the Cheviot trust

Statement of Investment Principles With Profits Section

October 2022

1. 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 is 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 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. No bonuses have been paid since 2001.

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.

2. Investment Objectives

2.1 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 any requirement for 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.
iv. To reach a level of funding over the medium term which will allow the remaining benefits to be bought out.

2.2 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.

3. Risks

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[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

3.1 The main funding risks are:

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

3.2 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 keep these risks under regular review.

3.3 The interest rate and inflation risks are mitigated by the use of a liability hedge, constructed using derivatives and gilts or a combination of appropriate assets. This provides protection against interest or inflation rate movements adversely affecting the funding level. It is not practical to hedge mortality risk.

3.4 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.

3.5 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.

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

3.7 The Trustee has considered these risks and other relevant risks such as market risk, counterparty risk, operational risk, environmental/social/ governance risk, the risk of failing to provide value for members and risk of ill-timed disinvestments to meet cash flow requirements, when designing the investment strategy.

3.8 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 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.

4. Investment strategy

4.1 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.

4.2 The Investment Fund holds assets with the objective of producing a return to meet some of the cost of the benefits. It is invested in a diversified range of investments to manage investment risk. Some equities[3] may be held via a structured equity portfolio which includes derivatives to protect against the downside risk.

4.3 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.

4.4 The Matching Fund holds lower risk assets which more closely match the cost of the benefits. The Matching Fund is invested in in a combination of gilts 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 Credit Fund provides income to help meet the cashflow requirements of the Section. The level of protection against market movements varies depending on market conditions but will not be reduced below 50% of the estimated cost of the promised benefits.

4.5 The Trustee's policy is to set the target returns annually for the Investment Fund and Matching Fund based on advice from the Investment Manager reflecting current expectations of the assets held. The target returns for these funds combined with the asset split at the date of this Statement, gives an overall target return of 2.7% per year above the return available from gilts.

4.6 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 the Appendix. The actual asset allocation is reviewed at least monthly in light of market conditions and is available on request.

5. Other Issues

Environmental, Social and governance factors

5.1 When selecting and monitoring an investment the Trustee 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.

5.2 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. More information is available in the annual Implementation Statements, including how the Trustee assesses the commitment and performance of

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

managers in relation to long term financial factors deriving from ESG. The latest Implementation Statement is available on the website.

5.3 The Trustee is also considering those elements of the investment strategy where the investment objective is short term in nature and were taking account of ESG factors is unlikely to influence investment performance.

5.4 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.

5.5 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).

5.6 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

5.7 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. The Trustee has no current plans to seek the views of the membership on ethical considerations.

Asset manager review

5.8 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.

5.9 Schroders Solutions (a trading name of Schroders IS Limited)[4] are appointed as the Investment Manager, under an Investment Management Agreement, for a portion of the investment portfolio.

[4] Schroders purchased the River and Mercantile Investments Limited, which was then renamed Schroders IS Limited on 1 February 2022.

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.

5.10 The Trustee and Investment Adviser undertake regular reviews of the investment managers (including Schroders Solutions 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.

5.11 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 their 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.

5.12 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.[5]

5.13 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

[5]https://www.schroders.com/en/identification-and-management-of-conflicts-of-interest/

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 mandate. Where there are material deviations, the Trustee engages with investment managers to understand the rationale for such deviations and take appropriate action.

Fees

5.14 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

5.15 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

5.16 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.

5.17 This statement is published on the Cheviot website.

Signed on behalf of the Cheviot Trustees Limited:

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Sir Derek Morris, Chair.
Date: October 2022

Appendix

Asset Allocation and Ranges

The chart below shows the long term allocation between the Matching and Investment Fund. This may change from time to time in light of market conditions and funding levels, without updating this Appendix.

	Strategic Asset Allocation (%)
Matching Fund	40-50%
Investment Fund	50-60%
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.

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.