the Cheviot trust

Statement of Investment Principles With Profits Section

October 2020

Introduction

1.1 This Statement describes the investment strategy and policies of the Trustee of the With Profits Section of the Cheviot pension. It reflects the legislative requirements[1] and forms the basis for the decision-making process in relation to investment strategy.

1.2 The With Profits Section of the Cheviot pension was previously understood to be a money purchase arrangement but is now a cash balance scheme under changes introduced in the Pensions Act 2011 and implemented by regulation in July 2014. Members continue to earn guaranteed returns on a with profits basis until Normal Retirement Date. Pensions are paid to members who retired before 2005. Bonuses may be awarded to members and pensioners in addition to the promised benefits if the funding permits in future.

1.3 The With Profits Section complies with the Scheme Funding Requirements.[2] Employers which were contributing in 2002 when the With Profits Section closed to future service have statutory funding obligations in relation to the promised benefits.

1.4 The Trustee introduced a contribution rule which extended the obligation to make additional funding contributions to a wider range of employers. Approximately 500 employers still have employees or former employees with benefits provided by the With Profits Section.

1.5 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.

1.6 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] Including those of the Pensions Act 1995 and the Occupational Pension Schemes (Investment) Regulations 2005

[2] Under Part 3 of the Pensions Act 2004

Investment governance

2.1 The Trustee sets the With Profits Section's general investment policy but has delegated[3] 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[4].

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 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 the investment objectives. 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 costs of different investment managers are part of the decision-making process when selecting managers or considering asset allocation decisions.

[3] As permitted by law

[4] The platform provider from October 2018 is Mobius Life Limited, a change from Old Mutual Wealth which is exiting the market.

Investment objectives

3.1 The primary objectives of the Trustee Board for the With Profits Section are:

i. To invest the assets of the With Profits Section so that pensions in payment can be met and any guaranteed return can be provided to members
ii. To balance the need to require contributions from employers against the potential to improve returns for members and pensioners where possible and prudent to do so.
iii. To protect the Section 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.

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 in the future.

Risk

4.1 The main funding risks are:

i. Mortality risk associated with existing pensioners
ii. Guaranteed returns on contributions
iii. Interest rate and inflation risk which affect the cost of providing the promised benefits
iv. Sponsor risk
v. Investment risk

4.2 The Trustee Board has recognised and addressed these risks as far as possible in the investment strategy for the Investment and Matching Funds. The Trustee Board will keep these risks under regular review.

4.3 The interest rate and inflation risks are factored into the investment strategy through the use of a liability hedge. This investment provides protection against interest or inflation rate movements adversely affecting the funding level. It is not practicable to hedge the mortality risk.

4.4 The Trustee also recognises that members and pensioners face risks:

i. Inflation risk – that the purchasing power of their investments or pension does not keep up with inflation
ii. Pension conversion risk – that the cost of converting their investments to an income varies
iii. Capital protection risk – that the cash value of their investments varies

4.5 Whilst it is not possible to fully protect against these risks, members who have not yet retired receive guaranteed increases which provide some protection against the inflation and capital risk. Members can transfer to the Money Purchase Section of the Cheviot pension as they approach retirement to access an option which provides protection against pension conversion risk. Members can also access some flexible retirement options including drawdown.

4.6 Some pensioners receive guaranteed increases on their pension which provide some protection against inflation. Most however, do not receive a guaranteed increase and this is not a risk that the Trustee can address without support from employers to increase the promised benefits.

4.7 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) when designing the investment strategy.

4.8 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 With Profits Section, 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 An Investment Fund/Matching Fund/Credit Fund structure is adopted for the management of asset allocation. The strategic allocation to each Fund is reviewed as part of each triennial valuation or more frequently if necessary. The allocation is based on an assessment of the strength of the combined employers' covenant by the Covenant Adviser and advice from the Investment Adviser.

5.2 The Investment Fund holds assets which are designed to make a contribution towards meeting the cost of the benefits. It is invested in a diversified range of investments to manage investment risk. Some equities[5] may be held via a structured equity portfolio which includes derivatives to protect against the downside risk.

5.3 Managers are appointed either directly or via an investment platform and are required to act within the terms of their appointment. The appointment may be delegated. Custody arrangements are reviewed regularly to ensure proper safekeeping of the assets. Assets are generally held in pooled funds to ensure assets are easily realised if required. The Trustee, working with its investment advisers, manages any cash flow requirements. A list of current managers is shown in Appendix B.

5.4 The Matching Fund holds lower risk assets which more closely match the cost of the benefits. The Matching Fund is invested in gilts, corporate bonds

[5] An **equity investment** is money **invested** in a company through the purchase of its shares.

(through the Credit Fund) and swaps which are designed to minimize the impact of movements in interest and inflation rates on the funding level of the With Profits Section. The level of protection against market movements provided by the swaps varies depending on market conditions but will not be reduced below 50% of the estimated cost of the promised benefits.
Assets can also be invested in equities through a structured equity portfolio with a high level of downside protection.

5.5 The target return for the total assets of the With Profits Section is currently 2.8% per year above the return available from SONIA swaps[6] over the longer term. At the time of the last valuation, this was higher than the rate assumed by the Scheme Actuary so as to provide a buffer against underperformance[7].

5.6 The benchmark asset allocation sets out the central range and is reviewed annually. The current central allocation and ranges for each asset class are shown in Appendix C. The actual asset allocation is reviewed at least monthly in light of market conditions and is available on request.

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. 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 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

[6] Swaps are contracts in which two parties agree to exchange periodic interest payments.
[7] The actuarial assumption in the 2017 valuation is a total return of 2.2% (relative to LIBOR swaps) per year for a period of five years and 0.7% per year thereafter.

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. As the Trustee does not have voting rights in respect of its investments in pooled products, it relies on the managers' engagement with the underlying funds in respect of matters including the approach to performance, strategy, capital structure, conflict management, risks, ESG impact and corporate governance. The Trustee does not currently engage in any formal way with other pooled fund investors in order to exert pressure on managers.

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 manger 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

6.8 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.

Asset manager review

6.10 As part of the appointment of the investment managers, the Trustee has entered formal manager agreements and accepted the terms of pooled investment vehicles, setting out the scope of the activities of each investment manager and pooled investment vehicle, their charging basis and other relevant matters. The Trustee has a limited ability to renegotiate commercial terms with such vehicles. The key mechanism by which the Trustee can influence managers in this context is its ability to decide whether to invest or disinvest in the manager's fund. River and Mercantile (R&M) are appointed as the Investment Manager, under an Investment Management Agreement, for a portion of the investment portfolio. The Investment Manager is appointed to carry out its role on an ongoing basis and the Trustee periodically reviews the overall value-for-money of this mandate. The Investment Manager has been provided with a copy of this document and is expected to exercise its powers with a view to giving effect to the principles contained herein.

6.11 The Trustee and Investment Adviser undertake regular reviews of the investment managers (including R&M as Investment Manager) and considers from time to time whether to carry out an independent review of the Investment Manager. These reviews incorporate benchmarking of performance and fees, with some managers on performance-related fees as well as quarterly performance reviews (including understanding key drivers of performance). The Investment Advisor and Trustee review the governance structures of the investment managers, as well as assessing whether their fees, expenses (and any other charges) are in line with industry peers at inception and from time to time whilst invested. The Trustee's arrangements with its investment managers are ongoing, with their duration subject to the Trustee's reviews of its managers. The Trustee's ability to terminate a manager's mandate is facilitated by the liquid nature of the Trustee's investments. The Trustee's regular reviews involve an assessment of whether the manager's performance and remuneration are in line with the Trustee's aims and objectives including the policies in this document.

6.12 Where it can be determined, the Trustee and Investment Advisor assess whether the investment manager remuneration arrangements are aligned with the Trustee's objectives on an annual basis. The Trustee periodically review the overall value-for-money of using the Investment Advisor and investment managers. Information in relation to costs associated with investing is included in annual fee review considered by the Trustee. The Trustee expect the investment managers:

- to align its investment strategy and decisions with the Trustee's investment policies, such as their return target and the restrictions detailed in the Investment Management Agreement/pooled fund investment documentation, and
- to assess and make decisions based on the medium- to long-term financial and non-financial performance (meaning relevant governance functions that can ultimately drive financial performance and enable

trustee oversight) of an issuer of debt or equity, and to engage with the issuers to improve this medium- to long -term performance. The success of such engagement will contribute to the With Profit Section's performance, which are reflected and measured relative to the Trustee's long-term performance objectives, and managers are incentivised to do so, as if managers' funds do not deliver in line with the expected risk and return policy, managers are aware that the Trustee will consider disinvesting. In addition, managers are aware that by failing to respond to the Investment Adviser's engagement on the Trustee's behalf, the manager risks being removed from the Investment Adviser's buy list.

6.13 The Trustee acknowledges the inherent potential for conflicts of interest which exist as part of ongoing investment management business activities. Where investment managers are regulated, they are likely to be subject to such requirements to manage conflicts of interest as are applicable in their jurisdiction of incorporation or operations. The Trustee and Investment Adviser monitor this as part of ongoing review. As an FCA regulated firm, the Investment Advisor is required to prevent or manage conflicts of interest. The Investment Advisor's Conflict of Interest policy is available publicly.[1]

6.14 The Trustee oversees the turnover costs (where available) incurred by the investment managers as part of its ongoing monitoring process and evaluates such costs to determine if they are in line with peer groups and the Investment Advisor's expectations. Information in relation to costs associated with investing is included in annual fee review considered by the Trustee. The Trustee does not have a defined targeted portfolio turnover or turnover range but monitors portfolio turnover on a quarterly basis to ensure that this is line in with each particular mandate. Where there are material deviations the Trustee engages with investment managers to understand the rationale for such deviations and take appropriate action.

Fees

6.15 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

6.16 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.

[1] https://riverandmercantile.com/Asp/uploadedFiles/file/Corporate_Governance/RMG_Conflicts_of_Interest_Policy.pdf

Review of Statement of Investment Principles

6.17 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 without delay when a significant change to investment strategy or policy is made. Any new options will be reflected in the next review of this Statement.

6.18 This statement is published on the Cheviot website.

Signed on behalf of Cheviot Trustees Limited

E. McKinnon

Date: 1 October 2020

Appendix A - Roles and 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 Section 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 Section as required and advising on the implications of the investment strategy on the funding position.
Legal Adviser	The Legal Advisers 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
Governance structure	Appointment of trustees	Trustee
	Establishment of Investment Committee	Trustee
Objective and strategy setting and design of arrangement	Selecting the adviser and agreeing investment governance process	Trustee appointment and then with advisers
	Scheme design	Trustee with advisers
Monitoring, review and change	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
Communication to members	Communication to members on investment choices, performance and retirement options etc.	Investment Committee with advisers
	Review communication to members	Management with advisers.

Appendix B - Advisers

The current advisers to the Cheviot Pension are as follows:

Scheme Actuary	Peter Black of XPS Pensions Group
Investment Adviser	River and Mercantile
Investment Managers (as at 31 July 2019)	BlackRock Life Limited BNY Mellon Legal and General Assurance (Pensions Management) Limited Marshall Wace Mobius Life Limited (platform provider) PIMCO Europe Limited Amundi Asset Management River and Mercantile Investments Limited Royal London Asset Management Limited Phoenix Investment Advisors LLC Mackay Shields LLC
Custodian	Kas Bank Nv
Auditors	Crowe U.K. LLP
Covenant Review Advisers	PricewaterhouseCoopers LLP
Legal Advisers	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.[8]

[8] For an up to date list of advisers, please contact the CEO's office.

Appendix C – Asset Allocation and Ranges

The chart below shows the split between the Matching and Investment Fund. This may change from time to time.

	Strategic Asset Allocation (%)
Matching Fund	45
Investment Fund	55
Total	**100**

The Matching Fund is invested in interest and inflation swaps, UK and global corporate bonds, gilts and cash. Typically, the allocation to corporate bonds is around 80-90% but this varies depending on the value of the swaps.

The central asset allocation and ranges for the Investment Fund of the With Profits Section are shown below and may change from time to time. The asset allocation is reviewed monthly[9].

Investment Fund			
Asset Class	Central Allocation	Minimum	Maximum
Total Equity*	**50.0%**	**15.0%**	**70.0%**
Other Bonds (higher yielding)	25.0%	0.0%	50.0%
Investment Grade Bonds	15.0%	0.0%	50.0%
Relative value	10.0%	0.0%	30.0%
Gilts	0.0%	0.0%	50.0%
Cash	0.0%	0.0%	50.0%
Total	**100.0%**		

* Some of the equity may be held via a structured equity portfolio which includes derivatives.

[9] The current asset allocation statement can be found on our website at: www.cheviottrust.com/already-with-cheviot/with-profits