



# Strategic investment framework

**2015-2020**

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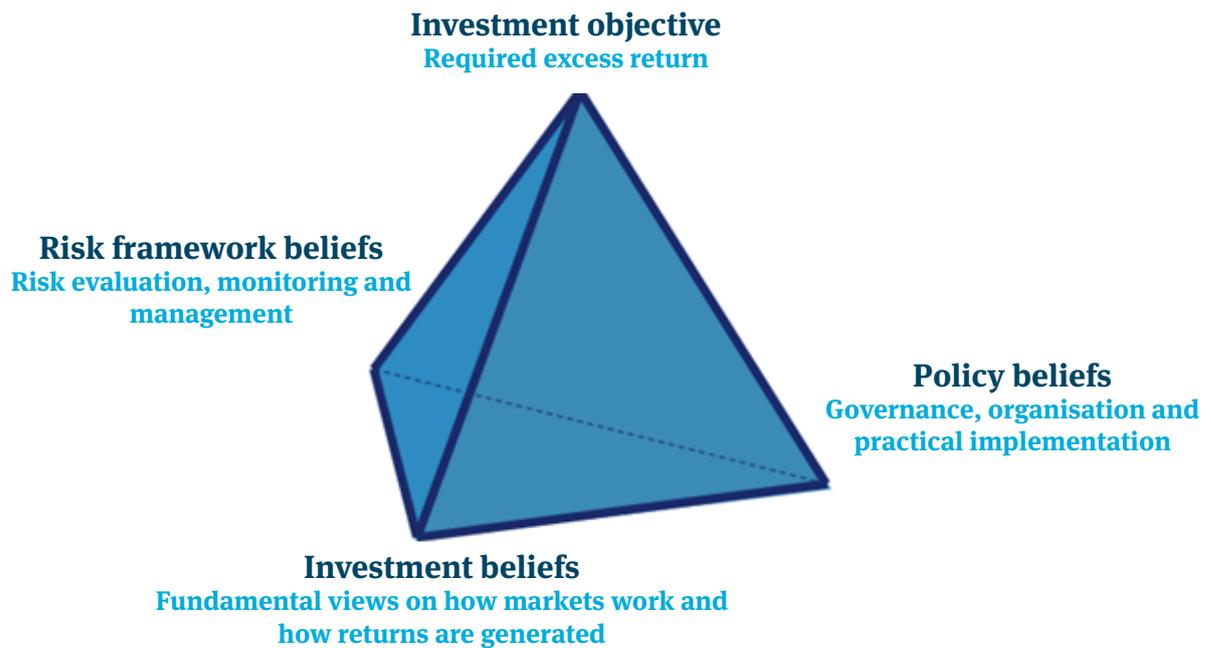
Approved on 8 December 2015

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## Introduction to the strategic investment framework

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This strategic investment framework can be described using a ‘pyramid’ – a schematic overview of the premise that a modern and comprehensive investment framework should comprise four coherent building blocks, at the top of which sits the investment objective, which in this case is to generate the required excess returns.



To achieve its investment objective, PMT applies three sets of principles:

- **Investment beliefs:** these indicate how PMT thinks it can generate returns. They reflect PMT’s convictions about how the economy and the financial markets operate.
- **Policy beliefs:** these define the way in which the investment process is governed, organised, and implemented in practice.
- **Risk framework beliefs:** these set out how the investment portfolio’s risk profile is reviewed and adjusted.

The investment objective and the three sets of beliefs and principles are looked at in greater detail below.

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# 1. Objective

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## Mission

PMT provides an affordable, sustainable and where possible inflation-linked pension for all participants. PMT is aware of its surroundings and anticipates future developments. There is collaboration with members, employers and social partners. The interest of members is always paramount. PMT is accessible and gives members - both digitally and in personal contact - optimal insight into their pension and their choices. PMT is also transparent about what happens with the paid contributions.

## Payments into the scheme

To achieve its mission, PMT must first of all ensure that it has sufficient assets. PMT administers the pension scheme as agreed under the collective agreement (CAO). It receives and invests pension contributions so as to be able to pay its members a pension later in life. The contributions are paid by the employees and employers according to an agreed ratio, and should be sufficient to fund annual pension accruals over the next five years (as shown in the analysis of the pension contract's financial sustainability).

## Pension objective

PMT's pension objective comprises, first of all, its commitment to providing a nominal pension and, secondly, its aspiration to provide an inflation-linked pension. Its investment policy aim is to deliver high enough returns on the assets invested in order to provide an index-linked pension as well as ensuring an affordable pension. The investment policy has a long-term horizon and is always reviewed against the pension liabilities.

## Excess returns are vital

PMT endeavours to achieve its pension objective in an environment of uncertainty, in which central banks are a major influence because of the exceptional monetary policies they are pursuing. Interest rates are historically low. Interest rates being what they are, the contributions paid into the scheme are in many cases just about sufficient to fund a nominal pension, leaving no space to fund an inflation-linked pension. PMT will therefore need to generate investment returns, now more so than in the past. This means that PMT's investment policy is key to achieving its long-term objective.

## Required excess returns

In practical terms, PMT's investment objective translates into a required annual long-term excess return of 1.5%. In other words, the annual rate of return on investments must exceed the change in market value of the pension liabilities by an average of 1.5%. Large fluctuations may occur in the short or medium term. In a period of prolonged interest rate declines, in particular, this objective is unlikely to be achieved. Over a long-term horizon, however, PMT has generated historical excess returns of 1.5%. Over the next few years, excess returns achieved will need to be used to restore the funding ratio and buffer. As PMT's financial position goes on to improve, excess returns may also increasingly be used to link pensions to inflation. Aiming to achieve a required excess return of 1.5% is in line with PMT's risk appetite.

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## 2. Investment beliefs

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In order to achieve its investment policy aim, PMT adheres to a number of investment beliefs. These indicate how PMT thinks it can generate returns. They reflect PMT's convictions about how the economy and the financial markets operate.

1. Economic activity is the driver of sustained value creation within an asset class.  
*[the basis for including, first and foremost, asset classes that have underlying economic activity]*
2. The number of fundamental return and risk drivers is limited; the key ones being credit risk and ownership risk.  
*[the basis for investing in fixed-income securities and taking ownership in companies and other assets]*
3. In a properly functioning market economy, taking on long-term illiquid exposures is compensated for.  
*[the basis for investing in illiquid assets]*
4. In a properly functioning market economy, taking on interest rate risk is not rewarded in the long term. In the long term, real interests rates will be positive, driven by positive long-term economic growth.  
*[the basis for hedging all or any part of interest rate risk]*
5. In a properly functioning market economy, taking on currency risk is not rewarded in the long term.  
*[the basis for hedging all or any part of currency risk of developed countries]*
6. Financial markets are geared to achieving appropriate valuations in the long term.  
*[the basis for using long-term equilibrium in ALM analyses]*
7. Economic conditions and fluctuations in the financial markets affect risk premiums and the relative attractiveness of investment choices.  
*[the basis for a dynamic policy]*
8. It is unlikely that liquid markets involving many market participants can be outperformed over longer-term periods.  
*[the basis for preferring passive management of liquid asset classes]*
9. Investments can yield solid returns only if the economy is allowed to evolve responsibly.  
*[the basis for responsible investing]*

## 3. Policy beliefs

In order to achieve its investment policy aim, PMT adheres to a number of policy beliefs. They define the way in which the investment process is governed, organised, and implemented in practice.

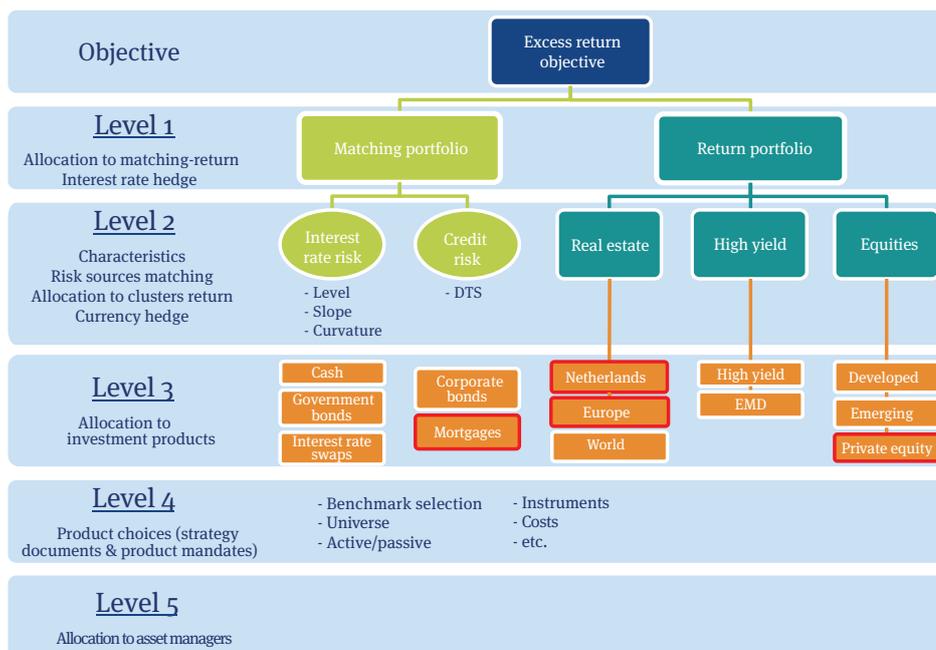
### A. Portfolio structure

#### 1. Excess returns are key

The investment portfolio is constructed with a view to generating excess returns, that is to say, returns in excess of the change in market value of liabilities. This requires considering the whole of the assets versus liabilities.

#### 2. Five investment levels

The investment portfolio comprises five levels (this is further clarified under *B. Portfolio governance*):



\* Illiquid assets are marked in red

#### 3. Matching and return portfolios

At level 1, PMT has divided the portfolio conceptually into a matching portfolio and return portfolio. The aim of the matching portfolio is to replicate the change in market value of liabilities. The aim of the return portfolio is to generate excess returns over and above the liabilities so as to achieve the excess return objective at an aggregate level.

#### 4. Minimum percentage investment products

An asset cluster may comprise different investment products, all of which, as a rule, must account for at least 4% of total assets. Smaller allocations would use up a disproportionate part of the governance budget, while having little impact. Any variation from this rule will require an explicit justification.

## B. Portfolio governance

### 1. Own objective is guiding principle

PMT pursues its own objective, and reviews its performance against that objective. It does not allow itself to be distracted from executing its policy by 'peer group pressure'.

### 2. Investment horizon

PMT takes the long-term nature of its liabilities as a basis and therefore uses a longer-term horizon for its investments. Circumstances may arise in the short term, however, which may put pressure on its longer-term objective. PMT is aware of the opposing forces of shorter-term requirements and longer-term objectives and therefore seeks a balanced approach to developing its investment policy.

### 3. ALM analyses

PMT uses ALM analyses as a test tool in the guidance of its portfolio.

### 4. No tactical policy

Since predicting shorter-term market fluctuations does not constitute an appropriate basis for a prudent investment policy, PMT pursues no tactical policy.

### 5. Dynamic policy

PMT pursues a dynamic policy in managing its portfolio. PMT believes that a structured portfolio governance approach is an appropriate way to control its complexity and ensure that the right issues are addressed at each level, allowing a clear division of responsibilities. This is why it distinguishes between the five portfolio levels referred to above:

#### Level 1

##### **Guidance**

At the highest level, PMT manages on the basis of allocations to the matching portfolio and return portfolio, and the size of the interest rate hedge, using a specific bandwidth for both. These strategic choices are linked directly to the objective and are driven by changes in the objective (or its feasibility), PMT's financial position and buffer, the pension contract, population demographics, legislation, regulatory framework, and similar factors.

##### **Governance**

At Level 1, the board is responsible for policy-making and the Investment Committee (*CBL*) for rendering advice and policy implementation. In practical terms, this means that the Investment Committee must:

- keep the portfolio within the bandwidths set by the board;
- bring the portfolio back to within the bandwidths set by the board if they are exceeded, within three months after the next following Investment Committee meeting.

If bandwidths are exceeded, consultations will be held and a decision made. If bandwidths are exceeded, the default action will be to move back to the middle of the bandwidth. If the Investment Committee initiates a move within the bandwidth, it must be towards the middle of the bandwidth.

The board sets out the policy choices made in the annual investment plans. The board may vary from those in separate decisions. The Investment Committee decides on how to perform its governance duties within the space allowed for policy implementation in separate decisions.

## **Level 2**

### **Guidance**

At Level 2, PMT manages the return portfolio on the basis of allocations to asset clusters, including bandwidths. PMT defines strategic characteristics for asset clusters, including objectives and expected returns after costs and risk. PMT also defines characteristics for the matching portfolio. PMT manages the matching portfolio based on the risk sources interest rate and credit; for each investment product both components are present to some degree. Level 2 also includes determining the size of the currency hedge, including bandwidths. The main factor to be assessed at this level is the extent to which asset clusters meet their objectives. This is done on the basis of risk premiums, economic conditions, and financial markets. The findings are used to formulate preferences in terms of the weights of asset clusters.

### **Governance**

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The board sets out the policy choices made in the annual investment plans. The board may vary from those in separate decisions. The Investment Committee decides on how to perform its governance duties within the space allowed for policy implementation in separate decisions.

## **Level 3**

### **Guidance**

Level 3 involves filling the asset clusters with assets that reflect the strategic characteristics of the asset clusters the most, and allocating funds to assets. Decisions are driven by the extent to which assets meet the cluster characteristics. This is done on the basis of risk premiums, economic conditions, and financial markets.

### **Governance**

The Investment Committee is responsible for policy-making and policy implementation at this level. This double role is mitigated by the board determining the cluster characteristics at Level 2. The Investment Committee decides what assets to include in the asset clusters and what funds to allocate to those assets. There are no bandwidths. PMT's Fiduciary Platform (FPP) is the advisory body and uses MN's knowledge and expertise. There is an exception for new illiquid assets and new liquid assets that have major reputation aspects: these are submitted for approval to the board. Decisions made are recorded in the strategy documents for the asset clusters, the annual investment plan, policy documents, and proposals to the Investment Committee and board.

## **Level 4**

### **Guidance**

Level 4 involves providing guidance by means of the detailed contents of the strategy documents and product mandates. These include, amongst other things, the benchmark, universe, choice of active/passive, use of instruments, costs, risk control, etc. The strategy documents and product mandates are driven by economic conditions, financial markets, and other external factors that impact the effective design of investment products.

### Governance

The Investment Committee is responsible for policy-making and adopting the strategy documents and product mandates. Document and mandate proposals are submitted by the FPP as an advisory body, using MN's knowledge and expertise. PMT may arrange for these proposals to be reviewed by a third party. MN is responsible for policy implementation and implementing the product mandates within the guidelines issued.

### Level 5

#### Guidance

Level 5 involves providing guidance by selecting, appointing and dismissing individual asset managers. This is done by entering into and terminating investment management agreements (IMAs). Guidance is also provided by allocating funds to and withdrawing funds from the asset managers appointed. Decisions are driven by the suitability of individual asset managers to play a role in implementing the product mandates.

#### Governance

The Investment Committee adopts the policy on asset manager selection and monitoring. As a general rule, MN selects asset managers within the product mandates. Exceptions include MN's internal asset managers, private equity, international property and Dutch direct property over and above a threshold: these are decided on by the Investment Committee. MN prepares the proposals, which the FPP submits to the Investment Committee.

## C. Investment products

### 1. Preference for few links in the chain and physical assets

PMT chooses to have as few links in the investment management chain as possible. It therefore prefers transparent and physical assets over synthetic instruments and products with built-in leverage or tax optimisation.

### 2. Use of derivatives

PMT allows the use of derivatives if they contribute to mitigating its risk profile or enabling efficient and effective portfolio management. PMT is cautious in using non-linear derivatives.

### 3. Preference for efficient beta implementation

For return and manageability purposes, PMT, at product level, concentrates on earning the risk premiums specific to the universe of an asset class as efficiently as possible. The guiding principle here is to take calculated and manageable risks that are sufficiently compensated for.

### 4. Implementation at product level

PMT believes that implementation at product level should be based on efficient portfolio management, whilst reducing any unnecessary complexity, improving transparency and explainability, and cost awareness.

### 5. Preference for own mandates

PMT prefers to invest on the basis of its own mandates rather than through investment funds. This means that assets are owned by PMT. Exceptions are private equity and international property, for which this method of investing is not possible for PMT.

### 6. External asset manager selection

In all cases, asset managers are selected with a view to protecting the interests of PMT's members. They are selected primarily on the basis of their quality and expected financial performance. Financial performance means achieving the best possible returns at suitable risk levels, net of expenses. Best possible returns mean returns that meet the specified objective.

### 7. Private equity, international property, or Dutch property

When selecting a private equity fund, international property or Dutch property over and above a specified threshold, the Investment Committee must approve the investment by authorising an investment proposal.

### 8. Monitoring of external asset managers

PMT arranges for its external asset managers to be monitored. It has defined criteria for the monitoring process, specifically with regard to performance and risk data. Asset managers are contacted frequently and visited at least once a year for monitoring purposes. The information yielded by this process will be included in the quarterly and annual reports presented to PMT.

## D. Costs

### 1. Costs versus added value

Asset management costs must be proportionate to the value added by investments.

### 2. Performance fees

PMT is aware of society's critical focus on performance fees and operates cautiously in this regard. It will continue to urge managers to reduce these fees. Performance fees too must be proportionate to the value added by investments.

### 3. Costs of policy adjustments

When adjusting the investment policy, consideration is given to the costs involved, both the transaction costs and management fees.

## E. Responsible investing

### 1. Responsible investment ambitions

In the light of its objective to generate excess returns, PMT seeks to invest as responsibly as possible, and to have as high a percentage of its portfolio as possible meet the ESG (Environmental, Social, Governance) integration requirements. PMT wants to prevent its investments from having any negative social impact and, where possible, to provide social benefits.

### 2. Fitting in with the metalworking and mechanical engineering sector

PMT seeks to fulfill its ambitions with regard to responsible investing in a way that fits in with the employees and employers of the metalworking and mechanical engineering sector who constitute its rank and file. This is amongst others reflected in the positive impact themes, the engagement themes and in the way PMT deals with the subject of climate change and the CO<sub>2</sub> footprint of the portfolio (see next belief).

### 3. Climate change and CO<sub>2</sub> footprint

PMT provides an affordable, sustainable and where possible inflation-linked pension for all members. A sustainable pension also means that the pension can be enjoyed in a healthy world. Therefore PMT measures the CO<sub>2</sub> footprint of the equity portfolio on an annual basis and actively examines the rest of the investment portfolio, with the aim of reducing the CO<sub>2</sub> footprint. PMT tries to reduce the CO<sub>2</sub> emissions of the companies in which it invests. PMT opts primarily for dialogue and does not immediately divest from companies with high CO<sub>2</sub> emissions. Many companies in the metalworking and mechanical engineering sector also contribute to CO<sub>2</sub> emissions. PMT encourages companies to switch to more environmentally friendly methods and stimulates the search for innovative solutions. PMT believes the metalworking and mechanical engineering sector - both in the Netherlands and abroad - can make the difference when it comes to new energy technologies and a different way of working. PMT wants to contribute to that.

#### 4. Integrated approach

PMT's approach to responsible investing forms an integral part of the investment process. This means that responsible investing is considered in each and every investment decision. Responsible investing is addressed in every new strategy document, product mandate, and investment proposal. When selecting and monitoring asset managers, consideration is given to the integration of ESG risks and opportunities.

#### 5. PRI signatory

PMT is a signatory to the United Nations Principles for Responsible Investment (PRI).

#### 6. Ten leading principles

In line with PRI, PMT has formulated ten leading principles for responsible investing. They are:

1. PMT seeks to generate solid and responsible investment returns. PMT will invest according to ESG criteria: Environment, Social, and Governance.
2. PMT will consider the social impact of its investment policy. PMT seeks to prevent that its policies give rise to or exacerbate social problems. Rather, PMT wants to contribute to addressing social challenges through its investments. Businesses should be aware of the impact they have on the environment, nature and biodiversity, and look for environmentally friendly processes and technologies.
3. PMT seeks to contribute to economic stability and sustainable economic growth. It expects the businesses and countries it invests in to be committed to creating economic value in the medium to long term.
4. PMT will engage with companies involved in bribery, corruption, cartels, extortion or any other form of market abuse, and will actively encourage them to abandon such activities. The same applies for companies that violate environmental standards, employment legislation, or human rights.
5. PMT will not, directly or indirectly, invest in companies that manufacture products in violation of international treaties signed by the Netherlands. Nor do we invest in countries that breach international treaties or which are on the sanctions lists of the United Nations or European Union.
6. PMT considers ESG risks when investing, where possible. If a company acts in violation of international treaties or breaches the guidelines set out in PMT's responsible investment policy, PMT will actively exercise its shareholders' rights to drive improvement. These efforts will need to produce a result at some point, or else PMT will sell its investment in the company or country in question.
7. PMT respects the Universal Declaration of Human Rights and related treaties. It also subscribes to the core conventions of the International Labour Organisation of the United Nations. PMT not only promotes the freedom of association and right to collective bargaining, but also seeks to ban all forms of forced and compulsory labour, child labour, and discrimination in the workplace. PMT adheres to the Rio Declaration on Environment and Development, adopted in 1992.
8. PMT wants the businesses it invests in to comply with the OECD Guidelines for Multinational Enterprises. These are recommendations on how businesses are expected to behave when doing – international – business in terms of corporate social responsibility. This bandwidths from human rights and child labour to taking responsibility for the entire supply chain.

9. PMT wants the businesses it invests in to have a solid corporate governance framework in place. This involves dealing responsibly with issues such as independent oversight, having appropriate pay policies, legal and regulatory compliance, having regard to the rights of (minority) shareholders, and transparent reporting.
10. PMT will make well-informed choices. In the case of any doubt or dilemma, it will make a careful and well-considered choice, based on its own responsible investment policy.

#### 7. Active ownership

PMT takes an active stance in its capacity as a shareholder. To give effect to active ownership, PMT has adopted the standards and principles of a variety of organisations, including the UN PRI active ownership principle, Dutch investor platform Eumedion's best practices for active ownership, the core principles of the United Nations Global Compact, and the OECD Guidelines for Multinational Enterprises. PMT seeks to exert influence with regard to the ESG criteria by, for example, exercising its voting rights, engaging with companies and, if necessary, filing legal proceedings to recover investment losses.

#### 8. Responsible pay structures

PMT encourages the market participants it works with to have responsible pay structures in place. This is set out in PMT's own pay policy.

### F. Dutch-based assets

#### 1. Positive stance

PMT takes a positive stance towards Dutch-based assets. This is because its members have ties with the Netherlands, both during the period when pensions are accrued and when they are in payment. The extent of this positive stance will therefore constantly need to be reviewed against the members' interests. Dutch-based assets will also contribute to fulfilling PMT's social responsibility.

#### 2. Preferences

The employers and employees who constitute PMT's rank and file require a healthy Dutch economy and a flourishing business community (private sector) including jobs. PMT's approach is therefore to invest in the private sector. Given the background of its members, PMT prefers to invest in:

- small and medium-sized businesses (in and outside the metalworking and mechanical engineering industry);
- energy and infrastructure projects, which metalworking and mechanical engineering businesses help construct and/or maintain.

#### 3. Visibility

PMT will allow its investments in Dutch-based assets to be publicised in a general sense. As regards individual investments in Dutch-based companies, however, PMT does not wish to have a direct and visible investment relationship, especially if the company is a PMT member.

#### 4. Place within the investment framework and system

PMT is aware that it uses a top-down investment approach, in which Dutch-based investment propositions are not always a natural phenomenon, due in part to their novelty and limited size. This does not mean to say that they are not suitable investments. PMT therefore assesses propositions on their individual merits on the basis of this investment framework.

The following criteria apply to all investments:

- The asset must fit in with the asset cluster in terms of its characteristics
- The risk/return profile must be justifiable
- The asset manager must meet the usual quality standards
- Manageability must meet the usual standards

The normal guidelines and preferences may be varied from as follows:

- The requirement that the investment product must account for at least 4% of total assets – The investment framework already allows an exception if properly substantiated. That is the case here: being able to convert PMT’s positive stance towards Dutch-based assets into actual investments.
- The preference for investing on the basis of in-house mandates rather than investment funds – As far as Dutch-based assets are concerned, investment funds are in many cases good vehicles, if only to avoid direct investment relationships and to forge alliance with other pension funds.
- The requirement of having a multi-year track record – Given the novelty of many propositions, there will be no track record and the risk/return profile will need to be assessed in a different way.

#### 5. Netherlands Investment Institution

PMT regards the Netherlands Investment Institution (*NLII*) as a vehicle that fits in perfectly with its positive stance towards Dutch-based investments. A co-founder and shareholder in the NLII, PMT recognises its strategic importance. PMT wants to work proactively with the NLII to develop propositions that are in line with PMT’s approach.

The first formal evaluation of the NLII is scheduled to take place at the end of 2016. That will be a natural point in time for PMT to assess whether its strategic relationship with the NLII has produced added value as intended. The relationship will then continue to be reviewed periodically.

#### 6. Decision-making

The Investment Committee may take decisions on Dutch-based investment propositions within the framework provided. If it feels that the proposition is highly sensitive from a social or political perspective, the Investment Committee will leave the decision to the board.

### G. Transparency

#### 1. Transparency as a standard

PMT believes that transparency should be business as usual, unless it would clearly have adverse consequences. This guiding principle arises from the fact that PMT invests contributions paid in by employers and employees. PMT wants to account for every euro and show how the investments will help build a pension.

#### 2. Transparent policy

PMT provides information about the policy frameworks it uses when investing pension contributions by, for example, making this strategic investment framework available to the general public.

#### 3. Transparent implementation

PMT provides information about the implementation of its investment policy through performance reporting.

#### 4. Transparency about responsible investing

PMT provides information about its responsible investment policy and policy implementation.

#### 5. Transparency about costs

PMT provides information about asset management costs by adhering to the Recommendations on Administrative Costs issued by the Federation of the Dutch Pension Funds (*Pensioenfederatie*).

## 6. Transparency about portfolio assets

PMT provides information about individual portfolio assets. Possible exceptions, because of any adverse consequences, may arise from duties of confidentiality, reputation or liability risk, competitive sensitivity, or transparency costs.

## 7. Transparency about history

PMT provides information about the historical development of the fund by making public the annual contributions, paid-out benefits and investment returns since its inception in 1948.

## H. Cooperation with MN

### 1. Fiduciary management

PMT has appointed MN to act as its fiduciary manager. PMT regards MN as a strategic partner, using a consensus model in its dealings with MN where possible. However, PMT has ultimate and decisive responsibility.

### 2. PMT's Fiduciary Platform

PMT's Fiduciary Platform (*FPP*) is composed of members of PMT's executive office staff and MN's Fiduciary Management unit. The chairmanship is held by PMT's Chief Investment Officer. The FPP liaises between PMT's Investment Committee and MN. The FPP prepares the agenda and documents for Investment Committee meetings. These documents will, in principle, be endorsed by both PMT's executive office staff and MN. Exceptions include issues which directly affect (implementation by) MN, issues on which no consensus can be reached, or other issues of a special nature.

### 3. MN attends Investment Committee meetings

The services MN provides will benefit from its having broad-based knowledge of PMT. Because it attends Investment Committee meetings, MN is better able to draw up documents that match PMT's needs and requirements.

### 4. Research and development

PMT regards MN as its primary partner for researching and developing investment expertise for pension purposes. MN develops and keeps its expertise up to date through its activities in financial markets, where it is trading on behalf of PMT, through its contacts with external managers, and by sharing knowledge with its peers, the academic world, and in-house research.

### 5. Extensive contacts with MN

In order to make expertise available to the Investment Committee, PMT maintains contact with a wide range of MN staff so as to keep in touch with the various disciplines at MN that are involved in PMT's investment process. Contacts run primarily through the executive office and MN's Fiduciary Management unit.

### 6. External asset manager selection and monitoring

In all cases, asset managers are selected with a view to the interests of PMT's members. They are selected primarily on the basis of their quality and expected financial performance. Financial performance means achieving the best possible returns at suitable risk levels, net of expenses; best possible returns meaning returns that meet the specified objective. MN may also select in-house asset managers. This is known as internal management. The choice for a particular asset manager may in no event be driven by the interests of MN or any of its staff. The Investment Committee decides on internal management proposals.

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## 4. Risk framework beliefs

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The risk framework beliefs set out how the investment portfolio's risk profile is reviewed, and adjusted.

### 1. Statement of risk appetite

Risk appetite refers to PMT's consistent and predictable view of investment management risks, and the way in which it deals with these risks. PMT's risk appetite in terms of investment management is based on two related perspectives:

- The investment policy directs the way in which PMT goes about achieving its financial ambition. Given that the contributions are defined, PMT's risk appetite is reflected primarily in the trade-off between ambition and risk. The choices made in this respect are set out and substantiated in the document 'Details of strategic asset mix and risk appetite'. This document states amongst others that PMT needs an excess return of 1.5% in order to achieve its ambition. To realize this excess return a strategic asset mix is needed with a relatively high risk profile.
- This risk profile requires a high level of risk control. The design of PMT's risk control framework is explained in this document. Information (part of which is quantitative in nature) on how the framework is implemented is given in the document 'Details of strategic asset mix and risk appetite'. It discusses the requirements to be met by the matching portfolio, the use of cluster characteristics in the return portfolio, currency policy, the use of bandwidths, etc.

### 2. Purpose of risk management

PMT's risk management is designed to achieve the objective of generating the required excess returns within the framework of a high level of risk control.

### 3. Role obligations

PMT will assess risks versus liabilities, where appropriate. These may involve its nominal or real liabilities, depending on the question to be addressed.

### 4. No more risk than necessary

PMT will take no more risk than necessary to achieve its excess return objective.

### 5. Risks must be rewarded

PMT will only take risks if it reasonably expects those risks to be rewarded by appropriate returns.

### 6. Diversification

In order to mitigate its risk exposure, PMT chooses to diversify its allocations across different risk drivers with low correlations.

### 7. Basis of risk management

For every level of return required, a portfolio construction can be devised that produces the least risk. This is how PMT controls its risk exposure.

### 8. Restrictions on size of illiquid assets

PMT allows illiquid assets in both the matching and return portfolio. PMT assesses whether it can benefit from an illiquidity premium by assessing the added value of illiquid investments over comparable liquid investments. In addition, PMT assesses whether the total size of illiquid assets is in line with the investment horizon, the strategic investment framework and the liquidity needs arising from short-term risks.

## 9. Risk indicators

PMT monitors the following risk indicators as a minimum:

- Balance sheet risk
- Required capital (*VEV*)
- Long-term pension performance
- Level of interest rate hedge (level, slope, and curvature of the yield curve)
- Credit risk exposure within the matching portfolio
- Level of currency hedge (for each currency pair)
- Level of cash

If bandwidths are exceeded, an analysis will be performed and a decision made. The default action will be to bring the indicator back to the middle of the bandwidth.

## 10. Risk scenarios based on economic conditions

In addition to risk indicators, PMT also monitors potential risk scenarios arising from economic conditions through quarterly dashboards and – historical – stress tests.

## 11. Definition of balance sheet risk

To monitor balance sheet risk, PMT looks at the volatility of its assets versus its liabilities (tracking error), based on historical data.

## 12. Definition of interest rate hedge

PMT defines the interest rate hedge primarily on the basis of the legal requirements, which currently prescribe the use of the Ultimate Forward Rate (UFR). Since the UFR interest rate does not work properly in managing the interest rate hedge, PMT translates this to an interest rate hedge on the basis of market rates.

## 13. Definition of interest rate risk

Interest rate risk is defined as ‘DV01’: the change in euro value for a 0.01% fall in interest rates. PMT looks at the following key rates: 5, 10, 20, 30, 40, and 50 years; these, and the level, slope and curvature of the yield curve.

## 14. Definition of credit risk in the matching portfolio

Credit risk in the matching portfolio is defined by the Duration Times Spread (DTS) measure.

## 15. Crisis policy

Only in very exceptional crisis situations may PMT decide to vary from the policy adopted and the regular meeting schedules. If an additional meeting is held in such a situation, the default decision will be not to change standing policy. This is to prevent any rash decisions from being taken, because ‘something’ needs to be done. PMT has set out further procedural arrangements to deal with crisis situations in its financial crisis plan and internal rules and regulations.

