Statement of Investment Principles – British Steel Pension Scheme

A Introduction

1. This document is the Statement of Investment Principles ('SIP') made by the Trustee of the British Steel Pension Scheme (the 'Scheme') in accordance with the requirements of Section 35 of the Pensions Act 1995 (as amended by the Pensions Act 2004 and regulations made under it) ('the Pensions Act'). Before adopting this SIP, the Trustee formally consulted with the Sponsoring Employer.

2. The Trustee will review this SIP at least every three years, or without delay following any significant change in investment strategy.

3. The Scheme operates for the exclusive purpose of providing retirement benefits to eligible participants and beneficiaries ("members").

4. The powers of the Trustee to determine the manner in which assets of the Scheme are to be invested from time to time are set out in the trust deed and rules governing the Scheme. The policies in this SIP are intended to be consistent with, but are subject to, the proper exercise of those powers.

5. The Trustee's Investment Consultant provides written advice that the Scheme's investments are satisfactory for the purpose of satisfying Section 36 of the Pensions Act.

B Trustee objectives

6. The Trustee's objective is to manage the Scheme so that members receive their benefits as and when they fall due, without needing contributions from the Employer. The assets of the Scheme, which collectively are referred to as the 'Fund', are held by the Trustee for this purpose.

7. The long term investment objective of the Fund is to provide a high level of security of pension benefits in a cost effective manner, taking into account the risks to which the Scheme is exposed, as set out in section E.

C Investment strategy

8. The over-riding principle is to acquire a portfolio of assets that offer well-defined, low risk cashflows that in aggregate provide a good match to the benefit payments in any given year. In seeking to accomplish the long term investment objective, there are six major factors that govern the investment strategy of the Fund:

   - The projected amounts of benefits that are expected to be payable each year into the future.
   - The extent to which the Scheme's liabilities are linked to inflation.
   - The maturity of the Scheme, as it determines the requirement to manage the reinvestment of the asset portfolio.
   - The nature and extent of unhedged risks.
   - The extent to which risks are likely to be covered by reserves in the Fund or underwritten through the covenant offered by the Employer, and
   - A desire to diversify its risk exposures and to manage its investments efficiently.

9. The Trustee has received advice to determine an appropriate investment strategy for the Fund. The Fund will be invested in accordance with the Strategic Asset Allocation ('SAA') and ranges set out in Appendix A.

10. The expected return on a portfolio constructed to be consistent with the SAA, was gilts + 0.85% pa as at 31 March 2018. This is to be used as a reference point for determining a suitably prudent discount rate under the Scheme's Statement of Funding Principles.

11. While the Trustee's objective is to hold assets that will generate cash flows at least sufficient to meet liabilities, it also expects that the exposure to interest rate and inflation risk will be carefully managed through the Fund, in order to maintain a level of hedging consistent with the targets and ranges set out below:

Hedge ratios as a % of buy-out liabilities	**Lower**	**Target**	**Upper**
Interest rate exposure	70%	75%	80%
Inflation exposure	65%	75%	80%

12. Derivatives will only be used in a controlled manner to facilitate the timely implementation of significant asset allocation moves, for the purposes of efficient portfolio management, to reduce risk and to facilitate closer asset/liability management through interest rate and inflation hedging. It is expected that derivative usage will be limited to the use of:

    - currency forwards for hedging foreign exchange exposure (if it arises, and with the expectation that the Fund will undertake selective currency hedging).
    - swaps to reduce the mismatch between the interest rate and inflation risk sensitivity of the Scheme's assets and liabilities.
    - options as an efficient way of managing some of the risks to which the Fund is exposed, in particular to provide protection against downside risks which could negatively impact the Fund.

13. Sale and repurchase transactions (known as “repo transactions”) are permitted for the purpose of managing interest rate and inflation risk. Use of repo and reverse repo transactions are also permitted for cash and/or collateral management purposes.

14. The Fund will not invest in overseas property, investments such as paintings and antiques, or speculative property investments.

15. It is intended that the overall Fund will be constituted as a series of notional sub–funds as set out below, namely:

    - Fixed interest credit.
    - Index–linked credit.
    - Alternative Assets (comprising a Secure Income sub-portfolio, Global Duration sub-portfolio, Growth Property and other legacy assets).
    - Maturity Property.
    - Gilts and derivatives.

16. The investment guidelines that cover intended allocations and credit criteria for these sub-funds are set out in the Investment Management Agreement (IMA) in place with the investment manager (the ‘Manager’).

17. The Trustee's policy is that there will be sufficient investments in liquid or readily realisable assets to meet cashflow requirements as they arise in foreseeable circumstances so that the realisation of assets will not disrupt the Fund's overall investments, where possible. The Fund will hold assets in cash and other money market instruments from time to time as may be deemed appropriate for short-term, non-strategic reasons, e.g. cash income received and not yet reinvested or held to be paid out shortly to pensioners. The Fund may also hold cash and cash equivalents for collateral management purposes.

18. The Trustee will not borrow money for any purpose, except by way of an overdraft with its custodian or a duly appointed sub-custodian for the purposes of meeting settlement or redemption mismatches on a short term basis. (For the avoidance of doubt, this does not preclude the use of repos for hedging purposes or for cash and/or collateral management.)

D Fund Managers

19. The Trustee will set general investment policy and will delegate the responsibility for day to day investment decisions as required by law.

20. Pension Services Limited (PSL), which is an entity entirely owned by the Trustee, is the appointed Manager. By virtue of this relationship as well as the IMA which defines the mandate for the Manager, the Trustee ensures that the investment strategy and decisions of the Manager are aligned with the policies as set out in this Statement. Given the ownership structure, the arrangement with the Manager is ongoing, and does not have an expected or minimum duration.

21. The Trustee’s expectation is that the Fund undertakes all investments with a view to them being long term investments with reference to the liability cash flows, and only when circumstances change materially, or long term objectives are achieved in a shorter space of time, will consideration be given to realising assets on a shorter time scale. The investment objectives and mandate that have been given to the Manager are consistent with operating with a longer term horizon.

22. The Trustee will maintain processes to ensure that performance of the Manager is assessed on a regular basis against measurable objectives consistent with the achievement of the Fund's long term objectives, and an acceptable level of risk. The Trustee will monitor investment performance at least quarterly, although with a focus on longer term outcomes. Key criteria will be based on there being no material negative cash flow deviations relative to expectations and performance relative to specified benchmarks, as set out in the IMA.

23. The Trustee is responsible for setting the overall remuneration of the Manager, part of which is related to performance relative to the objectives set by the Trustee. This further aligns the actions of the Manager with the Trustee’s objectives and policies set out in this Statement.

24. As part of its monitoring of the Manager, the Trustee will, at least annually, monitor the level of turnover within the Fund, compare this with their expectations for the level of turnover given the nature of the Fund’s investment arrangements and monitor the resulting transaction costs.

25. The Trustee recognises an investment’s financial success is influenced by a wide range of factors including environmental, social and governance (ESG) issues (including climate change) and stewardship. The extent to which social, environmental or ethical issues may have an impact on the portfolio will be taken into account by its Manager when making day-to-day decisions about the investment of the Fund.

26. The Trustee recognises that active ownership (including the exercise of voting rights and engagement) can protect and enhance the value of investments. The Trustee’s policy is to delegate responsibility for the exercising of rights (including voting rights) attaching to investments to its Manager and to encourage the Manager to exercise those rights. Rights attached to investments, including voting rights, will be exercised for the benefit of the Fund.

27. The Trustee will engage with the Manager on a regular basis, and at least annually, to understand how financially material considerations have been taken into account in the management of the Fund, and how its responsibilities with regards to voting and engagement have been discharged.

28. At present, the Trustee does not explicitly take account of non-financial matters in Fund design or strategy but may consider reflecting specific non-financial considerations in the future.

E Risks and regulation

29. The Trustee has developed a detailed Integrated Risk Management policy and monitoring framework to ensure the risks to which the Fund is exposed are appropriately managed. A summary of the key risks and how they are measured and managed is set out below:

— Credit risk

- is measured by monitoring defaults of and the credit rating of assets held in the portfolio.
- is managed through diversification, a reserve in the funding level and cash flow projections, the Manager's credit screening process, and limitations on the proportions of assets that can be held by credit rating.

— Longevity risk

- is measured through analysis carried out by the Scheme Actuary and embedded in cash flow projections provided to the Manager.
- is managed through a reserve in the funding level and cash flow projections.

— Deficit risk:

- is measured through a qualitative and quantitative assessment of the expected development of the liabilities relative to the current and alternative investment policies.
- is managed through assessing the progress of the liabilities relative to the selected investment policy.

— Manager risk:

- is measured by the expected deviation of the return relative to the benchmark set.
- is managed by consideration of the appropriate amount of the Fund to allocate to each active portfolio and by monitoring the actual deviation of returns relative to the benchmark and factors supporting the Manager's investment process.

— Liquidity risk:

- is measured by the level of cashflow required by the Fund over a specified period.
- is managed by the Fund's Manager and administrators assessing the level of cash held in order to limit the impact of the cash flow requirements on the investment policy and through holding sufficient assets of appropriate liquidity.

— Currency risk:

- is measured by the level of exposure to non-Sterling denominated assets.
- is managed through consideration of both currency and investment aspects when gaining exposure to overseas assets.
- currency hedging strategies are employed to manage this risk on a selective basis.

— Interest rate and inflation risk:

- is measured by comparing the likely movement in the Scheme's liabilities and assets due to movements in inflation and interest rates.
- is managed by holding a portfolio of matching assets (physical bonds and/or other real assets) and derivatives that enable the Fund to better match movements in the value of the liabilities due to inflation and interest rates.
- The Trustee recognises that not all of the Scheme's liability indexation can be precisely hedged via market instruments. The Scheme Actuary will project the liabilities by using assumptions on CPI/RPI differences and CPI volatility that will allow the Manager to hedge the expected inflation exposure with market instruments. These assumptions will be re-examined regularly and any resultant changes to expected cash flows will be immediately communicated to the Manager.

— Political risk:

- is measured by the level of concentration of any one market leading to the risk of an adverse influence on investment values arising from political intervention.
- is managed by regular reviews of the actual investments relative to policy and through the level of diversification within the existing policy.

— Employer risk:

- is measured by receiving regular financial updates from the Employer and periodic independent covenant assessments.

— Derivatives risk

- Derivatives are used only in the manner set out in section C.
- Counterparty risk – this risk is mitigated through collateral management, diversifying exposure across counterparties, and the use of robust derivatives documentation.
- Basis risk – the returns from backing assets used to meet the payable leg of a derivative contract may not match exactly. This risk is addressed through the investment policy adopted by the Trustee for the supporting assets and the Fund's asset management capabilities.
- Liability risk – pension liabilities can only be estimated and there is a risk of divergence between the performance of the derivatives and the actual value of the liabilities (for example, due to changes in assumptions or demographics, and the lack of any investments that give CPI protection). This risk is mitigated by updating the liability hedging benchmark at appropriate regular intervals.
- Roll risk – derivatives are chosen in order to minimise the risk of repos maturing at the same time and having to enter new contracts on then prevailing terms.
- Legal and operational risk – the successful operation of derivatives depends on the various legal documents governing the derivative contracts and the correct completion of some operational tasks. The Trustee takes appropriate advice when putting in place legal documents, reviewing legal documents already in place and appointing and monitoring providers capable of carrying out the required operational tasks.

- The Trustee is also aware of the risks relating to the initial terms of entry in derivative contracts (for example, purchasing the contracts at a competitive price) and the valuation of the derivatives on an ongoing basis.

30. The Trustee exercises its powers of investment, and any managers to whom discretion has been delegated, will exercise their discretion in accordance with Regulation 4 of the Occupational Pension Schemes 2005 Investment Regulations (as amended from time to time).

31. Inadvertent breaches of guidelines may happen including as a result of market movements and will be reported to the Trustee. The aim in such cases will be to bring back the Fund within the guidelines within a reasonable period by asset purchases and/or disposals but without fire sales of assets.

31 March 2021

This Statement of Investment Principles, dated has been signed on behalf of the Trustee of the British Steel Pension Scheme

Appendix A

Strategic Asset Allocation

Asset Class	Strategic Weights and Ranges		
	Lower	Target	Upper
Alternative Assets *	0%	4%	8%
Maturity Property	5%	15%	20%
Gilts and derivatives	26%	31%	36%
Credit (fixed and index linked)	45%	50%	60%
Other**	-5%	0%	5%

* Alternative Assets includes:
- the Global Duration sub-portfolio (comprising listed infrastructure assets that were transferred into the Fund at inception).
- the Secure Income sub-portfolio (comprising infrastructure debt and equity, real estate debt and renewable energy assets).
- a number of less liquid legacy holdings (including timber, private equity, catastrophe reinsurance and Growth Property) which are either in run-off or are to be sold for fair value when it is opportune to do so.

** Other includes the mark to market value of any option strategies used to manage downside risk.

The intention is that, within Alternative Assets, the existing Global Duration portfolio will be sold down by 1 January 2025. This is expected to be done as and when appropriate opportunities arise and such that the yield on the portfolio is preserved, with the proceeds reinvested in the Secure Income sub-portfolio.

For avoidance of doubt, outside of the rebalancing within the Global Duration sub-portfolio or for use purely as a conduit for Secure Income returns, the Manager may not make any new purchases in the form of equity securities.