Statement of Investment Principles – Pearson Pension Plan

Introduction

This Statement of Investment Principles (SIP) has been prepared by the Plan Trustee (Pearson Pension Trustee Limited) of the Pearson Pension Plan (the Plan) to comply with the requirements of the Pensions Acts 1995, as amended, the Occupational Pension Schemes (Investment) Regulations 2005 and to reflect the Government's Voluntary Code of Conduct for Institutional Investment in the UK.

The Plan Trustee has consulted with the Principal Employer on the content of this document.

Effective Date

This SIP is effective from 24 May 2018.

1. Strategy – Final Pay Sections

Investment Objectives – Final Pay Sections

The Trustee's objectives for the Final Pay Sections are:

- An overall objective to invest the Plan's assets in such a way that sufficient money is available to meet the liability to provide benefits to the members of the Plan into the future. This includes, where possible and agreed with the Principal Employer, discretionary increases to pensions in payment in excess of the guarantees in the Plan Rules, so that total pension increases broadly aim to protect against cost of living increases.
- A shorter term objective of endeavouring to invest the Plan's assets to achieve returns in excess of the growth in the liabilities, whilst maintaining a prudent approach to meeting the Plan's liabilities.
- The Trustee is targeting a self-sufficiency investment portfolio and the primary focus is accurate cashflow matching and risk control.

Allocation of Assets – Final Pay Sections

Asset allocation is considered regularly by the Trustee and reviewed in detail following each actuarial valuation. The Trustee divides the assets of the Plan into two sections the **Insurance Portfolio** and the **Main Portfolio** which are composed as follows:

- The **Insurance Portfolio** consists of assets which are held in the form of insurance contracts matching a portion of the liabilities of the Plan.

  The insurer pays the Plan an amount equal to the pension payment in respect for the members underlying the policy. These insurance contracts are assets of the Plan and the pension liability remains within the Plan.

  Towards the end of 2017 the Plan purchased two separate buy-in policies with Aviva Life & Pensions UK Limited (Aviva) and Legal and General Life Assurance Limited (L&G). The two policies covered approximately two thirds of the pensioner member's liabilities at the time of the transactions.
- The **Main portfolio** consists of all Plan assets outside of the Insurance Portfolio. The Main portfolio is composed of **Matching** and **Return Seeking** assets.

- The **Matching Assets** are assets which produce cashflows that can be expected to match the cashflows for a proportion of the membership. The Matching Assets include bonds, inflation linked property, and infrastructure. Liability Driven Investment is a key component of the Plan's Matching Assets as it allows it to match a higher proportion of the expected liability cashflows.
- The **Return Seeking Assets** are invested with a long term horizon to generate the returns needed to provide the remaining expected cashflows for the beneficiaries. This portfolio is invested in a diversified portfolio of return seeking assets. The Return Seeking Assets are expected to be formed of an allocation to Diversified Growth Funds (DGFs), Property, Private Equity and Infrastructure.

During the third and fourth quarters of 2017 the Plan purchased two separate buy-in policies, as a result the Plan's total allocation, as at 31 October 2017, was 88% to the Insurance portfolio and Matching Assets and 12% to Return Seeking assets. The actual allocation depends on the relevant market values and so will fluctuate over time.

This is a low risk asset allocation which maintains a low probability of requiring further contributions from the Plan's Sponsor in excess of those already agreed. Progress has been made towards reaching this asset allocation following strong performance of the Plan's investments and corresponding increase in the self-sufficiency funding level. Debt payments from the Plan's Sponsor, relating to the Financial Times and Penguin corporate activity (triggering what is called a Section 75 Debt payment), is expected to result in the Plan being fully funded on a self-sufficiency funding level basis by the end of 2020.

The primary focus of the Plan's allocation of investments is accurate cashflow matching and risk control.

The Insurance Portfolio is cashflow matching as it provides payments which are expected to exactly match the benefit payments for the insured members.

Liability Driven Investment is a key component of the Plan's Matching Assets as it allows for accurate cashflow matching and risk reduction.

A small allocation to Return Seeking Assets has been maintained in the Plan's self-sufficiency asset allocation to provide a buffer for any changes in actuarial assumptions, longevity risk, and to potentially allow for discretionary increases to members in certain scenarios as described in the investment objectives.

Based on asset-liability modelling as at 31 December 2014, the asset allocation strategy, allowing for planned de-risking, was expected to generate a return of 3.2% per annum with an acceptable level of volatility over the next ten years. The expected return of the Plan's asset allocation, incorporating the two buy-in transactions, was checked in 2017 to ensure it remained appropriate immediately following the transactions. The Plan's investment strategy is due to be fully reviewed and modelled in 2018 alongside the Actuarial Valuation. The allocation to each asset class will vary due to market movements and will be kept under review by the Trustee.

2. Strategy – Money Purchase Sections

Investment Objectives – Money Purchase Sections	The Trustee's objective for the Money Purchase Sections is to make available to members of the Money Purchase Sections 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 his or her benefit at retirement.
Investment Strategy – Money Purchase Sections	Alongside the Final Pay Sections are the Money Purchase Sections, which are treated entirely separately and look to provide each member with an appropriate range of Funds to select as well as ensuring that the strategy for each of the Lifecycle options is appropriate for the variety of members taking part. The investment choices should provide appropriate exposures to generate income and capital appreciation which, combined with member and employer contributions, will help towards the provision of a sufficient retirement benefit. The investment funds offered to members are provided by the Aviva investment platform and consist of the following asset classes: ▪ Equity ▪ Bonds ▪ Diversified Growth ▪ Property ▪ Cash

3. Risks

Risks

The table below sets out the key risks in relation to both the Final Pay and Money Purchase Sections.

<table>
<tr><th>Risk</th><th>Final Pay Sections</th><th>Money Purchase Sections</th></tr>
<tr><td>Funding
Insufficient assets to cover accrued liabilities.</td><td>Managed by careful structuring of the funding and investment arrangements, along with regular monitoring.</td><td rowspan="2">The liabilities equal the assets, but there is a related risk of not meeting members' reasonable expectations in terms of pension proceeds on retirement, bearing in mind members' contributions and fund choices. This is managed through careful design of the lifecycle strategies and offering an appropriate fund range, along with regular monitoring.</td></tr>
<tr><td>Mismatching
A difference in the sensitivity of asset and liability values to financial and demographic factors.</td><td>This is considered when setting the investment strategy and managed through regular reviews of the investment strategy.

The Insurance portfolio is expected to perfectly match the liabilities of the insured members.</td></tr>
<tr><td>Interest Rate
The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.
These fluctuations will affect the valuations of both assets and liabilities (the Scheme Actuary values the Final Pay Sections liabilities with reference to UK Government bond yields).</td><td rowspan="2">This is managed by formal review of the sensitivity between the assets and liabilities after each triennial valuation, or if there are any significant changes to the profile of the liabilities, or major changes in investment markets.
The Insurance portfolio is expected to perfectly match the liabilities of the insured members.</td><td rowspan="2">The liabilities equal the assets, but there is a related risk of not meeting members' reasonable expectations in terms of pension proceeds on retirement, and this will be subject to interest rate and inflation risk. This is managed through careful design of the lifecycle strategies and offering an appropriate fund range, along with regular monitoring.</td></tr>
<tr><td>Inflation
The risk that the fair value or future cash flows from an investment will fluctuate due to changes in realised or expected inflation.
The Plan's liabilities are often directly linked to inflation and the risk is that the assets do not also have this sensitivity.</td></tr>
<tr><td>Longevity
Related to the increasing life expectancy of pensioners and policy holders. This can result in higher than expected payout.</td><td>This is currently managed by including a buffer in the targeted returns and a funding reserve in the Main portfolio; and through the purchase of buy-in policies held within the Insurance portfolio.</td><td>Not applicable since members decide how to take their own benefits.</td></tr>
</table>

Risk	Final Pay Sections	Money Purchase Sections
Credit The risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation.	This is managed by ensuring that appropriate guidelines are in place. The Trustee receives regular reports from the managers setting out the extent of credit risk within their portfolios and, in particular, whether any agreed guidelines have been breached. For the Insurance Portfolio the Plan is exposed to the risk that an insurer defaults on its obligation to pay the pensions of the insured members. This risk is mitigated as the two policies have been purchased on a collateralised basis. Collateral pools are held within accounts in the Plan's name at the Plan's Custodian. Should the insurer fail, the Trustee takes back the collateral pool. The collateral contained in these accounts is in the form of Gilts and Corporate bonds and are governed by contractual guidelines one of which is that the bonds contained in the collateral pools must be of Investment grade. This means that they have a rating of BBB- or above.	The Plan's Money Purchase Sections are subject to credit risk associated with the underlying investments. A wide range of funds are available to allow members to suitably diversify their investments to manage this risk. This is also considered when setting the lifecycle strategies.
Currency The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.	The Plan assets are, for the most part, Sterling denominated, as are the Plan's liabilities. A small level of currency risk remains in relation to the investment in overseas assets. The Trustee takes a long term view on currency risk and accepts some of the short term volatility in currency markets to avoid the costs associated with currency hedging.	The Trustee has discussed currency risk for Money Purchase Sections members and determined that members are reasonably well protected in the Lifecycle strategies given that the risk relates primarily to the global equity exposure which is reduced from 15 years before retirement. Members who self-select their own Funds are able to manage this risk themselves and all members are made aware of the currency risks in relation to relevant investments through the available literature.
Other Price The risk that the fair value or future cash flows of a financial asset will fluctuate as all investments are subject to	These risks are managed by ensuring that the portfolio is well diversified both across asset classes and within each individual asset class. In addition the Trustee takes	Other price risks are managed through regular reviews of the investment strategy and fund managers.

idiosyncratic price risks.	advice from its investment consultant as to the continuing suitability of the asset classes and managers in which it invests.	

Risk	Final Pay Sections	Money Purchase Sections
Investment managers This risk arises from a failure to meet target returns.	This is managed by the Investment Committee which closely monitors the performance of the managers and receives formal quarterly reports from the investment consultant giving views on each manager's continuing appropriateness.	
Diversification This risk relates to an inadequate spread of investments and sources of return.	This is managed by spreading the Plan's investments over a range of asset classes and is considered as part of each investment strategy review.	The Trustee has selected a wide range of funds to be available to allow members to suitably diversify their investments to manage this risk. This is also considered when setting the lifecycle strategies.
Covenant This risk relates to the possibility of the failure of the Plan's sponsor.	This risk is managed through the appointment of an independent third party covenant advisor and the monitoring of a number of key metrics, such as the size of the Plan's deficit in relation to the Company, on a quarterly basis.	
Pension Conversion There are risks relating to the point of retirement for members and the approach they take to retirement, in other words whether they take cash, transfer to an income drawdown provider or purchase an annuity.	Not applicable as these risks are borne by the Scheme not the members.	These risks are considered when designing the lifecycle strategies and determining the fund range and are managed through regular monitoring.
Cash flows This risk relates to a shortfall of liquid assets relative to the Plan's immediate liabilities.	This is managed by regular monitoring of liquidity levels and expected outgo.	All of the funds used are all daily dealt so sufficient liquidity should be available to members if they required cash for any outflow.
Operational This risk relates to fraud, poor advice or negligence.	Operational risk is reduced as far as possible by due diligence on the appointment and review of managers and advisers, and by contracts of engagement. Additional controls are provided by the regular reviews of the Plan and its operations carried out by Pearson plc's internal audit team and external auditors.	
Political This is the risk of an adverse influence on investment values arising from political intervention.	It is managed through regular reviews of the investment strategy, and fund managers. Relevant government consultations will be discussed with the investment consultant in advance of any anticipated changes.	

4. Implementation – Final Pay Sections

Insurance Portfolio The Plan holds two Insurance policies details of which are outlined below.

Investment Manager/Insurer	Objective
Aviva Life & Pensions UK Limited	To make payments to the Plan which are expected to match the benefit payments of the insured members.
Legal and General Assurance Society Limited	To make payments to the Plan which are expected to match the benefit payments of the insured members.

Matching Assets The Plan's assets invested in matching asset classes are outlined below.

Investment Manager/Insurer	Objective
Legal & General Investment Management	To manage a bespoke Liability Driven Investment mandate, benchmarked against the Plan's expected liability cashflows. This mandate includes UK fixed interest government securities, UK index-linked government securities, interest rate and inflation swaps and other derivative instruments or bonds as appropriate.
LaSalle Investment Management	To manage a portfolio of RPI linked properties.
Infrared Capital Partners	To manage an infrastructure portfolio.
Aberdeen	To manage an infrastructure portfolio.

Return Seeking Assets The Plan's assets invested in Return Seeking assets are outlined below.

Investment Manager	Objective
LaSalle Investment Management	To manage a portfolio of property investments.
Pantheon Ventures	To manage a portfolio of Unquoted Equity 'Fund of Funds'. Pantheon invests in a range of different Fund of Fund products which provide the Plan with diversification across global regions (US, Europe and Asia), strategies and vintages.
EQT	The EQT Fund will make primarily controlling and co-controlling investments in infrastructure investments located in Northern and Eastern Europe with the flexibility to invest globally.
Alinda	To invest in large economic infrastructure assets, predominantly from the secondary market. These assets will predominantly be sourced from the US and Western Europe.
Meridiam	To manage an infrastructure portfolio with an emphasis on the Transportation (primarily roads) and Social sectors in Continental Europe.
CB Richard Ellis	To manage a diversified exposure to pan-European real estate (excl. UK) through investment in Investment Funds and/or Property Related Assets.
BlackRock	To manage a Diversified Growth Fund.
Standard Life	To manage a Diversified Growth Fund.

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 Plan's benefit payments 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 Plan. The Trustee expects the investment managers to give effect to the principles in this statement as far as is reasonably practical.

The Trustee has agreed a series of investment restrictions for each manager where there is a separate Investment Management Agreement (IMA) in place. The Trustee will monitor the continuing tenure of the Investment Managers, including the competitiveness of their fee structures, from time to time, based on advice from the Investment Committee and the external investment adviser. The Trustee will also utilise compliance reporting provided by the custodian, Bank of New York Mellon, in the monitoring of Investment Managers.

5. Fund range – Money Purchase Sections

A list of funds that are currently provided are shown below, along with their investment objectives:

Fund	Objective
Blended Global Equity Fund	The fund aims to provide returns consistent with the composite benchmark by investing in a range of funds that provide exposure to global equities, including emerging markets.
MFS Global Equity Fund	An actively managed fund invested in a portfolio of equity securities of global issuers. The Fund aims to outperform the MSCI World Index.
Aquila UK Equity Index Fund	A passively managed fund invested in shares of UK companies which aims to achieve a return that is consistent with the return of the FTSE All Share Index.
Blended Multi Asset Fund	The fund aims to outperform its benchmark by 3.75% per annum over rolling 5 year periods investing in a range of asset types, which might include global equities, fixed income, property and other assets. The benchmark for the fund is set as 50% 3 Month LIBOR and 50% 1 Month LIBOR.
Threadneedle Pensions Pooled Property Fund	An actively managed fund invested in property with a performance objective of achieving a return above the AREF/IPD UK Quarterly Property Fund Index.
Aquila World ex-UK Index Fund	A passively managed fund primarily invested in shares of overseas companies, with a performance objective of achieving a return in line with the FTSE All-World Developed ex-UK Index.
Blended Index Linked Gilt Fund	The fund aims to perform in line with its benchmark by investing in a range of funds that provide exposure to both long and short dated UK index linked gilts.
Aquila Over 15 Year Corporate Bond Fund	A passively managed fund primarily invested in investment grade corporate bonds denominated in Sterling that have a maturity period of 15 years or longer. The fund aims to achieve a return in line with the iBoxx Sterling Non-Gilts Over 15 Years Index.

Aquila Over 15 Year Gilt Index Fund	A passively managed fund primarily invested in UK government fixed interest securities that have a maturity period of 15 years or longer. The fund aims to achieve a return in line with the FTSE UK Gilts Over 15 Years Index.
BlackRock Sterling Liquidity Fund	The fund seeks to maximise current income consistent with the preservation of capital and liquidity through the maintenance of a portfolio of high quality short-term "money market" instruments.
Jupiter Ecology Fund	An actively managed fund invested worldwide in companies that demonstrate a positive commitment to the long-term protection of the environment. The fund aims to provide long term capital growth consistent with a policy of protecting the environment. The fund measures performance relative to the FTSE World and the FTSE Environmental Technology 100 Index.

Lifecycle Options

The aim of the Lifecycle Options is 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 Lifecycle Options' strategies involve a phased switching approach as described below:

The **Drawdown Lifecycle is the default Lifecycle Option** for the Plan and initially invests in the Blended Global Equity Fund. Starting from 15 years from retirement this holding is gradually switched into the Blended Multi Asset Fund such that 12 years from selected retirement age the member is invested 72% in the Blended Global Equity Fund and 28% in the Blended Multi Asset Fund. 12 years from retirement the Aquila Over 15 Year Corporate Bond Index and the Blended Index Linked Gilt Fund are gradually incorporated such that at retirement members are invested in the following proportions: 32% Blended Global Equity Fund, 28% Blended Multi Asset Fund, 20% Aquila Over 15 Year Corporate Bond Index and 20% Blended Index Linked Gilt Fund.

The Plan also makes available two additional Lifecycle strategies for members to self-select:

The **Annuity Lifecycle** invests members' money in the same way until 5 years before retirement from when the member is gradually switched into a combination of 75% Blended Index Linked Gilt Fund and 25% BlackRock Sterling Liquidity fund.

The **Cash Lifecycle** invests members' money in the same way until 5 years before retirement from when the member is gradually switched to the BlackRock Sterling Liquidity fund.

Choosing investments

The Trustee decides which fund options to put forward to members. When deciding to add or remove investment fund options the Trustee will use the criteria set out in the Occupational Pension Schemes (Investment) Regulations 2005.

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 Plan's benefit payments and other expenditure can be met.

6. Default Investment - Money Purchase Sections

Requirement for a default	The Plan Trustee is required to designate a default arrangement into which members who are automatically enrolled are invested. The Trustee has designated the Drawdown Lifecycle (as outlined in section 5) as the default arrangement for the Plan.
Default design	The default Lifecycle strategy was constructed following analysis of the membership of the Plan. This analysis took into account factors such as age, salary, contribution level, accumulated fund values and term to retirement to identify different types of member in order to test alternative investment strategies. The design of the default Lifecycle strategy reflects this analysis having carried out multiple simulations of future economic and investment scenarios.
Objective of the default	The aim of the Drawdown Lifecycle strategy is to provide members with the potential for higher levels of growth during the accumulation of their retirement savings though exposure to equity and diversified growth funds and then to gradually diversify their investments in the years approaching retirement, in order to reduce volatility while still providing suitable exposure to growth assets, as appropriate for members who are expected to take their funds flexibly, through income drawdown. The asset allocation throughout the default Lifecycle strategy and the phasing of the gradual switching of investments takes into account members' greater capacity for risk early on and reduced capacity for risk in later years.
Reviewing the default	The default Lifecycle strategy will be reviewed periodically with reference to the manner in which members are expected to take their benefits from the Plan. This periodic review will also take into account any significant changes in the demographic profile of the relevant members, changes in available investment options and market conditions.
Compliance with the Investment Regulations	The Trustee's policies in relation to the default arrangement in respect of matters set out in Regulation 2(3) of the Occupational Pension Schemes (Investment) Regulations 2005, as amended, are those set out in the previous sections.

7. General

Division of responsibilities

The Plan Trustee has ultimate responsibility for decision making on investment matters. In order to ensure that such decisions are taken effectively, the Plan Trustee uses other bodies either through direct delegation or in an advisory capacity. These groups include:

- Investment Committee
- Property Trustee (Pearson Pension Property Trustee Limited)
- Money Purchase Working Party
- Investment Managers and Custodian
- External Advisors such as the Scheme Actuary and Investment Adviser
- In house Pensions department.

Each group has a range of responsibilities which have been agreed by the Plan Trustee.

Additional Voluntary Contributions (AVCs)

The Plan provides a facility for members to pay AVCs to enhance their benefits at retirement. The members are offered a range of funds in which to invest their AVC payments. This includes the option to pay AVCs to the funds outlined in the Fund Range – Money Purchase Sections on pages 10 and 11, or the AVC Lifecycle Option.

The AVC Lifecycle Option invests members' money in the same way as the Cash Lifecycle noted above.

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. Written advice will be obtained from the Investment Adviser when reviewing, buying or selling direct investments.

The Trustee will use the criteria set out in the Occupational Pension Schemes (Investment) Regulations 2005 when selecting direct investments and will exercise its powers in accordance with this statement.

Socially Responsible Investment (Environmental, Social and Governance Factors)

The Plan Trustee's policy is that the extent to which, environmental, social, governance or ethical considerations are taken into account is left to the discretion of the Investment Managers. Currently, the Plan's active Investment Managers have mandates that allow the exercise of such discretion. However, the Plan's Investment Committee (IC) proactively monitors all of the Plan's active investment managers. In addition to the usual quarterly monitoring, the active investment managers are required to attend IC meetings, typically once a year. These Manager presentations provide an opportunity for the IC to discuss responsible investment along with other aspects of the manager's mandate and are considered an important aspect of these discussions.

It is not appropriate for the Plan's passive Investment Manager to take account of social, environmental or ethical considerations in selecting investments for their portfolio but their corporate governance policy reflects the key principles of socially responsible investment.

In addition to the above the IC also undertakes the following:

- When appointing new active investment managers, their approach to socially responsible investment and environmental, social and governance factors is incorporated into the selection process and referenced in their Investment Management Agreements.
- The IC reviews the Plan's responsible investment policy, typically once a year. The latest investment manager policies are also reviewed and developments in responsible investment are discussed.
- The Plan monitors whether its Investment Managers are signatories of the UN Principles for Responsible Investment (PRI). The IC encourages investment managers to become PRI signatories and requests explanations where they are not.

The Money Purchase Sections includes the Jupiter Ecology Fund as an option for members who wish to invest in a fund focussed on environmental protection.

Corporate Governance

It is the Plan Trustee's policy to encourage the Plan's Investment Managers to pursue a policy of engagement, where appropriate, with companies in which they invest.

Custody

The Trustee employs Bank of New York Mellon (BNY Mellon) as the Plan's global custodian and monitors its ongoing suitability on a periodic basis. A list of responsibilities has been devised for the custodian.

Investment Adviser

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

Review of SIP

In drawing up this document, the Plan Trustee has sought advice from the Plan's Investment Consultant, Aon Hewitt Limited, and the Scheme Actuary, and has consulted with the Investment Managers.

This SIP will be reviewed typically annually or immediately following a change of investment policy. Written advice on any changes will be taken from the Investment Adviser and the Sponsoring Company will also be consulted.

Policy on Rights Attaching to Investments

The Plan Trustee is in agreement with the principles of effective stewardship included in the Financial Reporting Council UK Stewardship Code, and has requested the Investment Managers to comply with these principles.