Statement of Investment Principles

2022

Final Salary Schemes

Issued July 2022

1. 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 legal advisers 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.t

1.5 The investment strategy described in section 4 below is implemented using 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.

1.6 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.

2. Investment objectives

2.1 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.

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 held over time.

3. Risk

3.1 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

3.2 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.

3.3 Risks are measured and managed as part of regular investment strategy governance, asset allocation reviews and investment strategy reviews. The Investment Committee 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.

4. Investment strategy

4.1 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).

4.2 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:

- efficient diversification in investment terms
- the strength of the relevant employers' covenant and
- the time to maturity of the promised benefits.

4.3 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.

4.4 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.

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

4.6 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 scheme sponsor.

- The allocation to the Investment Funds[1] 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 scheme sponsor.

1.1 [1] 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

- The minimum allocation to the Matching Fund[2] is usually 30% of total scheme assets to ensure sufficient assets to support the liability hedge[3].
- If there is more cash within the Matching Fund than required to support the liability hedge, a Credit Fund[4] 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[5] and the employer's ability and willingness to pay any deficit contributions required.
- The relevant allocation for each scheme is shown in the scheme specific Appendix D to this Statement of Investment Principles.

5.6 Rebalancing to the strategic allocation between the Funds[6] 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.

5.7 The objective of the Long Term Investment Fund is to outperform cash[7] by 3.8% 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.[8] 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 2.8% 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 1.3% 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.

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[2] The Matching Fund holds assets which move broadly in line with the cost of providing the benefits. See paragraph 5.9.
[3] 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.
[4] 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.
[5] The Recovery Plan is the period over which the funding level of the scheme is expected to return to 100% on the funding basis.
[6] Long Term and Lower Risk Investment Funds, Credit and Matching Funds
[7] Cash being defined as the Sterling Overnight Index Average Rate (or SONIA)
[8] See Appendix C for details of the asset ranges

5. 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 and the insurance policy. 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.

6. 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. 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 take into account non-financially material factors when making investment decisions. Some social and environment issues will be considered as financially material factors.

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.

6.11 The Trustee and Investment Adviser undertake regular reviews of the investment managers. 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 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 performance, which are reflected and measured relative to the Trustee's long-term performance objectives. 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.[9]

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.

Liquidity

6.15 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

6.16 The Trustee's investment policy as described in this Statement comply with the relevant legislation and are reviewed each year. The Trustee may change the underlying managers or the asset allocation within the existing investment strategy. Any significant changes will lead to the review of this Statement.

Signed on behalf of Cheviot Trustees Limited

Elspeth McKinnon

Date: 8 July 2022

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

APPENDIX

ASSET ALLOCATION AND RANGES[10]

Long Term Investment Fund, Lower Risk Investment Fund and Credit Fund

The chart below shows the central asset allocation and ranges for the Long Term Investment Fund, the Lower Risk Investment Fund and the Credit Fund. The central position and the ranges may change from time to time. Asset allocation is reviewed monthly.

	Long Term Investment Fund			Lower Risk Investment Fund			Credit Fund
	Central (%)	**Min (%)**	**Max (%)**	**Central (%)**	**Min (%)**	**Max (%)**	**%**
Global Equity – active	17.5	0	n/a	-	-	-	-
Small Cap Equity	10	0	30	-	-	-	-
Developed Market Equity – passive	17	0	70	17.3	0	35	-
Emerging Market Equity	5	0	30	2.7	0	15	-
Total Equity	***50***	***15***	***70***	***20***	***0***	***35***	-
Alternatives	10	0	30	20	10	50	-
Investment Grade Bonds	15	0	50	24	0	50	-
Index-Linked Gilts	0	0	50	-	-	-	-
Fixed Interest Gilts	0	0	50	-	-	-	-
High Yield Bonds	15	0	50	20	0	50	-
Emerging Market Debt	10	0	50	-	-	-	-
Duration Hedged Credit	-	-	-	-	-	-	100
Cash/Short-dated Gilts	0	0	50	16	0	40	-
Total	**100**			**100**			**100**

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

[10] The current asset allocation statement can be found on our website at: http://cheviottrust.com/our-investment-approach/performance-and-asset-allocation