INVESTMENT AND FUNDING DURING 2022

The funding level of the With Profits Section has historically been maintained around 100% without the need for any contributions from employers. However, adverse market conditions in 2022 resulted in a fall in the funding level to 88% at the end of the year. The Investment Committee, on behalf of the Trustee, has reviewed this deterioration in detail with our investment consultants and Scheme Actuary to quantify the key factors leading to this outcome. It has also commissioned an external consultant to review and comment on the performance against wider market returns. The analysis below is based on the report from the external consultant.

MARKET CONDITIONS

2022 was a very difficult year for all investments because of three key factors:

- Russia's invasion of Ukraine led to market instability and all asset classes falling in value.
- The sharp rise in inflation because of supply issues, particularly in relation to energy supplies
- The extreme volatility caused by the Chancellor's mini budget in September.

IMPACT ON WITH PROFITS SECTION

The position was exacerbated for the With Profits Section by the following factors:

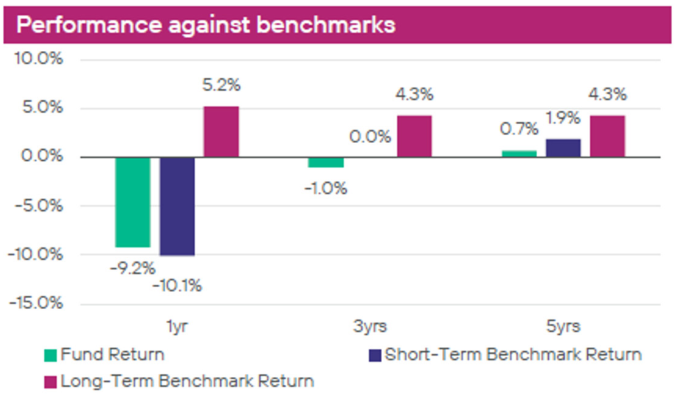
i. Following the mini-budget crisis, the significant cash calls required to increase the level of collateral to back the liability hedges, which provide funding protection against interest rate and inflation changes. This required significant disinvestments from equities which led to a drag on performance. Although the downside protection in place for the equity holdings provided some benefit, it was not, in the circumstances, sufficient to provide a full offset
ii. The allocation to gilts (Government bonds) was increased as a defensive measure but gilts were also adversely affected by the market conditions and were a significant contributor to the negative returns.
iii. The cash flows underlying the hedges were due to be updated but had been delayed given the market volatility in the first half of the year. As a result, the hedge provided less protection than anticipated and the funding was not protected from rising inflation and interest rates as effectively as in the past.

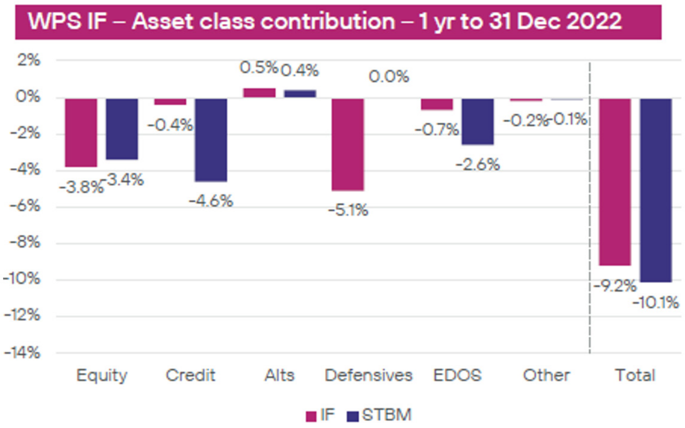
The Trustee took the difficult decision to reduce the hedge from 100% to 90% to ensure that the further cash calls could be met. The strategic balance of the assets was volatile as a result. The hedge has now been restored to 100% in early 2023.

INVESTMENT PERFORMANCE IN 2022

The right hand chart shows the Investment Fund's performance of its on-risk assets against its short and long term benchmarks The short term benchmark is based on relevant market indices. Over the three year period, performance has been behind the short term benchmark; however, this reflects the Trustee's aim to reduce risk. During 2022, performance was slightly ahead.

The long-term benchmark indicates what is needed to meet full funding; and so the difference between the return made and the long-term benchmark is what impacts the funding position.





The chart shows the contribution from each asset class to the performance over 2022. As explained above, the equity allocation was reduced to facilitate the cash required to maintain the liability hedges and therefore the underperformance stems from smaller holding than anticipated. The EDOS (the defensive derivative for equities) produced a positive outcome. The credit and the alternatives performance were higher than the benchmark, partly because the holdings were larger than anticipated. A significant negative contributor was the defensive allocation, mostly gilts.

The With Profits Section also has a credit fund which aims to provide some extra return on the assets which are held "off risk". The performance of these assets is matched against a cash benchmark which does not reflect the market over the shorter term.

The overall impact of the investment performance (excluding the liability hedge) was a loss of £10.7m during 2022.

IMPACT ON FUNDING

The funding position of the With Profits Section has been significantly impacted by the negative investment performance and the overall reduction in assets, which reduces the contribution from investment return going forward.

The progression of the scheme funding level since the last valuation is shown in the table.

31 December 2022 (£m)	**Buy-out** *Securing benefits with an insurer*	**Scheme Funding** *Current valuation basis*	**FRS102** *Accounting basis*
Total liabilities	74.1	72.9	69.7
Total assets	64.5	64.5	64.5
Surplus/(shortfall)	**(9.6)**	**(8.4)**	**(5.2)**
Funding level	**87%**	**88%**	**93%**

NEXT STEPS

The Trustee is currently considering scenarios to restore the funding position of the With Profits Section, but this is very likely to require contributions from employers.