Statement of Investment Principles for the Pearson Pension Plan

14 October 2021

1. Introduction

This Statement of Investment Principles ("SIP") sets out the policy of Pearson Pension Trustee Limited ("the Trustee") on various matters governing decisions about the investments of the Pearson Pension Plan ("the Plan"), a Plan with Final Pay and Defined Contribution ('DC') sections. This SIP replaces the previous SIP dated 23 June 2020.

The SIP is designed to meet the requirements of Section 35 (as amended) of the Pensions Act 1995 ("the Act"), the Occupational Pension Schemes (Investment) Regulations 2005 (as amended) and the Pension Regulator's guidance for defined benefit pension schemes (March 2017) and the Occupational Pension Schemes (Charges and Governance) Regulations 2015. The Plan's assets are held in trust by the Trustee. The investment powers of the Trustee are set out in the Plan's Trust Deed. The SIP also reflects the Trustee's response to the Myners' Voluntary Code of Investment Principles for Defined Benefit ('DB') and DC Schemes, as well as the DC Code of Practice 13.

This SIP has been prepared after obtaining and considering written professional advice from LCP, the Plan's investment adviser, whom the Trustee believes to be suitably qualified and experienced to provide such advice. The advice takes into account the suitability of investments including the need for diversification given the circumstances of the Plan and the principles contained in this SIP. The Trustee has consulted with the relevant employer in producing this SIP.

The Trustee will review this SIP from time to time and, with the help of its advisers, will amend it as appropriate. These reviews will take place as soon as practicable after any significant change in investment policy or in the demographic profile of the relevant members in respect of the DC sections and at least once every three years.

- **Appendix 1** sets out details of the Plan's investment governance structure, including the key responsibilities of the Trustee, investment advisers and investment managers. It also contains a description of the basis of remuneration of the investment adviser and the investment managers.
- **Appendix 2** sets out the Trustee's policy towards risk appetite, capacity, measurement and management.
- **Appendix 3** sets out the Plan's investment manager arrangements.

2. Investment objectives

2.1. Final Pay Sections

The primary objective for the Final Pay sections is to ensure that the Plan should be able to meet benefit payments as they fall due. In addition to this primary objective, the Trustee has additional objectives. These are as follows:

- An overall objective to invest the Plan's assets in such a way that sufficient money is available to meet the liability to provide benefits to the members of the Plan into the future. This includes, where possible and agreed with the Principal Employer, discretionary increases to pensions in payment in excess of the guarantees in the Plan Rules, so that total pension increases broadly aim to protect against cost of living increases.
- A shorter term objective of endeavouring to invest the Plan's assets to achieve returns in excess of the growth in the liabilities, whilst maintaining a prudent approach to meeting the Plan's liabilities.

2.2. Money Purchase and Auto Enrolment Sections (Defined Contribution ("DC") Sections)

The Trustee's primary objectives for the DC sections of the Plan are to:

- Provide an appropriate range of investment options, reflecting the membership profile of the DC sections and the variety of ways that members can draw their benefits in retirement;
- Provide clear information on the investment options and their characteristics that will allow members to make informed choice and;
- Provide a default investment option that the Trustee believes to be reasonable for those members that do not wish to make their own investment decisions. The objective of the main default option for the DC sections, the Drawdown Lifecycle, is to generate returns significantly above inflation whilst members are some distance from retirement, but then to switch automatically and gradually to lower risk investments as members near retirement.

3. Investment strategy

3.1. Final Pay Sections

Asset allocation is considered regularly by the Trustee and reviewed in detail following each actuarial valuation, taking into account the objectives described in Section 2 above. The Trustee divides the assets of the Plan into two sections the **Insurance Portfolio** and the **Main Portfolio** which are composed as follows:

- The **Insurance Portfolio** consists of assets which are held in the form of insurance contracts matching a portion of the liabilities of the Plan.

  The insurer pays the Plan an amount equal to the pension payment in respect of the members underlying the policy. These insurance contracts are assets of the Plan and the pension liability remains within the Plan.

  Towards the end of 2017 the Plan purchased two separate buy-in policies with Aviva Life & Pensions UK Limited (Aviva) and Legal and General Life Assurance Limited (L&G). The two policies covered approximately two thirds of the pensioner member's liabilities at the time of the transactions. The Plan purchased a further buy-in under the same policy with L&G in February 2019 which covered most of the remaining uninsured pensioner member's liabilities at the time of the transaction.

- The **Main portfolio** consists of all Plan assets outside of the Insurance Portfolio. The Main portfolio is composed of **Matching** and **Return Seeking** assets.

  - The **Matching Assets** are assets which produce cashflows that can be expected to match the cashflows for a proportion of the membership. The Matching Assets include bonds, inflation linked property, and infrastructure. Liability Driven Investment is a key component of the Plan's Matching Assets as it allows it to match a higher proportion of the expected liability cashflows.

  - The **Return Seeking Assets** are invested with a long term horizon to generate the returns needed to provide the remaining expected cashflows for the beneficiaries. This portfolio is invested in a diversified portfolio of return seeking assets. The Return Seeking Assets are expected to be formed of an allocation to Infrastructure, Private Equity and Property.

  - The Plan's total allocation as at 31 March 2021 was c.96% to the Insurance portfolio and Matching Assets and c.4% to Return Seeking assets. The actual allocation depends on the relevant market values and so will fluctuate over time.

This is a low risk asset allocation which maintains a low probability of requiring further contributions from the Plan's Sponsor.

The primary focus of the Plan's allocation of investments is accurate cashflow matching and risk control.

The Insurance Portfolio is cashflow matching as it provides payments which are expected to exactly match the benefit payments for the insured members.

A small allocation to Return Seeking Assets has been maintained in the Plan's asset allocation to provide a buffer for any changes in actuarial assumptions, longevity risk, and to potentially allow for discretionary increases to members in certain scenarios as described in the investment objectives.

Based on asset-liability modelling as at 31 March 2021, the Plan's invested assets (excluding the Insurance Portfolio), are expected to generate a return of 1.3% per annum above gilts with an acceptable level of volatility. The Plan's investment strategy is reviewed and modelled following each Actuarial Valuation. The allocation to each asset class will vary due to market movements and will be kept under review by the Trustee.

3.2. Defined Contribution Sections

Alongside the Final Pay sections are the DC sections, the Money Purchase sections and the Auto Enrolment section, which are treated entirely separately to the Final Pay sections and look to provide each member with an appropriate range of Funds to select as well as ensuring that the strategy for each of the Lifecycle options is appropriate for the variety of members taking part.

The Trustee has taken into account the needs of members in deciding which investment funds should be offered. The investment choices should provide appropriate exposures to generate income and capital appreciation which, combined with member and employer contributions, will help towards the provision of a sufficient retirement benefit.

The investment funds offered to members are provided by the Aviva investment platform and consist of the following asset classes:

- Equity
- Bonds
- Diversified Growth
- Property
- Cash

The Trustee is aware that different members will have different personal circumstances and different attitudes towards risk. Each member is responsible for specifying one or more funds for the investment of their account, having regard to their attitude to the risks involved. If a member does not choose an investment option, their account will be invested into the main default option, the Drawdown Lifecycle, which is managed as a "lifecycle" strategy (i.e. it automatically combines investments in proportions that vary according to the time to retirement age). The Drawdown Lifecycle is also the default arrangement for members who make Additional Voluntary Contributions ("AVCs"). This applies to all existing members that have assets invested in the Money Purchase and Auto Enrolment sections that are targeting Drawdown and also new members. This does not apply, however, to AVC benefits where the member has no assets already invested in the Drawdown Lifecycle through the Money Purchase or Auto Enrolment sections, or is a DB member with AVC benefits but no assets in these aforementioned DC sections.

The Plan also has a "lifecycle" strategy that targets lump sum at retirement called the Cash Lifecycle. This lifecycle is also the default Lifecycle Option for existing members with AVC benefits within the Plan who have do not have assets invested in the Drawdown Lifecycle, or are DB members with AVC benefits who do not have assets invested in the Money Purchase or Auto Enrolment sections of the Plan. This lifecycle is also open to members to select.

Additionally, there is a legacy default option, the Annuity Lifecycle, which remains a lifecycle option for members to select. This option targets annuity at retirement.

In the initial growth phase, the above lifecycle options (including the legacy default, the Annuity Lifecycle) are invested to target a return significantly above inflation, and then in the 15 years before retirement, they switch gradually into less risky assets, with the asset allocation at retirement being designed to be appropriate for members wishing to access drawdown (in the case of the Drawdown Lifecycle), take their pot as cash (the Cash Lifecycle) or purchase an annuity at retirement (Annuity Lifecycle).

The default lifecycle options were designed to be in the best interests of the majority of the members based on the demographics of the Plan's membership. Each option is designed to reflect the Trustee belief that most members in that cohort will take their benefits in the specified form.

The Threadneedle Pensions Property Fund was suspended by the manager in May 2020 due to pricing uncertainty caused by the Covid-19 crisis. Member contributions were therefore redirected into the BlackRock Sterling Liquidity Fund until the Property Fund reopened on 17 September 2020. As members' contributions were directed into the BlackRock Sterling Liquidity Fund during this time without them making an active selection, this fund will be treated as a default for the purpose of fulfilling legislative requirements.

Further details of the fund range including the lifecycles are set out in Appendix 3. The Trustee reviews the range of investment funds, the lifecycle strategies and the default options offered to members of the DC sections from time to time with the help of its advisors and will amend them as appropriate. These reviews will take place as soon as practicable after any significant change in investment policy or in the demographic profile of the relevant members in respect of the DC sections, and at least once every three years. The Trustee will monitor the relevant members' behaviour to check whether assumptions made about how members will access their benefits are borne out in practice.

4. Considerations in setting the investment arrangements

When deciding how to invest the Plan's assets, the Trustee considers several risks, including, but not limited to, those set out in Appendix 2. Some of these risks are more quantifiable than others, but the Trustee has tried to allow for the relative importance and magnitude of each risk.

The Trustee considered a wide range of asset classes for investment, taking account of the expected returns and key individual risks associated with those asset classes as well as how these risks can be mitigated where appropriate. The key financial assumptions made by the Trustee change periodically, reflecting the market outlook. As at 31 March 2021, the long term, expected returns above gilts are as follows:

- Private equity: 5.8% pa
- Listed equity: 4.8% pa
- Infrastructure 4.2% pa
- UK property: 3.1% pa
- DGFs: 2.9% pa
- Investment grade credit 0.6% pa

In setting the strategy for the Final Pay sections the Trustee considered:

- the Plan's investment objectives, including the target return required to meet the Trustee's investment objectives;
- the Plan's cash flow requirements in order to meet benefit payments in the near to medium term;
- the best interests of members and beneficiaries;
- the circumstances of the Plan, including the profile of the benefit cash flows (and the ability to meet these in the near to medium term), the funding level, and the strength of the employer covenant;
- the risks, rewards and suitability of a number of possible asset classes and investment strategies and whether the return expected for taking any given investment risk is considered sufficient given the risk being taken;

- the need for appropriate diversification between different asset classes to ensure that both the Plan's overall level of investment risk and the balance of individual asset risks are appropriate;
- any other considerations which the Trustee considers financially material over the time horizon that the Trustee considers is needed for the funding of future benefits by the investments of the Plan; and
- the Trustee's investment beliefs about how investment markets work, and which factors are most likely to impact investment outcomes.

In determining the investment arrangements for the DC sections, the Trustee considered:

- the best interests of members and beneficiaries;
- the profile of the membership and what this is likely to mean for the choices members might make upon reaching retirement;
- the risks, rewards and suitability of a number of possible asset classes and lifecycle strategies and whether the return expected for taking any given investment risk is considered sufficient given the risk being taken;
- the need for appropriate diversification within the default strategies and other lifecycle options to ensure that, for each such option, both the overall level of investment risk and the balance of individual asset risks are appropriate;
- the need for appropriate diversification within the other investment options offered to members;
- any other considerations which the Trustee considers financially material over the periods until members' retirement, or any other timeframe which the Trustee believes to be appropriate; and
- the Trustee's investment beliefs about how investment markets work, and which factors are most likely to impact investment outcomes.

5. Implementation of the investment arrangements

Before investing in any manner, the Trustee obtains and considers proper written advice from its investment adviser on the question of whether the investment is satisfactory, having regard to the need for suitable and appropriately diversified investments.

Details of the investment managers and the platform provider for the DC sections are set out in Appendix 3.

In respect of the DC sections, the Trustee has entered into a contract with a platform provider, who makes available the range of investment options to members. There is no direct relationship between the Plan and the underlying investment managers of the DC investment funds.

The Trustee has signed agreements with the investment managers (in respect of the Final Pay sections), and a platform provider (in respect of the DC sections) setting out in detail the terms on which the portfolios are to be managed. The investment managers' primary role is the day-to-day investment management of the Plan's investments.

The Trustee and investment managers to whom discretion has been delegated exercise their powers to giving effect to the principles in this Statement of Investment Principles, so far as is reasonably practicable.

The Trustee's view is that the fees paid to the investment managers, and the possibility of their mandate being terminated, ensure they are incentivised to provide a high quality service that meets the stated objectives, guidelines and restrictions of the fund. However, in practice managers cannot fully align their strategy and decisions to the (potentially conflicting) policies of all their pooled fund investors in relation to strategy, long-term performance of debt/equity issuers, engagement and portfolio turnover.

It is the Trustee's responsibility to ensure that the managers' investment approaches are consistent with its policies before any new appointment, and to monitor and to consider terminating any existing arrangements that appear to be investing contrary to those policies. The Trustee expects investment managers, where appropriate, to make decisions based on assessments of the longer term financial and non-financial performance of debt/equity issuers, and to engage with issuers to improve their performance. It assesses this when selecting and monitoring managers.

The Trustee evaluates investment manager performance by considering performance over both shorter and longer-term periods as available. Except in closed-ended funds where the duration of the investment is determined by the fund's terms, the duration of a manager's appointment will depend on strategic considerations and the outlook for future performance. Generally, the Trustee would be unlikely to terminate a mandate on short-term performance grounds alone.

The Trustee's policy is to evaluate each of its investment managers by reference to the manager's individual performance as well the role it plays in helping the Plan meet its overall long-term objectives, taking account of risk, the need for diversification and liquidity. Each manager's remuneration, and the value for money it provides, is assessed in light of these considerations.

The Trustee recognises that portfolio turnover and associated transaction costs are a necessary part of investment management and that the impact of portfolio turnover costs is reflected in performance figures provided by the investment managers. The Trustee expects its investment consultant to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Plan's investment mandates.

6. Realisation of investments

6.1. Final Pay Sections

In general, individual investment managers have discretion in the timing of the purchase and sale of investments and in considerations relating to the liquidity of those investments. Additional realisations may be required to ensure that the Plan's benefit payments and other expenditure can be met.

The Trustee, and investment managers (to the extent delegated), will use the criteria set out in the Occupational Pension Schemes (Investment) Regulations 2005, when selecting investments on behalf of the Plan. The Trustee expects the investment managers to give effect to the principles in this statement as far as is reasonably practical.

The Trustee has agreed a series of investment restrictions for each manager where there is a separate Investment Management Agreement (IMA) in place. The Trustee will monitor the continuing tenure of the Investment Managers, including the competitiveness of their fee structures, from time to time, based on advice from the Investment Committee and the external investment adviser. The Trustee will also utilise compliance reporting provided by the custodian, Bank of New York Mellon, in the monitoring of Investment Managers

6.2. Defined Contribution Sections

For the DC sections, the Trustee's policy is to invest in funds that offer daily dealing to enable members to readily realise and change their investments. The Trustee decides which fund options to put forward to members. When deciding to add or remove investment fund options the Trustee will use the criteria set out in the Occupational Pension Schemes (Investment) Regulations 2005.

In general, individual investment managers have discretion in the timing of the purchase and sale of investments and in considerations relating to the liquidity of those investments. Additional realisations may be required to ensure that the Plan's benefit payments and other expenditure can be met.

7. Consideration of financially material and non-financial matters

The Trustee believes that environmental, social and governance (ESG) factors are likely to be one area of market inefficiency and so managers may be able to improve risk-adjusted returns by taking account of ESG and climate related factors.

The Trustee has considered how ESG and ethical factors should be taken into account in the selection, retention and realisation of investments, given the time horizon of the Plan and its members. The Trustee expects its investment managers to take account of financially material considerations (including climate change and other ESG considerations). The Trustee seeks to appoint managers that have appropriate skills and processes to do this, and from time to time reviews how its managers are taking account of these issues in practice.

The Trustee has limited influence over managers' investment practices where assets are held in pooled funds, but it encourages its managers to improve their practices where appropriate.

The DC sections include one equity investment option as a choice for members to select if they wish to invest in a fund focused on ESG risks. A small number of members remain invested in an alternative option which takes account ESG risks; however, this fund is now closed to new members. At this time, it does not believe there are any ESG-focused investment options available that meet its needs in any asset classes other than equity but will keep this under review.

The Trustee does not take into account any non-financial matters (i.e. matters relating to the ethical and other views of members and beneficiaries, rather than considerations of financial risk and return) in the selection, retention and realisation of investments. However, it recognises the importance of offering a suitable range of investment options for members who wish to express an ethical preference in their pension saving and so has suitable options available.

The IC proactively monitors all of the Plan's active investment managers. In addition to the usual quarterly monitoring, the active investment managers are required to attend IC meetings periodically. These Manager presentations provide an opportunity for the IC to discuss responsible investment along with other aspects of the manager's mandate and are considered an important aspect of these discussions.

In addition to the above the IC also undertakes the following:

- When appointing new active investment managers, their approach to socially responsible investment and environmental, social and governance factors is incorporated into the selection process and referenced in their Investment Management Agreements.
- The IC reviews the Plan's responsible investment policy, typically once a year. The latest investment manager policies are also reviewed and developments in responsible investment are discussed.
- The Plan monitors whether its Investment Managers are signatories of the UN Principles for Responsible Investment (PRI). The IC encourages investment managers to become PRI signatories and requests explanations where they are not.

8. Voting and engagement

The Trustee recognises its responsibilities as owners of capital, and believes that good stewardship practices, including monitoring and engaging with investee companies, and exercising voting rights attaching to investments, protect and enhance the long-term value of investments. The Trustee has delegated to its investment managers the exercise of rights attaching to investments, including voting rights, and engagement with issuers of debt and equity and other relevant persons about relevant matters such as performance, strategy, capital structure, management of actual or potential conflicts of interest, risks and ESG considerations.

The Trustee does not monitor or engage directly with issuers or other holders of debt or equity. It expects the investment managers to exercise ownership rights and undertake monitoring and engagement in line with the managers' general policies on stewardship, as provided to the Trustee from time to time, considering the long-term financial interests of the beneficiaries.

The Trustee seeks to appoint managers that have strong stewardship policies and processes, reflecting where relevant the recommendations of the UK Stewardship Code issued by the Financial Reporting Council, and from time to time the Trustee reviews how these are implemented in practice.

Investment governance, responsibilities, decision-making and fees

The Trustee has decided on the following division of responsibilities and decision-making for the Plan. This division is based upon the Trustee's understanding of the various legal requirements placed upon it, and its view that the division of responsibility allows for efficient operation and governance of the Plan overall. The Trustee's investment powers are set out within the Plan's governing documentation.

1. Trustee

In broad terms, the Trustee is responsible in respect of investment matters for:

- developing a mutual understanding of investment and risk issues with the employer;
- setting the investment strategy, in consultation with the employer;
- formulating a policy in relation to financially material considerations, such as those relating to ESG considerations (including but not limited to climate change);
- formulating a policy on taking account of non-financial matters in the selection, retention and realisation of investments;
- setting the policy for rebalancing between asset classes;
- setting a policy on the exercise of rights (including voting rights) and undertaking engagement activities in respect of the investments;
- putting effective governance arrangements in place and documenting these arrangements in a suitable form;
- appointing, monitoring, reviewing and dismissing investment managers, investment advisers, actuary and other service providers;
- monitoring the exercise of the investment powers that they have delegated to the investment managers and monitoring compliance with Section 36 of the Act;
- communicating with members as appropriate on investment matters, such as the Trustee's assessment of its effectiveness as a decision-making body, the policies regarding responsible ownership and how such responsibilities have been discharged;
- reviewing the investment policy as part of any review of the investment strategy;
- reviewing the content of this SIP from time to time and modifying it if deemed appropriate; and
- consulting with the employer when reviewing the SIP.

Whilst the Plan Trustee has ultimate responsibility for decision making on investment matters, to ensure that such decisions are taken effectively, the Plan Trustee uses other bodies either through direct delegation or in an advisory capacity. These groups include:

- Investment Committee
- Property Trustee (Pearson Pension Property Trustee Limited)
- Member Engagement Working Party
- Investment Managers and Custodian
- External Advisors such as the Scheme Actuary and Investment Adviser
- In house Pensions department.

Each group has a range of responsibilities which have been agreed by the Plan Trustee.

2. Platform provider

The investment platform provider will be responsible for:

- providing access to a range of funds managed by various investment managers; and
- providing the Trustee with regular information concerning the management and performance of the assets.

3. Investment managers

In broad terms, the investment managers will be responsible for:

- managing the portfolios of assets according to their stated objectives, and within the guidelines and restrictions set out in their respective investment manager agreements and/or other relevant governing documentation;
- taking account of financially material considerations (including climate change and other ESG considerations) as appropriate when managing the portfolios of assets;
- exercising rights (including voting rights) attaching to investments and undertaking engagement activities in respect of investments;
- providing the Trustee (in respect of the Final Pay sections) and investment platform provider (in respect of the Money Purchase sections) with regular information concerning the management and performance of their respective portfolios; and
- having regard to the provisions of Section 36 of the Act insofar as it is necessary to do so.

The custodians of the portfolios (whether there is a direct relationship between the custodian and the Trustee or not) are responsible for safe keeping of the assets and facilitating all transactions within the portfolios.

4. Investment adviser

In broad terms, the investment adviser will be responsible, in respect of investment matters, as requested by the Trustee, for:

- advising on how material changes within the Plan's benefits, membership, and funding position may affect the manner in which the assets should be invested and the asset allocation policy (in respect of the Final Pay sections);
- advising on a suitable fund range and default strategy for the Plan, and how material changes to legislation or within the Plan's benefits and membership may impact this (in respect of the DC sections);
- advising on the selection, and review, of the investment managers, incorporating its assessment of the nature and effectiveness of the managers' approaches to financially material considerations (including climate change and other ESG considerations); and
- participating with the Trustee in reviews of this SIP.

5. Fee structures

The Trustee recognises that the provision of investment management and advisory services to the Plan results in a range of charges to be met, directly or indirectly, by deduction from the Plan's assets.

The Trustee has agreed Terms of Business with the Plan's actuarial and investment advisers, under which work undertaken is charged for by an agreed fixed fee or on a "time-cost" basis.

The fund managers receive fees calculated by reference to the market value of assets under management. The fee rates are believed to be consistent with the managers' general terms for institutional clients and are considered by the Trustee to be reasonable when compared with those of other similar fund managers.

The platform provider receives fees calculated by reference to the market value of assets under management. The fee rates are believed to be consistent with the provider's general terms for institutional clients and are considered by the Trustee to be reasonable when compared with those of other similar providers.

The Trustee has appointed a custodian in respect of the Plan's investments. The custodian fees are calculated using a mixture of fixed fee, a line item charge and market value of asset held. The fee rates are believed to be consistent with the custodian's general terms for institutional clients and are considered by the Trustee to be reasonable when compared with those of other similar providers.

The fee structure used in each case has been selected with regard to existing custom and practice, and the Trustee's view as to the most appropriate arrangements for the Plan. However, the Trustee will consider revising any given structure if and when it is considered appropriate to do so.

6. Performance assessment

The Trustee is satisfied, taking into account the external expertise available, that there are sufficient resources to support its investment responsibilities. The Trustee believes that it has sufficient expertise and appropriate training to carry out its role effectively.

It is the Trustee's policy to assess the performance of the Plan's investments, investment providers and professional advisers from time to time. See Section 5 of the SIP. The Trustee will also periodically assess the effectiveness of its decision-making and investment governance processes and will decide how this may then be reported to members.

7. Working with the Plan's employer

When reviewing matters regarding the Plan's investment arrangements, such as the SIP, the Trustee seeks to give due consideration to the employer's perspective. While the requirement to consult does not mean that the Trustee needs to reach agreement with the employer, the Trustee believes that better outcomes will generally be achieved if the Trustee and employer work together collaboratively.

Policy towards risk

1. Risk appetite and risk capacity

Risk appetite is a measure of how much risk the Trustee is willing to bear within the Plan in order to meet its investment objectives. Taking more risk is expected to mean that those objectives can be achieved more quickly, but it also means that there is a greater likelihood that the objectives are missed, in the absence of remedial action. Risk capacity is a measure of the extent to which the Trustee, can tolerate deviation from its long term objectives before attainment of those objectives is seriously impaired. The Trustee aims to strike the right balance between risk appetite and risk capacity.

When assessing the risk appetite and risk capacity for the Final Pay sections, the Trustee considered a range of qualitative and quantitative factors, including:

- the strength of the employer's covenant and how this may change in the near/medium future;
- the agreed journey plan and employer contributions;
- the Plan's long-term and shorter-term funding targets;
- the Plan's liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged;
- the Plan's cash flow and target return requirements; and
- the level of expected return and expected level of risk (as measured by Value at Risk ("VaR")), now and as the strategy evolves.

When assessing risk appetite and risk capacity for the DC sections, the Trustee has addressed these issues by ensuring that, given the ways in which members can take their benefits, a range of investment options have been made available that take account of members' reasonable risk/return preferences as well as a default option for those who do not wish to make their own choice.

2. Approach to managing and monitoring risks

The Trustee considers that there are a number of different types of investment and non-investment risks in relation to both the Final Pay and DC sections that are important to manage and monitor. These include, but are not limited to:

Risk	Final Pay Sections	Defined Contribution Sections
Funding Insufficient assets to cover accrued liabilities.	Managed by careful structuring of the funding and investment arrangements, along with regular monitoring.	The liabilities equal the assets, but there is a related risk of not meeting members' reasonable expectations in terms of pension proceeds on retirement, bearing in mind members' contributions and fund choices. This is managed through careful design of the lifecycle strategies and offering an appropriate fund range, along with regular monitoring.
Mismatching A difference in the sensitivity of asset and liability values to financial and demographic factors.	This is considered when setting the investment strategy and managed through regular reviews of the investment strategy. The Insurance portfolio is expected to perfectly match the liabilities of the insured members.	
Interest Rate The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. These fluctuations will affect the valuations of both assets and liabilities (the Scheme Actuary values the Final Pay sections liabilities with reference to UK Government bond yields).	This is managed by formal review of the sensitivity between the assets and liabilities after each triennial valuation, or if there are any significant changes to the profile of the liabilities, or major changes in investment markets. The Insurance portfolio is expected to perfectly match the liabilities of the insured members.	The liabilities equal the assets, but there is a related risk of not meeting members' reasonable expectations in terms of pension proceeds on retirement, and this will be subject to interest rate and inflation risk. The assets are subject to interest rate and inflation risk because some of the assets are invested in bonds via pooled funds. The Trustee considers the interest and inflation risk exposure appropriate in the context of the overall range of investment options. This is managed through careful design of the lifecycle strategies and offering an appropriate fund range, along with regular monitoring.
Inflation The risk that the fair value or future cash flows from an investment will fluctuate due to changes in realised or expected inflation. The Plan's liabilities are often directly linked to inflation and the risk is that the assets do not also have this sensitivity.		

Longevity Related to the increasing life expectancy of pensioners and policy holders. This can result in higher than expected payout.	This is currently managed by including a buffer in the targeted returns and a funding reserve in the Main portfolio; and through the purchase of buy-in policies held within the Insurance portfolio.	Not applicable since members decide how to take their own benefits.

Credit The risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation.	This is managed by ensuring that appropriate guidelines are in place. The Trustee receives regular reports from the managers setting out the extent of credit risk within their portfolios and, in particular, whether any agreed guidelines have been breached. For the Insurance Portfolio the Plan is exposed to the risk that an insurer defaults on its obligation to pay the pensions of the insured members. This risk is mitigated as the two policies have been purchased on a collateralised basis. Collateral pools are held within accounts in the Plan's name at the Plan's Custodian. Should the insurer fail, the Trustee takes back the collateral pool.	The Plan's Defined Contribution sections are subject to credit risk associated with the underlying investments. A wide range of funds are available to allow members to suitably diversify their investments to manage this risk. This is also considered when setting the lifecycle strategies.
Currency The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.	The Plan assets are, for the most part, Sterling denominated, as are the Plan's liabilities. A small level of currency risk remains in relation to the investment in overseas assets. The Trustee takes a long-term view on currency risk and accepts some of the short-term volatility in currency markets to avoid the costs associated with currency hedging.	The Trustee has discussed currency risk for Defined Contribution sections members and determined that members are reasonably well protected in the Lifecycle strategies given that the risk relates primarily to the global equity exposure which is reduced from 15 years before retirement. Members who self-select their own funds can manage this risk themselves and all members are made aware of the currency risks in relation to relevant investments through the available literature.

Other Price The risk that the fair value or future cash flows of a financial asset will fluctuate as all investments are subject to idiosyncratic price risks.	These risks are managed by ensuring that the portfolio is well diversified both across asset classes and within each individual asset class. In addition, the Trustee takes advice from its investment consultant as to the continuing suitability of the asset classes and managers in which it invests.	Other price risks are managed through regular reviews of the investment strategy and fund managers.
Investment managers This risk arises from a failure to meet target returns.	This is managed by the Investment Committee which closely monitors the performance of the managers and receives formal quarterly reports from the investment consultant giving views on each manager's continuing appropriateness. Prior to appointing an investment manager, the Trustee also receives written advice from a suitably qualified individual and will typically undertake an investment manager selection exercise.	
Diversification This risk relates to an inadequate spread of investments and sources of return.	This is managed by spreading the Plan's investments over a range of asset classes and is considered as part of each investment strategy review.	The Trustee has selected a wide range of funds to be available to allow members to suitably diversify their investments to manage this risk. This is also considered when setting the lifecycle strategies.
Covenant This risk relates to the possibility of the failure of the Plan's sponsor.	This risk is managed through the appointment of an independent third-party covenant advisor and regular monitoring of a number of key metrics.	The payment of DC pots would not be impacted by the failure of the Plan sponsor.
Pension Conversion There are risks relating to the point of retirement for members and the approach they take to retirement, in other words whether they take cash, transfer to an income drawdown provider or purchase an annuity.	Not applicable as these risks are borne by the Plan not the members.	These risks are considered when designing the lifecycle strategies and determining the fund range and are managed through regular monitoring.

Cash flows This risk relates to a shortfall of liquid assets relative to the Plan's immediate liabilities.	This is managed by regular monitoring of liquidity levels and expected outgo.	All of the funds used are daily dealt so sufficient liquidity should be available to members if they required cash for any outflow. For some asset classes there is a small risk of temporary suspension of daily dealing. These would be dealt with on a case by case basis but are mitigated by the small proportion of assets involved.
Operational This risk relates to fraud, poor advice or negligence.	Operational risk is reduced as far as possible by due diligence on the appointment and review of managers and advisers, and by contracts of engagement. Additional controls are provided by the regular reviews of the Plan and its operations carried out by the Pensions team and external auditors.	
Political This is the risk of an adverse influence on investment values arising from political intervention.	It is managed through regular reviews of the investment strategy, and fund managers. Relevant government consultations will be discussed with the investment consultant in advance of any anticipated changes.	
Environmental, social and corporate governance (ESG) and climate related factors This risk relates to insufficient consideration of ESG and climate related factors.	ESG factors are sources of risk to the Plan’s investments, some of which could be financially material, over both the short and longer term. These potentially include risks relating to factors such as climate change, unsustainable business practices, and unsound corporate governance. The Trustee seeks to appoint investment managers who will manage these risks appropriately on their behalf and from time to time reviews how these risks are being managed in practice.	

Investment manager arrangements

Appendix 3

Details of the investment managers, their objectives, and investment guidelines and custody arrangements are set out below.

The Final Pay Sections

1. Insurance Portfolio

The Plan holds two insurance policies, details of which are outlined below.

Insurer	Objective
Aviva Life & Pensions UK Limited	To make payments to the Plan which are expected to match the benefit payments of the insured members.
Legal and General Assurance Society Limited	To make payments to the Plan which are expected to match the benefit payments of the insured members.

2. Matching Assets

The Plan's assets invested in matching asset classes are outlined below.

Investment Manager	Objective
Legal & General Investment Management	To manage a bespoke Liability Driven Investment mandate, benchmarked against the Plan's expected liability cashflows. This mandate includes UK fixed interest government securities, UK index-linked government securities, interest rate and inflation swaps and other derivative instruments or bonds as appropriate.
LaSalle Investment Management	To manage a portfolio of RPI linked properties.
Infrared Capital Partners	To manage an infrastructure portfolio.
Aberdeen	To manage an infrastructure portfolio.
Kames	To manage a credit portfolio. The core of the portfolio will be sterling investment grade corporate bonds, and the portfolio will be managed on a 'buy and maintain' basis.

3. Return Seeking Assets

The Plan’s assets invested in Return Seeking assets are outlined below:

Investment Manager	Objective
LaSalle Investment Management	To manage a portfolio of property investments.
Pantheon Ventures	To manage a portfolio of Unquoted Equity 'Fund of Funds'. Pantheon invests in a range of different Fund of Fund products which provide the Plan with diversification across global regions (US, Europe and Asia), strategies and vintages.
EQT	The EQT Fund will make primarily controlling and co-controlling investments in infrastructure investments located in Northern and Eastern Europe with the flexibility to invest globally.
Alinda	To invest in large economic infrastructure assets, predominantly from the secondary market. These assets will predominantly be sourced from the US and Western Europe.
Meridiam	To manage an infrastructure portfolio with an emphasis on the Transportation (primarily roads) and Social sectors in Continental Europe.
CB Richard Ellis	To manage a diversified exposure to pan-European real estate (excl. UK) through investment in Investment Funds and/or Property Related Assets.

4. Custodian

The Trustee employs Bank of New York Mellon (BNY Mellon) as the Plan's global custodian and monitors its ongoing suitability on a periodic basis. A list of responsibilities has been devised for the custodian.

5. Additional Voluntary Contributions

The Plan provides a facility for members to pay AVCs to enhance their benefits at retirement. The members are offered a range of funds in which to invest their AVC payments. This includes the option to pay AVCs to the funds outlined below, or the Cash Lifecycle Option (which is the default option for existing members with AVC benefits within the Plan who do not have assets invested in the Drawdown Lifecycle, or are DB members with AVC benefits who do not have assets invested in the Money Purchase or Auto Enrolment sections of the Plan). In other cases, the default for AVC contributions is the Drawdown Lifecycle Option.

The Defined Contribution Sections

A list of funds that are currently provided are shown below, along with their investment objectives

Fund	Objective
Blended Global Equity Fund	The fund aims to provide returns consistent with the composite benchmark by investing in a range of funds that provide exposure to global equities, including emerging markets.
MFS Meridian Global Equity Fund	An actively managed fund invested in a portfolio of equity securities of global issuers. The Fund aims to outperform the MSCI World Index.
BlackRock UK Equity Index Fund	A passively managed fund invested in shares of UK companies which aims to achieve a return that is consistent with the return of the FTSE All Share Index.
Blended Multi Asset Fund	The fund invests with one or more investment managers with the aim of providing long term growth in excess of inflation. The Fund may invest in a broad range of asset classes which might include global equities, fixed income, property and other assets. For efficiency purposes, the fund may use derivatives.
BlackRock World (ex-UK) Equity Index Fund	A passively managed fund primarily invested in shares of overseas companies, with a performance objective of achieving a return in line with the FTSE All-World Developed ex-UK Index.
Threadneedle Pensions Property Fund	An actively managed fund invested in property with a performance objective of achieving a return above the AREF/IPD UK Quarterly Property Fund Index.
Blended Index Linked Gilt Fund	The fund aims to perform in line with its benchmark by investing in a range of funds that provide exposure to both long and short dated UK index-linked gilts.
Annuity Targeting Fund	The fund invests with one or more investment managers with the aim of providing diversified exposure to assets that reflect the investments underlying a typical traditional annuity product.

BlackRock Over 15 Year Corporate Bond Fund	A passively managed fund primarily invested in investment grade corporate bonds denominated in Sterling that have a maturity period of 15 years or longer. The fund aims to achieve a return in line with the iBoxx Sterling Non-Gilts Over 15 Years Index.
BlackRock Over 15 Year Gilt Index Fund	A passively managed fund primarily invested in UK government fixed interest securities that have a maturity period of 15 years or longer. The fund aims to achieve a return in line with the FTSE UK Gilts Over 15 Years Index.
Short Duration Credit Fund	The fund invests with one or more managers in a range of fixed income securities, predominantly those with short-term maturities of 5 years or under. The fund aims to outperform the benchmark.
BlackRock Sterling Liquidity Fund	The fund seeks to maximise current income consistent with the preservation of capital and liquidity through the maintenance of a portfolio of high quality short-term “money market” instruments.
Jupiter Ecology Fund (closed to new members)	An actively managed fund invested worldwide in companies that demonstrate a positive commitment to the long-term protection of the environment. The fund aims to provide long term capital growth consistent with a policy of protecting the environment. The fund measures performance relative to the FTSE World and the FTSE Environmental Technology 100 Index.
BMO Responsible Global Equity Fund	The fund aims to provide long-term capital growth. It seeks to achieve this by investing in companies screened against defined responsible and sustainable criteria, including exclusions on tobacco, alcohol, weapons, gambling, nuclear and pornography. The fund also requires companies to meet sector standards on social and environmental impacts, including systems for managing labour standards, human rights, supply chains, environmental impacts, water, waste and biodiversity. .

6. Lifecycle strategies

The aim of the Lifecycle Options is to ensure that members' funds are invested in appropriate funds at the appropriate time, based on their age and the number of years until their selected retirement date. Each Lifecycle Option uses a combination of the funds listed above. Lifecycle Options' strategies involve a phased switching approach as described below:

The Drawdown Lifecycle is the main default Lifecycle Option for the DC sections of the Plan and initially invests in the Blended Global Equity Fund. Starting from 15 years from retirement this holding is gradually switched into the Blended Multi Asset Fund such that 12 years from selected retirement age the member is invested 72% in the Blended Global Equity Fund and 28% in the Blended Multi Asset Fund. 12 years from retirement the Short Duration Credit Fund and the Blended Index Linked Gilt Fund are gradually incorporated such that at retirement members are invested in the following proportions: 32% Blended Global Equity Fund, 28% Blended Multi Asset Fund, 20% Short Duration Credit Fund and 20% Blended Index Linked Gilt Fund. The Drawdown Lifecycle is also the default Lifecycle Option for the AVC benefits of members with assets invested in the Money Purchase or Auto Enrolment sections of the Plan.

The Cash Lifecycle invests members' money in the same way as the main DC default Lifecycle Option until 5 years before retirement, when the member is gradually switched to 100% invested in the BlackRock Sterling Liquidity fund at retirement. The Cash Lifecyle is also the default Lifecycle Option for existing members with AVC benefits within the Plan who do not have assets invested in the Drawdown Lifecycle, or are DB members with AVC benefits who do not have assets invested in the Money Purchase or Auto Enrolment sections of the Plan. The Plan also makes this Lifecycle Option available for members to self-select.

The Annuity Lifecycle is the Plan's legacy default for the DC sections but is no longer a current default for members. It invests members' money in the same way as the current default Lifecycle Option until 5 years before retirement, when the member is gradually switched into a combination of 75% Annuity Targeting Fund and 25% BlackRock Sterling Liquidity fund at retirement allocation. The Plan also makes this Lifecycle Option available for members to self-select.

7. The Default strategies

7.1. Requirement for a default

The Plan Trustee is required to designate a default arrangement into which members who are automatically enrolled are invested. The Trustee has designated the Drawdown Lifecycle (as outlined above) as the main DC default arrangement for the Plan and the default arrangement for AVC assets for new and existing members that have assets invested in the Money Purchase and Auto Enrolment sections. This does not apply; however, to AVC benefits where the member has no assets already invested in the Drawdown Lifecycle through the Money Purchase or Auto Enrolment sections, or is a DB member with AVC benefits but no assets in these aforementioned DC sections.

The Trustee has designated the Cash Lifecycle as the default arrangement for AVC assets within the Plan where existing members do not have assets invested in the Money Purchase and Auto Enrolment sections, or are DB members with AVC benefits who do not have assets invested in the Money Purchase or Auto Enrolment sections of the Plan.

7.2. Default design

The default Lifecycle strategies were constructed following analysis of the membership of the Plan. This analysis took into account factors such as age, salary, contribution level, accumulated fund values and term to retirement to identify different types of member in order to test alternative investment strategies. The design of the default Lifecycle strategies reflect this analysis having carried out multiple simulations of future economic and investment scenarios.

7.3. Objectives of the default Lifecycle strategies

The aim of all the default Lifecycle strategies is to provide members with the potential for higher levels of growth during the accumulation of their retirement savings though exposure to equity and diversified growth funds and then to gradually diversify their investments in the years approaching retirement, in order to reduce volatility while still providing suitable exposure to growth assets. The asset allocation throughout the default Lifecycle strategies and the phasing of the gradual switching of investments takes into account members' greater capacity for risk early on and reduced capacity for risk in later years.

7.4. Default created as result of temporary suspension of the Threadneedle Pensions Property Fund

This default option is a fixed allocation to the BlackRock Sterling Liquidity Fund and targets cash withdrawal at retirement, since the Trustee believes this is the most appropriate alternative for these contributions given the temporary suspension of the Property Fund and the inability for the Trustee to currently exercise members' choice to invest in the Property Fund. The aims and objectives of the strategy are that the fund aims to maximise current income consistent with the preservation of capital and liquidity through the maintenance of a portfolio of high quality short-term “money market” instruments and to achieve an investment return that is in line with its benchmark.

7.5. Reviewing the defaults

The default strategies will be reviewed periodically with reference to the manner in which members are expected to take their benefits from the Plan. This periodic review will also take into account any significant changes in the demographic profile of the relevant members, changes in available investment options and market conditions.

7.6. Compliance with the investment Regulations

The Trustee's policies in relation to the default arrangement in respect of matters set out in Regulation 2(3) of the Occupational Pension Schemes (Investment) Regulations 2005, as amended, are those set out in the previous sections.