

# *Statement of Investment Principles for the DB Section of the Volkswagen Group Pension Scheme*

## **1. Introduction**

This Statement of Investment Principles ("SIP") sets out the policy of Volkswagen Group Pension Scheme Trustee Limited ("the Trustee") on various matters governing decisions about the investments of the Defined Benefit ("DB") Section of the Volkswagen Group Pension Scheme ("the Scheme"). This SIP replaces the previous SIP dated October 2022.

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).

This SIP has been prepared after obtaining and considering written professional advice from LCP, the Scheme's investment adviser, whom the Trustee believes to be suitably qualified and experienced to provide such advice. The advice considers the suitability of investments including the need for diversification given the circumstances of the Scheme 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 and at least once every three years.

- **Appendix 1** sets out details of the Scheme'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 DB Section's investment manager arrangements.
- **Appendix 4** sets out the investment risk limits for the investment managers.

## **2. Investment objectives**

The primary short to medium term objective of the Employers is to reduce the volatility of the funding level of the DB Section on an accounting basis.

The primary objectives of the Trustee are as follows:

- pay benefits as they fall due to members by targeting an expected return on assets of 1.0% pa in excess of gilts.

- reduce the risk that the Scheme's ongoing funding level deteriorates significantly by using an investment strategy with an estimated investment risk of £9m (as at 31 March 2023). This means that it is estimated that there is a 1 in 10 chance of the funding level deteriorating by £9m or more in any one year period due to adverse investment condition.
- that the Scheme should be fully funded on a technical provisions basis (ie the asset value should be at least that of its liabilities on this basis), with a secondary objective of being fully funded on a gilts-only basis by 1 January 2025.

The Scheme has undergone an actuarial valuation under the Occupational Pensions Scheme (Scheme Funding) Regulations 2005.

### 3. What risks does the Trustee consider and how are these measured and managed?

When deciding how to invest the Scheme's assets, the Trustee considers a wide range of 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.

### 4. Investment strategy

The Trustee, with the help of its advisers and in consultation with the Employers, reviewed the investment strategy for the Scheme in late 2019 and early 2020, considering the objectives described in Section 2 above.

The result of the review was that the Trustee agreed that the investment strategy of the Scheme should be based on the allocation below. This benchmark allocation is indicative and will change as the funding position of the Scheme changes:

Portfolio	Benchmark allocation
Multi-factor equities	4.5%
Absolute return bonds	10.0%
Buy and maintain credit	30.0%
LDI portfolio (including money market fund)	55.5%
<b>Total</b>	<b>100.0%</b>

The Trustee has set a tolerance range of +/-2% for each of the individual asset allocations, and monitors this on a quarterly basis. If material deviations from the tolerance ranges occur the Trustee will consider with its advisers whether it is appropriate to rebalance the assets taking into account factors such as market conditions and anticipated future cash flows.

The Trustee has a leverage management plan in place which sets out the assets directly available to support the Scheme's LDI arrangements.

The Trustee had put in place de-risking triggers to reduce the investment risk of the Scheme as the funding level increases. The objective of this mechanism was to lock in gains following better than expected investment experience, by disinvesting from the Scheme's growth assets

(ie multi-factor equities) and investing the proceeds in the Scheme's matching assets (ie LDI and cash). The Scheme's current investment strategy is invested in line with the final switch position, following the last gilts-only deficit trigger having been hit.

## 5. Considerations in setting the investment arrangements

When deciding how to invest the Scheme'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 in determining the investment arrangements were as follows (values below as at 31 March 2020):

- average long-term inflation: 2.8%
- average long-term gilt yield: 0.8%
- average long-term return on currency hedged equities: 6.2%

Thus, assuming there is a 50/50 chance that, over the long term, currency hedged equity-type investment will outperform gilts by 5.4% pa.

In setting the strategy for the DB Section, the Trustee considered:

- the Scheme's investment objectives, including the target return required to meet the Trustee's investment objectives;
- the Scheme's cash flow requirements in order to meet benefit payments in the near to medium term;
- the best interests of all members and beneficiaries;
- the circumstances of the Scheme, 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 Scheme'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 Scheme; and
- the Trustee's investment beliefs about how investment markets work, and which factors are most likely to impact investment outcomes.

The Trustee's key investment beliefs, which influenced the setting of the investment arrangements, are as follows:

- asset allocation is the primary driver of long-term returns;
- risk-taking is necessary to achieve return, but not all risks are rewarded;
- equity, credit and illiquidity are the primary rewarded risks;
- risks that do not have an expected reward should generally be avoided, hedged or diversified;
- investment markets are not always efficient and there may be opportunities for good active managers to add value;
- 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 factors;
- investment managers who can consistently spot and profitably exploit market opportunities are difficult to find and therefore passive management, where
- long-term environmental, social and economic sustainability is one factor that trustees should consider when making investment decisions; and
- costs have a significant impact on long-term performance and therefore obtaining value for money from the investments is important.

## 6. 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 are set out in Appendix 3.

The Trustee has signed agreements with the two investment managers 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 Scheme'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 has limited influence over managers' investment practices because all the Scheme's assets are held in pooled funds, but it encourages its managers to improve their practices where appropriate.

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 Scheme 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 Scheme's investment mandates.

## 7. Realisation of investments

The investment managers have discretion over the timing of realisation of investments of the Scheme within the portfolios that they manage, and in considerations relating to the liquidity of investments.

When appropriate, the Trustee, on the administrators' recommendation, decide on the amount of cash required for benefit payments and other outgoings and inform the investment managers of any liquidity requirements.

The Trustee's preference is for investments that are readily realisable, but it recognises that achieving a well-diversified portfolio may mean holding some investments that are less liquid. The Scheme's standalone allocation to cash is intended to ensure that there is enough cash available to pay benefits as needed and to reduce the risk of having to disinvest from another asset class at a potentially unfavourable time.

## 8. Financially material considerations and non-financial matters

Page 6 of 21

The Trustee has considered how environmental, social, governance (“ESG”) and ethical factors should be taken into account in the selection, retention and realisation of investments, given the time horizon of the Scheme and its members. The time horizon is consistent with the Scheme’s secondary objective, as set out in Section 2, and therefore is relatively short-term.

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 takes advice from its investment advisor in regard to the selection and monitoring of its investment managers on ESG related matters.

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 Trustee does not take into account any non-financial matters (ie 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.

## 9. 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 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.

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 monitors the investment managers’ activities in relation to ESG factors, voting and engagement. The Trustee seeks to understand how the managers are implementing their stewardship policies in practice to check that their stewardship is effective and aligned with the Trustee’s expectations.

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Page 7 of 21

The Trustee has selected some priority themes to provide a focus for the monitoring of investment managers' voting and engagement activities. The Trustee reviews the themes regularly and updates them if appropriate. The Trustee communicates these stewardship priorities to its managers and also confirms more general expectations in relation to ESG factors, voting and engagement as appropriate.

If the Trustee's monitoring identifies areas of concern, the Trustee will engage with the relevant manager to encourage improvements.

**SIP signed for and on behalf of Volkswagen Group Pension Scheme Trustees Limited:**

**Signed:**

## *Investment governance, responsibilities, decision-making and fees*

The Trustee has decided on the following division of responsibilities and decision-making for the Scheme. 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 Scheme overall. The Trustee's investment powers are set out within the Scheme'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 Employers;
- setting the investment strategy, in consultation with the Employers;
- formulating a policy in relation to financially material considerations, such as those relating to ESG considerations (including but not limited to climate change);
- 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 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 Employers when reviewing the SIP.

The Trustee has delegated consideration of certain investment matters to an investment sub-committee, known as the Investment Stream ("IS"), although any decisions remain the responsibility of the Trustee.



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 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.

### 3. 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 Scheme's benefits, membership, and funding position may affect the manner in which the assets should be invested and the asset allocation policy;
- 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.

### 4. Fee structures

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

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

The investment managers receive fees calculated by reference to the market value of assets under management. The fee rates are believed to be consistent with the manager'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 Scheme. However, the Trustee will consider revising any given structure if and when it is considered appropriate to do so.

#### 5. 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 Scheme's investments, investment providers and professional advisers from time to time. 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.

#### 6. Working with the Scheme's Employers

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

## 1. Risk appetite and risk capacity

Risk appetite is a measure of how much risk the Trustee is willing to bear within the Scheme 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's aim is to strike the right balance between risk appetite and risk capacity.

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

- the strength of the Employers' covenant and how this may change in the near/medium future;
- the agreed journey plan and employer contributions;
- the Scheme's long-term and shorter-term funding targets;
- the Scheme's liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged;
- the Scheme'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.

The Trustee believes that level of risk of the Scheme's current investment strategy is appropriate given the Trustee's and Employers' risk appetite and capacity, given the Scheme's objectives.

## 2. Approach to managing and monitoring investment risks

The Trustee considers that there are several different types of investment risk that are important to manage and monitor. These include, but are not limited to:

### 2.1 Risk of inadequate returns

A key objective of the Trustee is that, over the long-term, the Scheme should generate its target return so that it has adequate assets to meet its liabilities as they fall due. The Trustee therefore invests the assets of the Scheme to produce a sufficient long-term return in excess of the liabilities. There is also a risk that the performance of the Scheme's assets and liabilities diverges in certain financial and economic conditions in the short term. This risk has been considered in setting the investment strategy and is monitored by the Trustee on a regular basis.

## 2.2 Risk from lack of diversification

This is the risk that failure of a particular investment, or the general poor performance of a given investment type, could materially adversely affect the Scheme's assets. The Trustee believes that the Scheme's assets are adequately diversified between different asset classes and within each asset class. This was a key consideration when determining the Scheme's investment arrangements and is monitored by the Trustee on a regular basis.

## 2.3 Investment manager risk

This is the risk that an investment manager fails to meet its investment objectives. Prior to appointing an investment manager, the Trustee receives written advice from a suitably qualified individual and will typically undertake an investment manager selection exercise. The Trustee monitors the investment manager on a regular basis to ensure it remain appropriate for its selected mandate. of the formal risk limits of the managers are shown in Appendix 4.

## 2.4 Counterparty risk

This is the risk that one party to a contract (such as a derivative instrument) causes a financial loss to the other party by failing to discharge a contractual obligation. This risk applies in particular for those contracts that are traded directly between parties, rather than traded on a central exchange.

In particular, CT makes use within its Dynamic LDI fund range of derivative and gilt repos contracts and this fund is used by the Trustee to match efficiently a portion of the Scheme's liabilities. Counterparty risk is managed within the fund through careful initial selection and ongoing monitoring of trading counterparties, counterparty diversification and a robust process of daily collateralisation of each contract, to ensure that counterparty risk is limited, as far as possible, to one day's market movements

## 2.5 Illiquidity/marketability risk

This is the risk that the Scheme is unable to realise assets to meet benefit cash flows as they fall due, or that the Scheme will become a forced seller of assets in order to meet benefit payments. The Trustee is aware of the Scheme's cash flow requirements and believe that this risk is managed appropriately via the measures described in Section 7.

## 2.6 Environmental, social and governance (ESG) risks

Environmental, social and corporate governance (ESG) factors are sources of risk to the Scheme'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 its behalf and from time to time reviews how these risks are being managed in practice.

**2.7 Collateral adequacy risk****Appendix 2 (cont)**

The Scheme is invested in leveraged Liability Driven Investment (“LDI”) arrangements to provide protection (“hedging”) against adverse changes in interest rates and inflation expectations. The LDI manager may from time to time call for additional cash to be paid to the LDI portfolio in order to support a given level of leverage. Collateral adequacy risk is the risk that the Trustee when requested to do so will not be able to post additional cash to the LDI fund within the required timeframe. A potential consequence of this risk is that the Scheme’s interest rate and inflation hedging could be reduced and that the Scheme’s funding level could suffer subsequently as a result. In order to manage this risk, the Trustee ensures that the Scheme has a sufficient allocation to cash and other highly liquid assets which can be readily realised, so that cash can be posted to the LDI manager at short notice.

**2.8 Credit risk**

This is the risk that a borrower will cause a financial loss for the other party by failing to meet required payments for a contractual obligation. The Scheme is subject to credit risk because it invests in bonds via pooled funds. The Trustee manages its exposure to credit risk by only investing in pooled funds that have a diversified exposure to different credit issuers.

**2.9 Currency risk**

Whilst the majority of the currency exposure of the Scheme’s assets is to Sterling, the Scheme is subject to currency risk because some of the Scheme’s investments are held in overseas markets. The Trustee considers the overseas currency exposure in the context of the overall investment strategy, and believes that the currency exposure that exists is appropriate. Furthermore, the Trustee manages the amount of currency risk by investing in pooled funds that hedge currency exposure where available.

**2.10 Equity risk**

Equity represents (part) ownership of a company. Equity risk is the risk that the value of this holding falls in value. The Trustee believes that equity risk is a rewarded investment risk, over the long term. The Trustee considers exposure to equity risk in the context of the Scheme’s overall investment strategy and believes that the level of exposure to this risk is appropriate.

**2.11 Interest rate and inflation risk**

The Scheme’s assets are subject to interest rate and inflation risk because some of the Scheme’s assets are held in bonds / interest rate swaps, via pooled funds. However, the interest rate and inflation exposure of the Scheme’s assets hedges part of the corresponding risks associated with the Scheme’s liabilities.

The Trustee considers interest rate, inflation and overseas currency risks to be generally unrewarded investment risks.

As a result, the Trustee aims to hedge the Scheme's exposure to interest rate risk and inflation risk in line with the de-risking steps described in Section 4, by investing in leveraged LDI arrangements managed by Columbia Threadneedle Investments. The Trustee also has a plan in place to increase this level of hedging as the Scheme's funding level improves, which is also described in Section 4.

The net effect of the Trustee's approach to interest and inflation risk will be to reduce the volatility of the funding level, and so the Trustee believes that it is appropriate to manage exposures to these risks in this manner and to review them on a regular basis.

## 2.12 Other non-investment risks

The Trustee recognises that there are other, non-investment, risks faced by the Scheme, and takes these into consideration as far as practical in setting the Scheme's investment arrangements as part of its assessment of the other aspects of the Scheme's Integrated Risk Management framework.

Examples for the DB Section include:

- longevity risk (the risk that members live, on average, longer than expected); and
- sponsor covenant risk (the risk that, for whatever reason, the sponsoring employer is unable to support the Scheme as anticipated).

Together, the investment and non-investment risks give rise generally to funding risk. This is the risk that the Scheme's funding position falls below what is considered an appropriate level. The Trustee regularly reviews progress towards the Scheme's funding target, both in the longer-term as well as against short-term milestones, comparing the actual versus the expected funding level.

By understanding, considering and monitoring the key risks that contribute to funding risk, the Trustee believes that it has appropriately addressed and is positioned to manage this general risk.

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

### 1. The dynamic LDI portfolio

The Trustee has selected Columbia Threadneedle Investments ("CT") as the investment manager for the Scheme's dynamic LDI portfolio.

The funds were invested as follows as at 31 March 2023:

Fund	Approximate allocation (%)	Fund objective
Real Dynamic LDI Fund	11	Provide a hedge against real rate liabilities using a range of hedging assets.  Its benchmark is a typical pension fund's liability profile as determined by CT.
Nominal Dynamic LDI Fund	46	Provide a hedge against nominal rate liabilities using a range of hedging assets.  Its benchmark is a typical pension fund's liability profile as determined by CT.
Short-Profile Real Dynamic LDI Fund	43	Provide a hedge against real rate liabilities using a range of hedging assets.  Its benchmark is a typical short duration pension fund's liability profile as determined by CT.
<b>Total Dynamic LDI</b>	<b>100</b>	

In addition, since the LDI Funds are levered (with the target leverage typically in the range of 2-3 times leveraged) , the Scheme has a holding in a CT money markets fund to reduce this leverage significantly. The fund used is the same as the fund described as "The money markets portfolio" in Section 5 of Appendix 3.

2. The buy and maintain credit portfolio

The Trustee has selected Legal and General Investment Management (“LGIM”) as the investment manager for the Scheme’s buy and maintain credit portfolio.

The funds were invested as follows as at 31 March 2023:

Fund	Approximate allocation (%)	Fund objective
Maturing B&M credit 2025-2029	42	<p>The funds aim to achieve growth of capital within a globally diversified portfolio of predominantly investment grade credit (ie corporate bonds).</p> <p>The Fund will purchase bonds with all expected cashflows to be paid during the target maturity 2025-2029</p>
Maturing B&M credit 2030-2034	58	<p>The funds aim to achieve growth of capital within a globally diversified portfolio of predominantly investment grade credit (ie corporate bonds).</p> <p>The Fund will purchase bonds with all expected cashflows to be paid during the target maturity 2030-2034</p>
Total B&M	100	

Due to the nature of the buy and maintain credit portfolios, the LGIM Funds do not have a specific benchmark.

3. The absolute return bond portfolio

The Trustee has selected Columbia Threadneedle Investments (“CT”) as the investment manager for the Scheme’s absolute return bond portfolio. CT’s benchmark is as follows:

Asset class	Benchmark index
Absolute return bonds	3 Month SONIA

CT’s objective is to outperform the prescribed benchmark by 3.0% pa before investment management fees, over the medium term, with positive returns over a 12 month period.



4. The multi-factor equities portfolio

The Trustee has selected Legal and General Investment Management (“LGIM”) as the investment manager for the Scheme’s multi-factor equities portfolio. LGIM’s benchmark is as follows:

Asset class	Benchmark index
Multi-factor equities	A blend of regional market-cap weighted equity indices that broadly reflects the regional allocation of the Fund and the currency hedging undertaken (33% FTSE North America Index, 50% GBP hedged, 52% FTSE Developed ex North America Index, 50% GBP hedged, and 15% FTSE Emerging Index)

LGIM’s objective is to provide long-term investment growth by investing in a diversified mix of global equities and providing exposures to multiple equity risk factors.

5. The money markets portfolio

The Trustee has selected CT and LGIM for the Scheme’s liquidity portfolios. The function for these holdings and their respective benchmarks are as follows:

Manager	Function	Benchmark index
CT	To meet Scheme benefit payments in the short-term and for collateral purposes for the Scheme’s LDI portfolio.	7 Day GBP SONIA
LGIM	To hold income generated from the buy and maintain credit portfolio for the purpose of meeting Scheme benefit payments.	7 Day GBP SONIA

CT’s objective is to maintain high levels of liquidity and generate a return in line with money market rates.

LGIM’s objective is to provide diversified exposure and a return in relation to 7 Day GBP SONIA.

6. Additional Voluntary Contributions (“AVCs”)

The Trustee has selected Fidelity International (“Fidelity”) as the investment manager for the Scheme’s money purchase AVCs. Fidelity offers funds managed by BlackRock, Legal & General Investment Management, Insight, and Nordea. In addition, prior to 2004 members were able to contribute to

policies with Clerical Medical Investment Group or Equitable Life Assurance Society.

7. Rebalancing between managers

The split is monitored each quarter and cashflows may be used to realign the portfolio with the benchmark. If the portfolio is more than 2% from the central benchmark the Trustee will consider whether to switch between asset classes to rebalance back to the central benchmark.

Each manager has in place specific risk limits on its mandate. The limits for each manager are listed below:

## **1. Columbia Threadneedle Investments (“CT”)**

### **1.1 Absolute return bonds**

- The permitted investments for the fund include, but are not restricted to: government bonds, supranational bonds, investment grade and high yield credit, asset backed securities and secured loans.
- Financial derivative instruments that may be used include financial futures contracts, currency forwards, interest rate and inflation swaps, credit default swaps, interest rate futures, exchange traded futures and currency futures.
- The fund may also invest in collective investment schemes, including those managed by CT.
- The fund is authorised to invest up to 100% of the assets in transferrable securities and money market instruments issued or guaranteed by Member States of the EU, by its local authorities or agencies, or by another state accepted by the Luxembourg supervisory authority. This is provided that the fund holds securities from at least six different issuers and securities from one issuer does not account for more than 30% of the total assets of the fund.
- The fund may borrow up to 10% of the assets held in the Fund in order to meet short-term cash flow and liquidity only.

### **1.2 Real Dynamic, Nominal Dynamic and Short-Profile Nominal Dynamic LDI Funds**

- CT’s philosophy is that an LDI hedge should be low risk and therefore use the lowest risk instruments available to implement the hedge. This means UK government bonds (gilts) and equivalent-risk instruments such as swaps collateralised by gilts or cash.
- In order to mitigate the risks of illiquidity the Dynamic funds are able to access a wide range of instruments so as to maximise liquidity and minimise trading costs.
- There is a process in place to maintain an appropriate level of fund resilience (or headroom) to rises in gilt yields. Should resilience fall below approximately 3.0% on any business day the manager will request additional assets to restore resilience to above 3.0%. Additionally, if any other fund breaches this threshold, at the same time cash will also be called in respect of any other fund(s) whose resilience is within 0.1% of this trigger (ie resilience of less than 3.1%).

- On a monthly basis, the manager will return cash to investors where resilience exceeds approximately 4.4% and will call cash in respect of funds where resilience is below 3.1%.
- If resilience should fall to approximately 1.0% the manager shall accelerate any outstanding capital call. The manager also has the discretion to initiate a capital call with an accelerated timeframe and whether a pre-defined resilience threshold has been breached or not.
- Should capital not be provided in response to a call, the manager will reduce hedging exposure to reduce leverage and any associated dealing costs will be passed on via a compulsory redemption of units.
- This process and its associated parameters are subject to change at the manager's discretion and in response to regulatory requirements.
- For the cash holdings held within the LDI portfolio, please refer to the section below.

### 1.3 Money markets fund

- A portion of the Scheme's money market holdings are invested in CT's Sterling Liquidity Fund, a conservative low-risk strategy, managed by the Money Markets team. The emphasis is on liquidity and credit quality.

## 2 Legal & General Investment Management

### 2.1 Buy and maintain portfolio

- The funds are predominantly invested in securities that are investment grade (ie that have a credit rating of BBB and above) and there is a limit of 10% for sub-investment grade bonds to ensure the funds do not become forced sellers of downgraded bonds.
- The funds may also hold derivatives such as interest rate swaps, credit default swaps, futures and forwards for efficient portfolio management or to generate additional income with acceptably low level of risk.
- Where investments are issued in currencies other than Sterling, currency hedging is typically employed to protect against exchange rate and interest rate movements between those currencies and Sterling.
- All duration is typically managed within +/- 1 year of guideline targets.
- Issuer and sector size positions are measured using both duration times spread and portfolio value (%).
- Credit quality evolution is monitored and tracked using weighted average rating factor.
- Portfolio volatility and collateral management for non GBP hedging instruments are monitored and tracked using Value at Risk.

- The fund will be fully invested in equities that exhibit the characteristics of certain equity risk factors that have been shown to be rewarded over the long term. The fund will gain exposure by investing in regional multi-factor building blocks. The regional allocation will be reviewed periodically (at least annually) and the fund will not take short term, tactical asset allocation positions.
- The fund is broadly exposed one third to each of North America, Europe/UK and the rest of the world, with ~50% of the developed market overseas currency exposure typically hedged to Sterling (although the fund is permitted to take a flexible approach to currency hedging).
- The constituents of the funds are selected and weighted by a pre-defined set of equity risk-factors, as defined by the index provider, Scientific Beta. A pragmatic approach is applied to managing the underlying funds and they will replicate the index within defined risk tolerances.
- The underlying funds may hold proxy securities and derivatives such as index and single stock futures for efficient portfolio management ie to reduce risk or cost, or to generate additional income with acceptably low level of risk.
- Investments in single equities, convertibles, bonds and property are not permitted.

## 2.3

## Money markets fund

- A portion of the Scheme's cash holdings are invested in LGIM's Sterling Liquidity Fund. LGIM's philosophy is to preserve capital and provide the required liquidity.