KINGFISHER PENSION SCHEME

STATEMENT OF INVESTMENT PRINCIPLES

June 2014

<u>Section</u> **<u>Contents</u>**

1. INTRODUCTION

1.1 Pensions Acts

Under the Pensions Act 1995 and as amended by the Pensions Act 2004, the Trustee is required to prepare a statement of the principles governing investment decisions of the Kingfisher Pension Scheme (the Scheme). This document fulfils that requirement.

The ultimate responsibility for deciding investment policy lies solely with the Trustee. However, the Trustee will consult the Principal Employer on changes in investment policy as set out in this document.

In drawing up this document, the Trustee has sought written advice from the Scheme's professional advisers. The Trustee will review this document, in consultation with their advisers, at least once a year, or sooner following a significant change to the investment arrangements.

1.2 Scheme Details

This document describes the investment policy pursued by the Trustee of the Kingfisher Pension Scheme (KPS).

KPS operates for the exclusive purpose of providing retirement and death benefits for members and other beneficiaries.

Members of the Final Salary Section of the Scheme are contracted-out of the State second pension under the Pension Schemes Act 1993.

KPS is a registered pension scheme for the purpose of the Finance Act 2004.

2. FINANCIAL SERVICES AND MARKETS ACT 2000 AND THE ROLE OF THE INVESTMENT COMMITTEES

In accordance with the Financial Services and Markets Act 2000, the Trustee sets the general investment policy, but has delegated day-to-day responsibility for investing the Scheme's assets (other than Trustee bank accounts) to external investment management organisations. This is to ensure that investment decisions are taken only by persons or organisations with the skills, information and resources necessary to take them effectively.

The Trustee has also established a Defined Benefit Investment Committee and a Defined Contribution Investment and Retirement Committee. The responsibilities delegated to the Investment Committees are detailed in the Investment Committees' Terms of Reference.

3. ROLE OF PROFESSIONAL ADVISERS

Professional advisers in this context include investment managers, the Actuary and investment consultants. Their role is to:

- participate with the Group Pensions Department (GPD) in periodic reviews of KPS investment arrangements and the Statement of Investment Principles (SIP);

- advise the Trustee of significant changes in the investment environment that may have implications for the existing investment strategy; the Trustee may use more than one investment advisory service to provide advice to the scheme, and will use an advisory service where they feel it is appropriate or legally required.

- in the case of investment managers, manage on a day-to-day basis the portfolios of assets delegated to them with a view to achieving the objectives mutually agreed with the Trustee and regularly report on progress.

4. INVESTMENT BELIEFS

Outlined below are a set of high level investment beliefs that represent the views of the Trustee of the Kingfisher Pension Scheme given the Scheme's funding objective.

The beliefs provide a framework that help maintain the quality of the investment decisions taken. Furthermore a clear set of investment beliefs can be used as a benchmark by which investment decisions can be judged.

Liabilities : A sound understanding of the Final Salary Section's liabilities is necessary in order to make investment decisions.

Investment Risk : The Trustee has agreed a secondary funding target with the employer, taking into account the strength of the employer covenant. In order for this to be reasonably affordable it is necessary to take investment risk. Appropriate risk measurement tools should be used to measure and monitor this risk. Investment decisions should be made with regard to an agreed risk budget.

The Trustee believes in concentrating on taking intended risks that they believe will be rewarded and seek to hedge unintended, unrewarded risks whenever practicable and at reasonable cost.

Asset Allocation : Asset allocation is a key decision in pension scheme investment with significant implications for long-term investment returns. The Trustee sets the overall strategy after consulting with the employer.

Diversification : Diversification of the Scheme's investment strategy with regard to both its 'growth' and 'matching' assets, should reduce the level of risk inherent in the Scheme's overall investment strategy.

Passive v Active Management : Passive investment management generally offers the best performance return after fees in a number of asset classes, particularly developed equity markets, but active management can add value and may be a more appropriate strategy when investing in some asset classes.

Responsible Ownership : All companies should be run in a responsible way because in the long run this should contribute to the success of those companies, but the Trustee equally recognises its fiduciary responsibility to act in the best financial interest of Scheme members.

Money Purchase Beliefs: The fundamental investment beliefs outlined above (with the exception of the Final Salary related liabilities beliefs) are equally applicable to the Money Purchase Section.

5. KPS FUNDING AND INVESTMENT OBJECTIVES AND STRATEGY– FINAL SALARY SECTION

5.1 Objectives

Kingfisher plc (the 'Company') and Kingfisher Pension Trustee Limited (the 'Trustee') have agreed :

- A funding and investment plan for the Scheme, the Secondary Funding Objective "2FO", which targets a strong funding level and relatively low investment risk and which is in excess of the minimum Statutory Funding requirements. From the 2010 valuation the ultimate 2FO target is for the Scheme to be sufficiently funded to secure benefits with insured annuities by 2030;

- Following completion of the 2013 valuation the employer contribution, effective from 1 April 2014 was agreed at £35.75m + RPI (this includes income from the Special Purpose Vehicle, but excludes the Pension Protection Fund levy which the Company has agreed to reimburse the Scheme for). The employer contribution will be reviewed again after the next 3 yearly valuation as at March 2016 and thereafter each formal valuation through to 2030;

- The 2FO funding target for 2030 will be the expected cost of securing benefits through insured annuities at that time. For the 2013 valuation the expected annuity terms in 2030 assume a discount rate for future benefit payments in line with yields on gilts of appropriate nature and duration;

- Planned investment de-risking switching from return seeking to matching assets. Matching assets constitute 66% of Scheme assets at April 2013 and will constitute 100% of Scheme Assets by April 2030. The Scheme is targeting hedging 79% of the interest rate and inflation risks through its liability hedging portfolio. The Company and the Trustee will agree circumstances under which this de-risking plan could be accelerated;

- That having extended the initial 2FO target date from 2024 to 2030, there is no intention to extend the target 2FO date beyond 2030.

Other details relating to the 2FO and the Statutory Funding Objective are set out in the Statement of Funding Principles and Group Pensions Policy Standard.

The Company and the Trustee have agreed the above planned high-level asset allocation changes in order to achieve an appropriate level of long-term return with an acceptable degree of risk. In practice, the Trustee wishes to move to the target asset allocation in a cost efficient manner, so the timing and magnitude of switches from return-seeking assets to matching assets will be decided upon by the Trustee based on monitoring of the Scheme's progress in reaching the 2FO and with input from the Company.

The objective is subject to regular monitoring by the Defined Benefit Investment Committee with a triennial review as part of the actuarial valuation exercise. The objective forms the basis from which the Defined Benefit Investment Committee develops a more detailed strategy approved by the Trustee Board, which is discussed with the Company. It is then for the Defined Benefit Investment Committee to implement that strategy in terms of asset allocation and the appointment and monitoring of the appropriate managers.

5.2 Asset Allocation

The Trustee's principles on asset allocation are as follows.

- Asset allocation is one of the key decisions of pension scheme investment with significant implications for long-term investment return.

- The Trustee will seek to achieve the investment objectives through investing in a suitable mixture of return-seeking (e.g. UK and overseas equities and property) and matching (e.g. bonds and derivatives) assets. The Trustee recognises that the returns on return-seeking assets, while expected to be greater over the long term than those on matching assets, are likely to be more volatile.

5.3 Investment Management

The Trustee believes that adopting a specialist management approach (where each individual manager has an objective related to a particular asset class) provides greater opportunity to benefit from specialist expertise compared to a balanced approach in the long-term. Furthermore, the Trustee believes they have the resources (including the Investment Committees and the Group Pensions Department) to allow them to monitor and control a specialist management structure. Details of the investment manager structure and their objectives are detailed in the Scheme's annual report and financial statements that can be found on the Scheme's website[1].

5.4 Additional Voluntary Contributions (AVCs)

The Trustee provided a facility for members to pay AVCs to enhance their benefits at retirement. To clearly distinguish AVC investments from other KPS assets, AVCs are invested separately in individually identified accounts with external investment managers. The Trustee monitors the AVC arrangements regularly to ensure that they remain appropriate. Details of the AVCs funds offered can be found on the Scheme's website[1].

In recognition of the wide diversity of individual members' circumstances and investment preferences, the Trustee's objective is to provide a range of funds which give members a choice in terms of varying degrees of risk, return and diversification, over the investment policy of their AVCs.

The Trustee considers that a With-Profits Fund providing diversification between real and monetary assets, as well as a smoothing approach to bonuses and some guarantees on the value of members' accounts, will meet some members' requirements. Alternatively, an appropriate option for other members may be one (or a combination) of the unit-linked funds, where returns are liable to fall as well as rise and which provide no guaranteed return.

5.5 Fees

In addition to base fees, the Trustee believes that performance fees are necessary in certain circumstances.

However, it is difficult to implement just one approach to fees, as managers may be inflexible on changing their standard basis. KPS may have to accept this if it believes a manager can add value and wishes to appoint them despite inflexibility on fees.

All Final Salary Section investment fees (excluding AVCs) are met by KPS.

5.6 Satisfactory Investments

As required by the Pensions Act, the Trustee obtains professional advice on whether these funds are satisfactory.

6. KPS INVESTMENT OBJECTIVES AND STRATEGY– MONEY PURCHASE SECTION

6.1 Objectives

A default strategy is provided which the Trustee believe is suitable for the needs of the membership. The Trustee reviews the investment default on a regular basis. The default option for the Money purchase Section is currently the ten year lifestyle option. The objective for the default option is to target investment returns of CPI +3% after all charges over the long term. The trustees believe this would provide a reasonable probability that an average member could achieve an income of 2/3rds of their final salary, including state pension, at retirement.

The Trustee makes available to members of the Money Purchase Section an appropriate range of investment options to which members and the Company will contribute in order to provide each member with a fund which will be used to secure their benefit at retirement. The Money Purchase Section offers a facility for members to contribute more on a voluntary basis.

In determining which investment options to make available, the Trustee has considered the investment risk associated with money purchase pension investment. This risk can be expressed as the uncertainty of the ultimate amount of savings available on retirement, the majority of which will be used to provide retirement benefits. There are a number of factors which contribute to this uncertainty. Some of them (such as the amount of contributions paid and the length of time these contributions are invested) cannot be managed by the investment options made available to members. The Trustee recognises, however, that some investment risks (such as inflation, capital and pension conversion) can be managed to some extent by the choice of investments.

6.2 Investment Funds

Details of the funds provided can be found on the Scheme's website[1]. The funds offered through the Money Purchase Section were selected by the Trustee in consideration of the Money Purchase Section's objectives, expected returns, risks and other characteristics and the Trustee's view of the needs of the membership. The Trustee recognises that no single option will be sufficient to manage the various risks associated with money purchase investment; the range is designed to be wide enough to enable individuals to manage the risks identified as they become relevant, according to each member's requirements.

In addition the Money Purchase Section offers Lifestyle options. The aim of these options is to try to ensure that members' funds are invested in appropriate funds at the appropriate time, based on their age and the number of years until their selected retirement date. The ten year Lifestyle option is currently the default option for members who fail to choose an investment option.

The investment funds offered through the Money Purchase Section are unit linked arrangements, wrapped in insurance policies.

6.3 Satisfactory Investments

As required by the Pensions Act, the Trustee obtains professional advice on whether these funds are satisfactory.

6.4 Fees

Money Purchase Section members pay an annual management charge. This charge is for administration provider services and investment management fees. The Trustee recognises that there may be additional investment associated administrative costs which will be reflected in the unit price of the fund.

7. INVESTMENT MANAGEMENT MONITORING

The Trustee uses the services of an independent performance measurement company to assess the managers' performance relative to the benchmark returns. The appointment of the investment managers is reviewed on a regular basis by the Investment Committees, based on its monitoring of performance and process.

7.1 Selection Criteria

The Investment Committees have identified the criteria by which investment managers should be selected or deselected. These include:

Business	- supportive ownership from a parent company committed to investment management. - evidence of clear strategic direction.
People	- high calibre, experienced professionals. - relatively low staff turnover. - evidence of clear commitment to investment house culture. - strong recruitment and training plans.
Process	- effective approach to accessing/interpreting research. - robust, repeatable process. - Process consistent with the stated philosophy.
Performance	- acceptable variability in relation to investment manager's style

7.2 Deselection Criteria

Investment managers may be replaced if:

- they fail to meet the performance objectives set
- the Investment Committees believe the investment manager is not capable of achieving the performance objectives in the future
- the Investment Committees believe that another investment manager is better placed to achieve the requisite level of investment performance

The Investment Committees hold meetings with the investment managers to satisfy themselves that they continue to carry out their work competently and have the appropriate knowledge and experience to manage the Investments of the Scheme. An Investment Consultant is present at these meetings. Employees from the Group Pensions Department also regularly meet with the investment managers in between Investment Committee meetings.

8. RISK MEASUREMENT AND MANAGEMENT

The Trustee recognises the following investment risks that the Scheme is exposed to and has taken the following measures to continually monitor and manage these risks. These measures do not render the investment policy free of risk. Rather, the measures endeavour to balance the need for risk control and the need for assets which are likely to achieve the required performance target.

- **Solvency Risk and Mismatch Risk**

The risk that the KPS assets fail to keep pace with the liabilities (due to investment factors) is measured and managed through qualitative and quantitative assessment of the expected development of the liabilities relative to the current and target investment policy. The results of this analysis are regularly discussed with the Actuary and the Scheme's investment advisers.

Mismatch risk can include inflation and interest rate risk. These risks are being managed through an actively managed liability driven investment programme.

- **Concentration Risk**

The KPS assets have been diversified across a range of asset classes, e.g. equities (UK and overseas), fixed interest (UK and overseas), Index-Linked Gilts and cash. Within each asset class there are further diversifying conditions placed on managers, e.g. a limit on the maximum holding in any one stock by each manager.

No investment is permitted in the shares or bonds of Kingfisher plc, or Companies majority owned by Kingfisher plc, other than indirectly through investment in pooled funds.

- **Manager Risk**

The Trustee aims to minimise the impact of any appointed manager underperforming. So, where appropriate, KPS assets are allocated in varying amounts to a number of managers in each asset class, often employing different management approaches (e.g. passive and active).

In addition, each manager is given a specific objective and is subject to guidelines and restrictions on what is permitted in achieving those objectives as specified in the individual Investment Management Agreements.

There is no limit on the value of assets managed by any one manager, however the volatility of the asset class and the manager's investment approach are taken into account when determining the size of each portfolio,

- **Derivative Risk**

Restrictions are imposed on the use of derivatives. Derivatives will be used by KPS for risk management purposes, as part of the strategic asset allocation. Derivatives are also used on a tactical basis by the KPS investment managers to ensure that they are able to cover exposed positions (i.e. risk reduction) and to increase or decrease exposure to markets, other than by direct investment, following asset allocation decisions. Derivatives are not to be used for speculative purposes or to 'gear up' fund returns. There are different facets to derivative risk, namely:

- Counterparty risk - addressed through the investment manager, banks and custodian guidelines with respect to cash management; in the use of derivatives this risk is mitigated through the exchange of collateral or margin.

- Basis risk – the returns from the backing assets used to meet the payable leg of a derivative may not match exactly. This risk is addressed through the investment policy adopted by the Trustee for the backing assets and the investment managers' asset management capabilities.

- Liability risk – pension liabilities can only be estimated and there is a risk of unanticipated changes in the assumptions used to value the KPS' liabilities, hence there may be a divergence between the performance of the derivatives and the actual value of the liabilities. This risk is managed by constructing a derivative strategy based on a best-estimate of future KPS cashflows.

- **Performance Risk**

The risk of the returns on KPS being less than anticipated is monitored by regular review of both individual manager and total fund performance. This allows action to be taken to address persistent deviation from expected levels.

- **Custodian Risk**

Includes the risk that a custodian of the investments held in respect of the Final Salary Section or Money Purchase Section misplaces Scheme investments, that it is receiving, delivering or safekeeping and includes the further risk introduced by the Custodian's use of sub-custodians within some overseas countries

The Trustee Board believes in separating custody of assets from fund management as far as is practical. This provides an element of extra protection for KPS assets as well as the opportunity for efficient consolidated reporting. In addition, restrictions are applied as to who can authorise transfers of cash and the accounts to which transfers can be made.

- **Liquidity Risk**

Sufficient liquidity is maintained to meet expected outflows with assets invested in appropriately realisable classes so as not to disrupt the Scheme's overall investment policy.

- **Currency Risk**

This risk is measured by the level of overseas investments and the translation effect of currencies leading to the risk of an adverse influence on investment values. It is managed by reducing translation risk of investing overseas by hedging a proportion of the overseas investments' currency translation risk for those overseas currencies that can be hedged efficiently.

- **Sponsor Risk**

Includes the risk that the sponsor (in the case of the Principal Employer) cannot, or will not, make good a current or future deficit of the Scheme.

Is measured by the level of ability and willingness of the sponsor to support the continuation of the Scheme and to make good any current or future deficit;

Is managed by assessing the interaction between the Scheme 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 a number of metrics reflecting the financial strength of the sponsor.

- **Contribution Income**

The Schedule of Contributions payable, and their due dates, is maintained by the Trustee, allowing any late (or lower than expected) payment to be raised with the relevant operating company at an early date (delays in the payment of contributions could affect the Scheme's solvency position).

- **Cash Transactions**

The risk of cash being transferred out of KPS in unauthorised circumstances is controlled by the restrictions imposed by the Bank Mandate and controls agreed with the Custodian and investment managers. These measures generally define the circumstances in which cash payments can be made and who is able to authorise them.

9. CORPORATE GOVERNANCE

The Trustee Board believe it is desirable:-

- To have a consistent approach on corporate governance issues.
- To act as a responsible investor.
- To be able to manage the process in a practical way.

Consequently, all investment managers have been asked to exercise voting rights where relevant, referring back to the Group Pensions Department only those issues which they feel are contentious and warrant further discussion before taking action.

10. RESPONSIBLE INVESTMENT

The Trustee Board has delegated day to day investment decisions to its appointed investment managers (within certain guidelines and restrictions).

The Trustee Board believes that all companies should be run in a responsible way as in the long run this should contribute to the success of those companies, but equally recognises its fiduciary responsibility to act in the best financial interest of the Scheme's members. Therefore, the Trustee Board's policy is that the investment managers should take account of social and environmental and governance considerations to the extent that they may have a financial impact on investment performance. With this in mind, the Trustee Board also encourages managers to pursue policies of engagement with their investee companies

The Trustee Board, however, recognises that because of the need to closely track the index benchmarks, it is not appropriate for the Scheme's passive manager to take account of social, environmental and governance considerations in the construction of their portfolio. However, the Trustee Board also encourages its passive manager, and its other pooled fund managers, to pursue a policy of engagement with investee companies.

[1] www.kingfisherpensions.com