



## Final Salary Schemes

# Statement of Investment Principles

## Introduction

- 1.1 This Statement describes the investment strategy and policies of the Trustee applicable to each final salary scheme of the Cheviot Trust. It reflects the legislative requirements and forms the basis for the decision making process in relation to investment strategy.
- 1.2 The Trustee has obtained and considered written advice from the Investment Adviser and Scheme Actuary, both of which the Trustee believes are qualified by their ability in and practical experience of financial matters and have the appropriate knowledge and experience of the management of investments of pension schemes. The Trustee also consulted its lawyers and employers about this Statement.
- 1.3 The Trustee will also obtain and consider advice (as required by law) before making any future changes in investment strategy or investment options, and before revising this Statement. The Trustee will consult with the employers on any proposed revisions.
- 1.4 Each final salary scheme is sponsored by an individual employer and has differing benefit structures and funding positions. This statement sets out the broad principles of the strategy. The specific strategy for each scheme is reflected in Appendix D.

## Governance

- 2.1 The Trustee sets the general investment policy for Final Salary Schemes but has delegated<sup>1</sup> some aspects of the investment governance to the Investment Committee on the basis of clear terms of reference and the day to day investment of the assets to appropriately authorised Investment Managers, accessed either directly or through an investment platform.
- 2.2 Specific roles and responsibilities have been agreed with all professional advisers and are set out in Appendix A. Service standards are in place where appropriate. A list of current advisers is set out in Appendix B.
- 2.3 The Investment Committee meets at least quarterly. Standing items include minutes of previous meetings, an investment governance overview, a governance report which includes detailed performance information, asset allocation review, extracts from the Trust's Strategic Plan relating to investment issues, risk register and value for members. Additional meetings or calls are held as required. Strategic issues are considered by the Investment Committee and then recommended as appropriate to the Trustee for approval.
- 2.4 The Investment Committee commissioned an independent review of the investment decision making structure and performance reporting in 2017 and 2018. The report concluded that the investment decision making structure is robust and allows for efficient management of the different portfolios. Having attended an Investment Committee meeting, the review

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<sup>1</sup> As permitted by law

also concluded that the Investment Committee can and does challenge the investment advisor.

2.5 The investment strategy described in section 5 below is implemented through the use of white labelled funds held on an investment platform. Asset allocation is reviewed at least monthly and changes are actioned as soon as practical. The Trustee believes this to be an appropriate approach to delivering against the investment objectives set out below. The quarterly governance reports include comparison against suitable peer groups, net of fees, which enable the Trustee to monitor both actual and comparative performance.

2.6 The cost of investment governance is shared with other Schemes and Sections within the Cheviot Trust. The relative cost of different investment managers is part of the decision making process when selecting managers or considering asset allocation decisions.

## Investment objectives

3.1 The primary objectives of the Trustee Board for the final salary schemes are:

- i. To ensure that funds will be available to secure members' benefits as they fall due;
- ii. To obtain a rate of return in excess of the return available on government securities or swaps that broadly match the term and nature of each scheme's future benefit payments with an acceptable level of risk for each scheme, and
- iii. To protect schemes as far as possible against adverse movements in the value of assets and the cost of providing the benefits as a result of changes in interest rates and price inflation when practicable and cost effective in the context of each scheme.

3.2 The investment performance objective is to achieve a stable level of return which will enable the Trustee to pay all the promised benefits and reduce the level of on risk assets held over time.

## Risk

4.1 The Trustee recognises that the final salary schemes risks include:

- Funding and Asset/liability mismatch risk
- Interest rates/inflation rises or falls
- Liabilities in excess of assets may not be covered by the liability hedge
- Inadequate diversification or inappropriate investment
- Country risk
- Default risk
- Organisational risk
- Sponsor risk
- Cash flow risk

- Currency risk

4.2 The Trustee has considered these risks (and other relevant risks such as market risk, counterparty risk, operational risk, environmental/social/governance risk or the risk of failing to provide value for members) addressed these risks as far as possible in the investment strategy for the Long Term Investment, Lower Risk Investment, Credit and the Matching Funds.

4.3 Risks are measured and managed as part of regular investment strategy governance, asset allocation reviews and investment strategy reviews. The Trustee identifies, evaluates, manages and monitors risks to the Final Salary Schemes, including their impact, what controls can be put in place to manage those risks and the effectiveness of the risk management process as a whole. As part of quarterly reporting, risks are measured against risk tolerance and market conditions to check whether the performance of each investment option remains in line with the agreed risk objectives

## Investment Strategy

5.1 When setting the investment strategy the Trustee will consider, among other things, the suitability of the investments, the need for diversification, the suitability of the fund managers and compliance with legal requirements. This Statement will then be updated as necessary, and after written consultation with employers. The investment strategy is set following written advice from the Investment Adviser and Scheme Actuary and in compliance with this statement (revised as necessary).

5.2 The Trustee Board has developed (with advice from the Advisers) a set of principles for choosing investments. These principles aim to balance for each scheme:

- Achieving efficient diversification in investment terms
- The strength of the relevant employer's covenant and its ability to withstand funding volatility, and
- The time to maturity of the promised benefits.

Where matters described in this Statement may affect the scheme's funding policy, input has been obtained from the Scheme Actuary. An Investment Fund/Matching Fund structure is adopted for the management of asset allocation.

5.3 The Trustee Board have developed two Investment Funds (a Long Term Investment Fund and a Lower Risk Investment Fund) to meet risk and Return objectives over different time horizons, reflecting the changing needs of schemes as their funding levels improve.

5.4 While both Investment Fund structures focus on risk management, the Lower Risk Investment Fund is designed to target lower risk but with a reduction in the expected return as a result, but with higher certainty and

lower expected risk than the Long Term Investment Fund. This is considered a suitable approach for Schemes with shorter investment outperformance time horizons, which require more certainty of outcome.

- 5.5 The strategic allocation to each Fund is reviewed as part of each triennial valuation for each Scheme or more frequently if necessary. The allocation is determined using the following principles which are designed to ensure the level of risk taken in the investment strategy is commensurate with that which can be sustained by the Sponsor.

The allocation to the Investment Funds<sup>2</sup> will reflect an assessment of the strength of the employer's covenant by the Covenant Adviser and advice from the Investment Adviser. The allocation to the Long Term versus the Lower Risk Investment Fund is based on the outperformance period, the level of outperformance required, the covenant strength and the objective of the Sponsor.

The minimum allocation to the Matching Fund<sup>3</sup> is usually 30% of total scheme assets to ensure sufficient assets to support the liability hedge<sup>4</sup>.

If there is more cash within the Matching Fund than required to support the liability hedge, a Credit Fund<sup>5</sup> is available.

- The Trustee Board may increase the allocation to one or other of the Investment Funds after consultation with the employer depending on the length of the Recovery Plan<sup>6</sup> and the employer's ability and willingness to pay any deficit contributions required.
- The relevant allocation for each scheme is shown in a scheme specific Appendix D to this Statement of Investment Principles.

- 5.6 Rebalancing to the strategic allocation between the Funds<sup>7</sup> normally occurs at least once a year (or if the allocations move more than 5% away from target) unless market conditions are such that the Investment Adviser advises against rebalancing. Investments are held that are readily realisable in most cases, although trading within the liability hedge pooled funds is subject to minimum trade sizes and so the funds are usually only rebalanced once a year.

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<sup>2</sup> The Long Term and Lower Risk Investment Funds hold assets which are designed to produce outperformance against the cost of providing the benefits. See paragraph 5.7 and 5.8

<sup>3</sup> The Matching Fund holds assets which move broadly in line with the cost of providing the benefits. See paragraph 5.9.

<sup>4</sup> The liability hedge protects schemes from interest rate and inflation rate changes and is effected through swaps provided on a pooled basis. The level of the hedge varies from time to time and from scheme to scheme depending on the circumstances. See paragraph 5.9.

<sup>5</sup> The Credit Fund invests in corporate bonds and provides limited out performance against the cost of providing the benefits with less volatility than the Investment Fund. See paragraph 5.10.

<sup>6</sup> The Recovery Plan is the period over which the funding level of the scheme is expected to return to 100% on the funding basis.

<sup>7</sup> Long Term and Lower Risk Investment Funds, Credit and Matching Funds

- 5.7 The objective of the Long Term Investment Fund is to outperform cash<sup>8</sup> by 3.5% per year net of investment management fees over the medium term (which has been defined as a period of more than 5 years). To achieve this target, the Long Term Investment Fund is invested in a diversified range of assets.<sup>9</sup> The asset allocation is reviewed at least monthly and rebalanced if required.
- 5.8 The objective of the Lower Risk Investment Fund is to outperform cash by 2.5% per year net of investment management fees, with a higher degree of certainty of achieving this target over shorter time horizons. To achieve this target, the Lower Risk Investment Fund is invested in a diversified range of assets, with a higher allocation to bond assets (and an overall lower risk profile) than the Long Term Investment Fund. The asset allocation is reviewed at least monthly and rebalanced if required.
- 5.9 The objective of the Matching Fund is to provide assets moving in line with the cost of providing the benefits. This may include investing in swaps or gilts to provide a hedge against movements in the cost of providing the benefits as a result of movements in interest rates or inflation expectations. The level of the liability hedge is reviewed regularly and may increase or decrease depending on prevailing economic expectations and based on advice from the Investment Adviser.
- 5.10 The Credit Fund is made available if a Scheme holds more cash than is required to provide collateral for the swaps in the Matching Fund. The objective of the Credit Fund is to outperform cash by 1.25% per year net of investment management fees. It invests in corporate bonds. The Credit Fund is expected to provide additional returns over cash and is included in the Matching Fund allocation at an overall strategic scheme level.
- 5.11 The Trustee Board may, after consultation with the relevant employer, decide to invest part or all of a scheme's investments in insured annuities to meet the relevant liabilities for pensions in payment or deferred pensioners or both. In these circumstances, the strategic allocation will not take into those investments held outside the Trust.

## Other issues

### Security of Assets

- 6.1 Funds on the investment platform are invested through a long term Insurance policy with Mobius Life Limited. This is a common way of investing under UK pension schemes and helps us give you a range of investment options. Mobius Life has a strong credit rating and solvency ratio. If Mobius Life fails, the underlying assets would benefit from protections through the structure provided by the underlying managers. We would also expect the Financial Conduct Authority to try and find another insurer to replace Mobius Life. If that did not happen

<sup>8</sup> Cash being defined as the Sterling Overnight Index Average Rate (or SONIA)

<sup>9</sup> See Appendix C for details of the asset ranges

and there were any loss associated with the failure of Mobius Life, members of the Money Purchase Section should be eligible for compensation from the Financial Services Compensation Scheme. If an underlying manager failed, the assets should be ring-fenced and Mobius Life, as policy holder, should be able to recover them. The Trustees are satisfied that the assets are as safe as possible whilst still enabling them to manage the assets using a range of underlying managers.

**Environmental  
social and  
governance  
factors**

- 6.2 When selecting and monitoring an investment the Trustee will take into account financially material factors. These are factors that can affect the long-term financial performance of investments and can (but do not have to) include the financial implications of environmental, social and governance factors (otherwise known as ESG) where relevant. All references to ESG also include climate change.
- 6.3 The Trustee has been considering the nature of its investments in the context of long term financial performance and the extent to which the existing investments implicitly include consideration of ESG factors. It is working to provide more information about how it includes consideration of these factors in its decision making. The Trustee is also considering those elements of the investment strategy where the fundamental investment objective is short term in nature and where taking account of ESG factors is unlikely to influence investment performance.
- 6.4 The Trustee is working with the Investment Adviser to understand the new information available to assist the Trustee to assess the commitment and performance of managers in relation to long term financial factors deriving from ESG. This will help the Trustee when making decisions where ESG factors are relevant and monitor performance to encourage change where appropriate.
- 6.5 Since the underlying investment funds used are pooled products (i.e. funds that are used for investment purposes by different clients), the Trustee is not able to require the managers concerned to make changes to their investment approach to take account of long term financial performance like ESG factors or give directions on stewardship such as how voting rights are used.
- 6.6 The primary way the Trustee considers long term financial performance including ESG factors and stewardship is through advice from the Investment Adviser and its engagement with investment managers. This enables the Trustee to understand the managers' investment approach in relation to such matters (where appropriate).
- 6.7 Long term financial performance including ESG factors and stewardship can be considered at the point of initial investment as a part of the manager selection criteria. Such factors may also be important criteria for considering the replacement of a manager. Once a manager is appointed, the Trustee can monitor ongoing compliance with ESG and other factors like stewardship as a part of overall performance and use its Investment Consultant's engagement with the managers on the Trustee's behalf in its decision making (where appropriate).

**Non-financially material factors**

The Trustee does not at present take into account non-financially material factors (such as members' ethical considerations, social and environmental impact matters or quality of life considerations) when making investment decisions as there is not likely to be a common view on any ethical matters amongst members. At this time the Trustee has no plans to seek the views of the membership on ethical considerations.

**Responsible investing**

6.9 The Trustee is supportive of the UN Principles for Responsible Investing and the UK Stewardship Code and considers whether managers are signatories and adhere to them.

**Fees**

6.10 Professional fees are charged in relation to the services received and may be based on assets under management, performance, hourly rates or fixed fees according to the agreement with each adviser. Fees are regularly reviewed by the Trustee.

**Liquidity**

6.11 Where practicable the Trustee will invest in assets that can be quickly realised (i.e. bought and sold) to allow it to invest or disinvest in each on a daily basis, recognising that contributions need to be invested promptly and members expect to be able to access or transfer their funds quickly. In practice the Trustee facilitates investments and disinvestments twice a week.

**Review of Statement of Investment Principles**

6.12 The Trustee's investment policy and the investment options offered to members and described in this Statement comply with the relevant legislation and are reviewed each year. This Statement will be reviewed at least every three years or when a significant change to investment strategy or policy is made. Any new options will be reflected in the next review of this Statement.

Signed on behalf of Cheviot Trustees Limited



Date

17/9/2019

### ROLES & RESPONSIBILITIES

#### **The Trustee Board**

The Trustee Board has primary responsibility for investment decisions, including reviewing the overall investment strategy, the implementation of that strategy and consultation with employers.

In practice, it delegates some of these responsibilities to the Investment Committee, the Strategic Committee, the Investment Adviser, the Scheme Actuary and the Chief Executive. It requires all relevant advisers to provide regular information to enable it to undertake appropriate governance on the investment arrangements. The Trustee is satisfied that its advisers are suitably qualified and have sufficient knowledge and experience to carry out their role. The Trustee assesses this regularly through reviews of its advisers and considers re-tendering regularly.

#### **Investment Managers**

The Investment Managers and platform provider will be responsible for taking all day to day decisions relating to the investments and securities within each asset class at their discretion, but within any asset allocation guidelines given by the Trustee Board which are set out in line with the principles set out in this Statement and legal requirements. The Trustee, having taken advice from the Investment Adviser, is satisfied that the Investment Managers have sufficient expertise and experience to carry out their role.

#### **Investment Adviser(s)**

The Investment Adviser will be responsible for regular reviews and advice regarding changes to the asset allocation in light of the strategic objectives for the Final Salary Schemes and market conditions. The Investment Adviser also reports on the suitability of the Investment Managers, Custodians or platform providers and any derivative contracts.

#### **Scheme Actuary**

The Scheme Actuary will be responsible for broad-ranging advice in relation to the Final Salary Schemes as required and advising on the implications of the investment strategy on the funding position.

#### **Legal Adviser**

The Legal Adviser will be responsible for providing advice on investment arrangements to ensure legal compliance.

#### **Table of accountabilities**

The following table sets out the detail of the investment governance arrangements.

|   | Investment governance decision or process                              | Decision maker for trust-based scheme   |
|---|--|---|
| <b>Governance structure</b>                                     | Appointment of trustees  | Trustee   |
|   | Establishment of Investment Committee                                  | Trustee   |
| <b>Objective and strategy setting and design of arrangement</b> | Selecting the adviser and agreeing investment governance process       | Trustee appointment and then with advisers  |
|   | Scheme design  | Trustee with advisers   |
| <b>Monitoring, review and change</b>                            | Compliance and ongoing monitoring of legal and regulatory requirements | Investment Committee with advisers (Investment Consultant, Lawyers, Actuaries and Auditors) |
|   | Monitoring and reviewing investment performance                        | Investment Committee with advisers  |
|   | Reviewing and changing provider /adviser and managers                  | Investment Committee with advisers  |
| <b>Communication to members</b>                                 | Communication to members on performance and retirement options etc.    | Investment Committee with advisers  |
|   | Review communication to members  | Management with advisers.   |

**ADVISERS**

**Scheme Actuary**

Edward Spencer of Barnett Waddingham LLP

**Investment Adviser**

River and Mercantile

**Investment Managers**

Amundi Asset Management  
BlackRock Limited  
BMO (previously known as F & C)  
Fidelity  
Invesco  
JO Hambro Capital Management  
Legal and General Investment Management  
Marshall Wace  
M & G Investments  
Phoenix Investment Adviser LLC  
PIMCO Europe Limited  
Royal London Asset Management Limited

**Dynamic Platform Provider**

Mobius Life<sup>10</sup>

**Custodian**

Kas Bank NV

**Auditors**

Crowe U.K. LLP

**Covenant review advisers**

PricewaterhouseCoopers LLP

**Legal Adviser**

Norton Rose Fulbright LLP  
ARC Pensions Law LLP

These advisers or their mandate may be changed without requiring a change to the Statement of Investment Principles.<sup>11</sup>

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<sup>10</sup> From October 2018

<sup>11</sup> For an up to date list of advisers, please contact the CEO's office.

ASSET ALLOCATION AND RANGES<sup>12</sup>

## Long Term Investment Fund

The chart below shows the central asset allocation and ranges for the Long Term Investment Fund of the Final Salary Schemes, which may change from time to time. The asset allocation of the Investment Fund is reviewed monthly.

| Long Term Investment Fund Asset Allocation |                              |             |           |
|--|------------------------------|-------------|-----------|
| Asset Class                                | Central Asset Allocation (%) | Range       |           |
|  |                              | Min (%)     | Max (%)   |
| Global Equity – active                     | 17.5                         | n/a         | n/a       |
| Small Cap Equity                           | 10.0                         | 0           | 30        |
| Developed Market Equity – passive          | 17.0                         | 0           | 75        |
| Emerging Market Equity                     | 5.5                          | 0           | 30        |
| <b>Total Equity</b>                        | <b>50.0</b>                  | <b>15.0</b> | <b>75</b> |
| Alternatives                               | 10.0                         | 0           | 30        |
| Investment Grade Bonds                     | 15.0                         | 0           | 50        |
| Index-Linked Gilts                         | 0                            | 0           | 70        |
| Fixed Interest Gilts                       | 0                            | 0           | 70        |
| High Yield Bonds                           | 15.0                         | 0           | 50        |
| Emerging Market Debt                       | 10.0                         | 0           | 50        |
| Cash                                       | 0                            | 0           | 70        |
| <b>Total</b>                               | <b>100.0</b>                 |             |           |

The range shows the minimum and maximum allocation to each asset class. It does not therefore add up vertically. The **minimum** allocation to equities is 15% with a maximum allocation to bonds and cash of 70%. The **maximum** allocation to equities is 75% with a minimum allocation to bonds and cash of 25%.

## Lower Risk Investment Fund

<sup>12</sup> The current asset allocation statement can be found on our website at:  
<http://cheviottrust.com/our-investment-approach/performance-and-asset-allocation>

The chart below shows the central asset allocation and ranges for the Lower Risk Investment Fund of the Final Salary Schemes, which may change from time to time. The asset allocation of the Investment Fund is reviewed monthly.

| Lower Risk Investment Fund Asset Allocation |                              |         |         |
|---|------------------------------|---------|---------|
| Asset Class                                 | Central Asset Allocation (%) | Range   |         |
|   |                              | Min (%) | Max (%) |
| Equity                                      | 8.0                          | 0       | 20      |
| Alternatives                                | 20.0                         | 10      | 50      |
| Investment Grade Bonds                      | 24.0                         | 10      | 50      |
| Fixed Interest Gilts                        | 16.0                         | 0       | 40      |
| High Yield Bonds                            | 32.0                         | 10      | 50      |
| Cash  | 0.0                          | 0       | 70      |
| <b>Total</b>                                | <b>100.0</b>                 |         |         |

The range shows the minimum and maximum allocation to each asset class. It does not therefore add up vertically.

### Credit Fund Allocations

| Asset Class           | Central Asset Allocation (%) |
|-----------------------|------------------------------|
| UK Corporate Bonds    | 66.0                         |
| Global Corporate Bond | 34.0                         |

The managers for each asset class are reviewed on a regular basis and are available on request from the Chief Executive's office.

The Trustees review the Investment Fund/Matching Fund splits for each Scheme on a regular basis to ensure they are in tolerance and it would not be expected to diverge by more than 5% from the Strategic Allocations.