflow forecasts. The cashflow policy also covers LDI collateral management and policies for how to manage cashflow and collateral in stressed markets.

8. COST MONITORING

Importance of Costs

The Group Trustee assesses the performance of the fund managers on a net of all costs basis and recognises that this provides an incentive on the manager to control costs. However, it also believes that explicit, regular monitoring of the level and the trends of costs incurred will enhance those incentives.

Manager relationships

Fund managers are remunerated on an ad valorem basis which ensures the fund managers' interests are aligned with those of the Group. In addition, fund managers pay commissions to third parties on many trades they undertake in the management of the assets and also incur other ad hoc costs.

The Group Trustee expects their fund managers to offer full cost transparency via industry standard templates. This will be reviewed before the appointment of any new manager and includes the existing managers held by the Group. The Group Trustee requests cost information from each of their fund managers on an annual basis.

Analysis of manager performance and remuneration

The Group Trustee evaluates the performance of their fund managers relative to their respective objectives on a regular basis via investment monitoring reports and updates from the fund managers and Investment Adviser. The Group Trustee also reviews the remuneration of the Group's fund managers on at least a triennial basis to ensure that these costs are reasonable in the context of the kind and balance of investments held.

The Group Trustee assesses value for money received from its fund managers on a regular basis by benchmarking them relative to the wider market. This enables the Group Trustee to have a detailed understanding of their overall costs irrespective of net of fees performance and identify opportunities to challenge their fund managers where a particular manager is an outlier.

Portfolio Turnover Costs

Targeted portfolio turnover is defined as the expected frequency with which each underlying fund managers' fund holdings change over a year. The Group's Investment Adviser monitors this on behalf of the Group Trustee as part of the manager monitoring they provide and flags where there are concerns.

The Group Trustee recognises that switching to asset classes with lower transaction costs will not necessarily lead to a better outcome for the Group's funding position. They accept that transaction costs will be incurred to drive investment returns and that the level of these costs varies across asset classes and by manager style within an asset class. In both cases, a high level of transaction costs is acceptable as long as it is consistent with the asset class characteristics and manager's style and historic trends. Where the Group Trustee's monitoring identifies a lack of consistency, the mandate will be reviewed.

9. RESPONSIBLE INVESTMENT

The Group Trustee's primary responsibility remains a fiduciary one. That is to say that its first duty is to ensure the best possible return on investments with the appropriate level of risk. However, it has a fiduciary and regulatory duty to consider Responsible Investment ("RI"). Responsible Investment is defined as an approach to investing that incorporates ESG factors, including climate change, into investment decisions (alongside other aspects) in order to better manage risk and generate more sustainable, long-term returns. This includes consideration of financially material factors, which include (but are not limited to) Environmental, Social and Governance ("ESG") factors, to the extent that they are aligned with and impact on this primary responsibility. The Group Trustee's beliefs relating to RI and how these are integrated into the Group's investment decisions and activities are set out in the Group's Responsible Investment Policy.

The Group Trustee considers ESG risk when setting the Group's asset allocation, when selecting managers and when monitoring their performance, in conjunction with advice from their Investment Adviser.

The Group's asset strategy has a long term time horizon and therefore the Group Trustee understands the importance of being a responsible investor over that time horizon.

ESG considerations are included in any selection exercise and, where relevant, will be an integral component of the manager's assessment as part of the due diligence process. This enables an assessment of the extent to which ESG is integrated in the manager's philosophy and process (i.e. analysis, voting policy, engagement, and associated policies). The Group Trustee aims to integrate ESG into risk management as well as manager selection and monitoring. The integration, impact and progress of the Group Trustee's Responsible Investment and ESG activities will be monitored by the Group Trustee's advisers, reviewed by the Investment Committee and reported to the Group Trustee on a regular basis.

The Group Trustee does not actively canvass members' opinions on non-financial matters (such as ethical beliefs) and has no reason to believe that a significant proportion of the Group's members hold a particular belief or set of beliefs in this regard. The Group Trustee does not actively take these matters into account in the selection, retention or realisation of its investments.

Stewardship – Voting and Engagement

The Group Trustee recognises the importance of its role as a steward of capital and the need to ensure the highest standards of governance and promotion of corporate responsibility in the underlying companies and assets in which the Group invests, as this ultimately creates long-term financial value for the Group and its beneficiaries.

The Group's assets are managed by third party fund managers, and the Group Trustee expects these fund managers to engage with the companies in which the Group's assets are invested on ESG matters. Fund managers are required to report to the Group Trustee on their ESG integration processes and also on their proxy voting and engagement activities on a quarterly basis. The Group Trustee also takes input from its advisers on the managers' approaches to ESG, where relevant and available, and monitors this quarterly.

The Group Trustee will review the alignment of the Group's stewardship and other policies to those of the Group's fund managers and ensure their managers, or other third parties, use their influence as major institutional investors to carry out the Group Trustee's rights and duties as a responsible shareholder and asset owner. This will include voting, along with – where relevant and appropriate – engaging with underlying investee companies and assets to promote good corporate governance, accountability, and positive change. If an incumbent manager is found to be falling short of the standards the Group Trustee has set out in their policy or is making decisions not in line with the Group Trustee's policies or expectations, the Group Trustee undertakes to engage with the manager and seek a more sustainable position in the first instance but may look to replace the manager if this is deemed necessary.

From time to time, the Group Trustee may consider the methods by which, and the circumstances under which, they would monitor and engage with an issuer of debt or equity, a fund manager or another holder of debt or equity, and other stakeholders. The Group Trustee may engage on matters concerning an issuer of debt or equity, including their performance, strategy, risks, social and environmental impact and corporate governance, the capital structure, and management of actual or potential conflicts of interest.

10. REVIEW OF THE SIP

As required by the Pensions Act, the Group Trustee has consulted with the sponsoring employer and other relevant employers prior to writing this Statement of Investment Principles, and has considered their recommendations and comments and will take these into account when the Group Trustee believes it is appropriate to do so.

The Group Trustee will review this SIP at least every three years and following any significant change in investment policy.

11. ADDITIONAL VOLUNTARY CONTRIBUTION ("AVC") ARRANGEMENTS

The Group Trustee provides a range of funds for the members. The key aim of the Group Trustee is to provide a range of investments that are suitable for meeting members' long and short-term investment objectives, based on the Group Trustee's consideration of members' needs.

The fund range is reviewed from time to time to ensure that it continues to meet the needs of members. On an annual basis the Group Trustee considers performance information and the range of funds is considered at least on a triennial basis.

SIGNATURE OF APPROVAL

Dated:

Signed on behalf of National Grid Electricity Group of the ESPS

Name:

Position:

Version	Document Name	Nature of change	Implemented
2016 V1	SIP v7.pdf	Reformatting SIP to allow for new 1PID	
2017 V1	SIP 2017 v1.0 pdf	Removing comments regarding unitised fund, Aon Hewitt's position as investment adviser (moved to IPID) and including investment beliefs (moved to IPID). Amended delegation wording.	i
2017 v2	SIP 2017 v1.1	Amended wording in Section 2 "Investment Objectives" for Company comments.	
2018 VI	SIP 2018 v1.0	Removal of list of investment beliefs and referral to supplemental Investment Beliefs document.	
2019	SIP 2019	Adding new content on the approach to Responsible Investment to reflect new requirements under Regulations (before October 2019)	
2020	SIP 2020.v3.0	Adding new content on arrangements with fund managers, voting and engagement and cost transparency to reflect new requirements under Regulations. Updating the GTB's long-term financial objective.	
2020	SIP 2020 v4.0	Updated draft reflecting IC comments for approval at the 9 September 2020 GTB meeting.	
2020	SIP 2020 - Final	Changes in v4.0 approved at 9 September 2020 GTB meeting.	
2022	SIP 2022	Made reference to the daily monitoring of the Group's funding level. Updated to formally document that the Group has an agreed cashflow policy.	
2023	SIP 2023	Removed reference to the de-risking flightplan and monitoring.	