Scottish Midland Co-operative Society Limited Pension Plan

Statement of Investment Principles

6th Edition

September 2020

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1 Introduction

This Statement of Investment Principles ("the Statement") has been prepared by the Trustee of the Scottish Midland Co-operative Society Limited Pension Plan ("the Plan") in accordance with Section 35 of the Pensions Act 1995, as amended, and its attendant Regulations.

The Statement outlines the principles governing the investment policy of the Plan and the activities undertaken by the Trustee to ensure the effective implementation of these principles.

In preparing the Statement, the Trustee has:

- obtained and considered written advice from a suitably qualified individual, employed by their investment consultants, Mercer, a trading name of JLT Employee Benefits Limited, whom they believe to have a degree of knowledge and experience that is appropriate for the management of their investments; and
- consulted with the Sponsoring Employer, although they affirm that no aspect of their strategy is restricted by any requirement to obtain the consent of the Sponsoring Employer.

The advice and the consultation process considered the suitability of the Trustee's investment policy for the Plan.

The Trustee will review the Statement formally at least every three years to coincide with the triennial Actuarial Valuation or other actuarial advice relating to the statutory funding requirements. Furthermore, the Trustee will review the Statement without delay after any significant change in investment policy. Any changes made to the Statement will be based on written advice from a suitably qualified individual and will follow consultation with the Sponsoring Employer.

2 Investment Objectives

The Trustee's primary investment objective for the Plan is to achieve an overall rate of return that is sufficient to ensure that assets are available to meet all liabilities as and when they fall due. In doing so, the Trustee also aims to maximise returns at an acceptable level of risk.

The Trustee believes that their investment objectives and the resultant investment strategy are consistent with the actuarial valuation methodology and assumptions used by the Scheme Actuary.

3 Investment Responsibilities

3.1 The Trustee's Duties and Responsibilities

The Trustee is responsible for setting the investment objectives and determining the strategy to achieve the objectives.

The Trustee's Directors carry out their duties and fulfil their responsibilities as a single body, rather than establishing an investment sub-committee. Sub-committees may be formed from time to time to examine specific issues.

The duties and responsibilities of the Trustee include, but are not limited to, the following tasks and activities:

- The regular approval of the content of the Statement.
- The appointment and review of the investment managers and investment advisers.
- The assessment and review of the performance of each investment manager.
- The setting and review of the investment parameters within which the investment managers can operate.
- The assessment of the risks assumed by the Plan at a total Plan level as well as on a manager by manager basis.
- The approval and review of the asset allocation benchmark for the Plan.
- The compliance of the investment arrangements with the principles set out in the Statement.

3.2 Investment Adviser's Duties and Responsibilities

The Trustee has appointed Mercer as the investment adviser to the Plan. Mercer provides advice as and when the Trustee requires it, as well as raising any investment-related issues, of which it believes the Trustee should be aware. Matters on which Mercer expects to provide advice to the Trustee include the following:

- Setting of investment objectives.
- Determining investment strategy and asset allocation.
- Determining an appropriate investment structure.
- Framing manager mandates.
- Selecting and replacing investment managers.

The Trustee may seek advice from Mercer with regard to both strategic and tactical investment decisions (see Section 4 - Investment Strategy); however, they recognise that they retain responsibility for all such decisions, including those that concern investments and disinvestments relating to cash flows (see Appendix 2). Mercer may be proactive in advising the Trustee regarding tactical investment decisions; however, there is no responsibility placed on Mercer to be proactive in all circumstances.

Mercer is remunerated primarily on a time-cost basis. Mercer does not receive commission or any other payments in respect of the Plan that might affect the impartiality of their advice. The Trustee believes that this is the most appropriate adviser remuneration structure for the Plan.

Mercer is authorised and regulated by the Financial Conduct Authority ("FCA").

3.3 Arrangement with Investment Managers

Investment managers are appointed by the Trustee after taking appropriate investment advice from its investment adviser, Mercer. Investment managers are appointed based on their capabilities and therefore, their perceived likelihood of achieving the expected return and risk characteristics required for the asset class being selected.

The Trustee will only invest in pooled investment vehicles. The Trustee therefore accepts that they cannot specify the risk profile and return targets of the managers, but the pooled funds are chosen with appropriate characteristics to align with the overall investment strategy.

The Trustee is a long term investor and does not look to change the investment arrangements on a frequent basis. If a manager is significantly downgraded by Mercer's Manager Research Team, the investment adviser will advise the Trustee and they may replace that manager with a suitable alternative.

The details of the managers' mandates and the basis of the contract between the Trustee and their investment managers are set out in Appendix 3.

In particular, the investment managers are responsible for all decisions concerning the selection and de-selection of the individual securities within the portfolios they manage.

In the case of multi-asset mandates, the investment manager is responsible for all decisions concerning the allocation to individual asset classes and changes in the allocations to individual asset classes.

All of the investment managers engaged by the Trustee are authorised and regulated by the Prudential Regulation Authority ("PRA"), the FCA or both.

For the non-buy-in assets, the investment managers are remunerated by ad valorem charges based on the value of the assets that they manage on behalf of the Plan.

None of the underlying managers in which the Plan's assets are invested have performance based fees which could encourage the manager to make short term investment decisions to hit their profit targets.

Based on the mandates currently held, the Trustee considers that the method of remunerating fund managers is consistent with incentivising them to make decisions based on assessments of medium to long-term financial and non-financial performance of an issuer of debt or equity. By encouraging a medium to long-term view, it will in turn encourage the investment managers to engage with issuers of debt or equity in order to improve their performance in the medium to long-term.

The Trustee accepts that has limited influence over the charging structure of the pooled funds in which the Plan is invested, but is satisfied that the ad-valorem charges for the different underlying funds are clear and are consistent with each fund's stated characteristics. The Trustee is therefore satisfied that this the most appropriate basis for remunerating the managers and is consistent with the Trustee's policies as set out in this SIP

3.4 Summary of Responsibilities

A summary of the responsibilities of all relevant parties, including the Scheme Actuary and the Plan's administrators, in so far as they relate to the Plan's investments, is set out in Appendix 4.

4 Investment Strategy

4.1 Setting Investment Strategy

The Trustee has determined their investment strategy after considering the Plan's liability profile and their own appetite for risk, the Sponsoring Employer's appetite for risk, and the strength of the Sponsoring Employer's covenant.

The basis of the Trustee's strategy is to hold "growth" assets, comprising assets such as equities and diversified growth funds, in respect of the liabilities pertaining to active and deferred members and "matching" assets, such as bonds and liability driven investments ("LDI"), in respect of pensioner liabilities. Following a buy-in of pensioner liabilities in 2012, the Plan's non buy-in assets currently consist of growth and stabilising assets in a portfolio deemed to meet the requirements of the scheme at a suitable level of risk. The Trustee regards the basic distribution of the assets to be appropriate for the Plan's objectives and liability profile.

A Scottish limited partnership, Scotmid Pension Limited Partnership, was established in 2012, into which the Trustee invested the Employer's recovery contribution. This is an asset-backed arrangement to generate a target income of £969,000 p.a. for the 20 year term of the Partnership.

The Trustee has established a benchmark allocation, which is set out in Appendix 1.

The Trustee recognises the benefits of diversification across growth asset classes, as well as within them, in reducing the risk that results from investing in any one particular market. Where they consider it advisable to do so, the Trustee has appointed their investment manager to select and manage the allocations across growth asset classes, in particular where it would not be practical (or appropriate) for the Trustee to commit the resources necessary to make these decisions themselves.

The Trustee's approach to the investment of contributions and any disinvestments to meet member benefit payments is set out in Appendix 2. The Trustee has decided on a structured approach to rebalance the assets in accordance with their overall strategy. This approach is also set out in Appendix 2.

4.2 Investment Decisions

The Trustee distinguishes between three types of investment decision: strategic, tactical and security-level.

Strategic Investment Decisions

These decisions are long-term in nature and are driven by an understanding of the objectives, needs and liabilities of the Plan.

The Trustee takes all such decisions themselves. They do so after receiving written advice from their investment adviser and consulting with the Sponsoring Employer. Examples of such decisions and of tasks relating to the implementation of these decisions include the following:

- Setting investment objectives.
- Determining the split between the growth and the matching portfolios.
- Determining the allocation to asset classes within the growth and matching portfolios.
- Determining any Plan benchmark.
- Reviewing the investment objectives and strategic asset allocation.

Tactical Investment Decisions

These decisions are short-term and based on expectations of near-term market movements. Such decisions may involve deviating temporarily from the strategic asset allocation and may require the timing of entry into, or exit from, an investment market or asset class.

These decisions are the responsibility of the Trustee. However, where such decisions are made within a pooled fund, they are the responsibility of the investment manager of the fund.

Security Selection Decisions

All such decisions are the responsibility of the investment managers of the pooled funds in which the Plan is invested.

4.3 Types of Investments to be Held

The Plan's assets are invested wholly via pooled vehicles.

The Trustee is permitted to invest across a wide range of asset classes, which currently include the following:

- UK and overseas equities
- Diversified growth
- Annuities
- Cash

The use of derivatives is as permitted by the guidelines that apply to the pooled funds.

The Plan has previously invested in liability driven investment products and the Trustee will ensure that any new investment type is permitted within the Plan rules.

4.4 Financial Considerations

The Trustee understands that they must consider all factors that have the ability to impact the financial performance of the Plan's investments over an appropriate time horizon. This includes, but is not limited to, environmental, social and governance (ESG) factors.

The Trustee recognises that ESG factors, such as climate change, can influence the investment performance of the Plan's portfolio and it is therefore in members' and the Plan's best interests that these factors are taken into account within the investment process.

The Trustee further recognises that investing with a manager who approaches investments in a responsible way and takes account of ESG (Environmental, Social & Governance)-related risks will lead to better risk adjusted performance results as omitting these risks in investment analysis could skew the results and underestimate the level of overall risk being taken.

Therefore, the Trustee will work with their Investment Consultant to help select the investment managers that have an appropriate rating for ESG factors.

The Trustee will review the available products and approaches in this space and strive for the Plan to continue to deliver strong risk-adjusted returns, incorporating responsible investments principles into the process, where possible.

4.5 Non-Financial Considerations

The Trustee only considers factors that are expected to have a financial impact on the Plan's investments. Non-financial considerations, such as ethical views, are not implemented in the current investment strategy.

4.5 Stewardship

The Trustee has concluded that the decision on how to exercise voting rights should be left with their investment managers, who will exercise these rights in accordance with their respective published corporate governance policies. These policies, which are provided to the Trustee from time to time, take into account the financial interests of shareholders and should be for the Plan's benefit.

Where the Trustee is specifically invited to vote on a matter relating to corporate policy, the Trustee will exercise their right in accordance with what they believe to be the best interests of the majority of the Plan's membership.

5 Risk

The Trustee is aware, and seeks to take account, of a number of risks in relation to the Plan's investments, including the following.

Under the Pensions Act 2004, the Trustee is required to state their policy regarding the ways in which risks are to be measured and managed. These are set out below.

Solvency Risk and Mismatching Risk

- These are measured through a qualitative and quantitative assessment of the expected development of the assets relative to the liabilities.
- They are managed by setting a Plan-specific strategic asset allocation with an appropriate level of risk.

Manager Risk

- This is assessed as the expected deviation of the prospective risk and return, as set out in the managers' objectives, relative to the investment policy.
- It is measured by monitoring the actual deviation of returns relative to the objective and factors supporting the managers' investment process.

Liquidity Risk

- This is monitored according to the level of cash flows required by the Plan over a specified period.
- It is managed by holding an appropriate amount of readily realisable investments. The Plan's assets are invested in pooled funds which are readily realisable.

Political Risk

- This is measured by the level of concentration in any one market leading to the risk of adverse influence on investment values arising from political intervention.
- It is managed by regular reviews of the investments and through regular assessment of the levels of diversification within the investment policy.

Corporate Governance Risk

- This is assessed by reviewing the Plan's investment managers' policies regarding corporate governance.
- It is managed by delegating the exercise of voting rights to their managers, who exercise this right in accordance with their published corporate governance policies. Summaries of these policies are provided to the Trustee from time to time and take into account the financial interests of the shareholders, which should ultimately be to the Plan's advantage.

Sponsor Risk

- This is assessed as the level of ability and degree of willingness of the sponsor to support the continuation of the Plan and to make good any current or future deficit.

- It is managed by assessing the interaction between the Plan and the sponsor's business, as measured by a number of factors, including the creditworthiness of the sponsor and the size of the pension liability relative to the sponsor.

Legislative Risk

- This is the risk that legislative changes will require action from the Trustee so as to comply with any such changes in legislation.
- The Trustee acknowledges that this risk is unavoidable but will seek to address any required changes so as to comply with changes in legislation.

Credit Risk

- This is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation is associated with the inability of a borrower to repay, in full or in part the monies which it owes to a creditor..
- The Trustee acknowledges that the assessment of credit risk on individual debt instruments is delegated to the investment manager. The Trustee will however ensure that they are comfortable with the amount of risk that the Plan's investment manager takes.

Market Risk

- This is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises of the following three types of risk:

Currency Risk

- This is the risk that occurs when the price of one currency moves relative to another (reference) currency. In the context of a UK pension scheme, the Plan may be invested in overseas stocks or assets, which are either directly or indirectly linked to a currency other than Sterling. There is a risk that the price of that overseas currency will move in such a way that devalues that currency relative to Sterling, thus negatively impacting the overall investment return.
- The Trustee accepts the currency risk related to its overseas vehicles, and acknowledges that a currency hedge can be implemented.

Interest rate risk

- This is the risk that an investment's value will change due to a change in the level of interest rates. This affects debt instruments more directly than growth instruments.
- The Trustee acknowledges that the interest rate risk related to individual debt instruments, and particularly liability driven instruments (LDI), is managed by the underlying investment managers through a combination of strategies, such as diversification, duration and yield curve management, and hedging via swaps, particularly where LDI is involved.

Other Price risk

- This is the risk that principally arises in relation to the return seeking portfolio, which invests in equities, equities in pooled funds, equity futures, hedge funds, private equity and property.
- The Trustee acknowledges that a plan can manage its exposure to price risk by investing in a diverse portfolio across various markets.

6 Monitoring of Investment Adviser and Managers

6.1 Investment Adviser

The Trustee assesses and reviews the performance of their adviser in a qualitative way.

6.2 Investment Managers

The Trustee receives regular reports on the performance of the Plan's non buy-in assets, from each investment manager. These present performance information over both short and long time horizons. The reports show the absolute performance and performance against the manager's stated target performance (over the relevant time period).

The Trustee in conjunction with advice from their investment adviser, has the role of replacing the underlying investment managers where appropriate. They take a long-term view when assessing whether to replace the underlying investment managers, and such decisions would not be made based solely on short-term performance concerns. Instead, changes would be driven by a significant downgrade of the investment manager by Mercer's Manager Research Team. This in turn would be due to a significant reduction in Mercer's confidence that the investment manager will be able to perform in line with their fund's mandate over the long term.

Changes will also be made to the underlying managers if there is a strategic change to the overall strategy that no longer requires exposure to that asset class or manager.

6.3 PORTFOLIO TURNOVER COSTS

The Trustee does not currently monitor portfolio turnover costs for the funds in which the Plan is invested, although note that the performance monitoring reports which they receive are net of all charges, including such costs. Portfolio turnover costs means the costs incurred as a result of the buying, selling, lending or borrowing of investments.

The Trustee is also aware of the requirement to define and monitor targeted portfolio turnover and turnover range.

Given that the Plan invests in a range of pooled funds, many of which invest across a wide range of asset classes, the Trustee does not have an overall portfolio turnover target for the Plan.

The Trustee is working with Mercer to determine the most appropriate way to obtain and monitor the information required in relation to the pooled funds in which the Plan is invested and will include further information about this in a future version of the SIP.

7 Additional Voluntary Contributions ("AVC's")

In the past, the Plan has made available with-profits policies with both Royal London & Zurich for members who wish to enhance their retirement benefits. This is no longer available to new contributors. This provides an asset mix which allows members to obtain access to smoothed returns which are expected to offset the adverse effects of inflation. The Trustee believes this to be an appropriate vehicle for this purpose, and the arrangement is monitored on a regular basis.

8 Code of Best Practice

The Trustee is aware the Pensions Regulator guidance ‘Investment Guidance for Defined Benefit Pension Scheme’, released in March 2017.

9 Compliance

The Plan’s Statement of Investment Principles and annual report and accounts are available to members on request.

A copy of the Plan’s current Statement is also supplied to the Sponsoring Employer, the Plan’s auditors and the Scheme Actuary.

This Statement of Investment Principles, taken as a whole with the Appendices, supersedes all others and was approved by the Trustee on 24 September 2020.

This Statement was approved by the Trustee on 24 September 2020.

Appendix 1: Plan Asset Allocation Benchmark

Excluding the buy-in assets and investment in the Scottish limited partnership, the Plan's central asset allocation benchmark is as set out below:

	Allocation	Guideline Range
Diversified Growth	**35.7%**	**25% to 45%**
Baillie Gifford Multi Asset Fund	24.5%	
Columbia Threadneedle Multi Asset Fund	11.2%	
Equity	**26.2%**	**15% to 35%**
Vanguard Developed Europe ex UK	6.7%	
Vanguard FTSE UK All Share Index	6.6%	
Vanguard Japan Stock index	3.9%	
Vanguard Pacific ex Japan Stock Index	2.3%	
Vanguard US Equity	6.7%	
Liability Driven Investments (LDI)	**38.0%**	**23% to 53%**
BMO Real Dynamic LDI Fund	14.5%	
BMO Nominal Dynamic LDI Fund	10.5%	
BMO Equity-Linked Real Dynamic LDI Fund	11.0%	
BMO Equity-Linked Nominal Dynamic LDI Fund	2.0%	

Note totals may not sum due to rounding.

The split between Diversified Growth, Equity and LDI assets was set when the Plan first invested in Baillie Gifford and Columbia Threadneedle in April 2019. Since this date, there has been no formal rebalancing in place in respect of this high-level allocation and the Trustee accepts that it will drift over time. Guideline ranges are set out above. The Trustee will review the asset allocation at each Trustee meeting and if the allocation falls outside the guideline range the Trustee will decide whether to take action.

Appendix 2: Cashflow and Rebalancing Policy

The asset allocation and manager allocation will be subject to consideration and review against the initial strategic allocation and rebalancing ranges set out in Appendix 1 at each Trustee meeting.

Any cashflow requirements (including rebalancing events on the LDI holdings) will be taken so as to bring the asset allocation closer to the central allocation (as set out in Appendix 1).

LDI holdings will not be used for cashflow purposes.

Appendix 3: Investment Manager Information

The Plan invests with both Bank of Montreal ("BMO"), Baillie Gifford, Columbia Threadneedle and Aberdeen Standard Life Investments("Standard Life"). Standard Life delegate their management of the equity tracker funds to Vanguard Asset Management Limited ("SL Vanguard"), however the Trustee's contract remains with Standard Life.

In 2012, the Plan undertook a buy-in of pensioner liabilities valued at £25m with Legal & General Assurance Society.

The tables below show the details of the mandate of each fund held:

Investment Manager / Fund	Fund Benchmark	Objective	Dealing Frequency
SL Vanguard FTSE UK All Share Index	FTSE All-Share Index	Track the total return of the benchmark, gross of fees	Daily
SL Vanguard FTSE Developed Europe ex UK Equity Index	FTSE All-World Developed Europe ex UK Index	Track the total return of the benchmark, gross of fees	Daily
SL Vanguard US Equity	S&P 500 Index	Track the total return of the benchmark, gross of fees	Daily
SL Vanguard Japan Stock Index	MSCI Japan Index	Track the total return of the benchmark, gross of fees	Daily
SL Vanguard Pacific ex Japan Stock Index	MSCI Pacific ex Japan Index	Track the total return of the benchmark, gross of fees	Daily
Baillie Gifford Multi Asset Growth Fund	UK Base Rate + 3.5%	At least 3.5% p.a. over UK Base Rate, net of fees, over 5-year rolling periods	Daily
Columbia Threadneedle Multi Asset Growth Fund	UK Base Rate + 4%	To outperform UK Base Rate by 4% p.a. over a 5 to 7 year cycle	Daily
Liability Driven Investments			
BMO LDI Funds	Cashflows for a typical UK DB pension scheme	To track a set of cashflows resembling a typical scheme, which will mature through time	Daily
BMO Equity-Linked LDI Funds	A combination of cashflows for a	To track a set of cashflows resembling a	Daily

	typical UK DB pension scheme and the returns on a combination of global equity indices	typical scheme, which will mature through time and provide returns on a combination of global equity indices through the use of equity futures.	

Appendix 4: Responsibilities of Parties

Trustee

The Trustee's responsibilities include the following:-

- Reviewing at least triennially and more frequently if necessary, the content of this Statement in consultation with the Investment Adviser and modifying it if deemed appropriate.
- Reviewing the investment strategy following the results of each actuarial review, in consultation with the Investment Adviser and Scheme Actuary.
- Appointing the investment managers and custodian (if required).
- Assessing the quality of the performance and processes of the Investment Managers by means of regular reviews of investment returns and other relevant information, in consultation with the Investment Adviser.
- Consulting with the Sponsoring Employer regarding any proposed amendments to this Statement.
- Monitoring compliance of the investment arrangements with this Statement on a continuing basis.

Investment Adviser

The Investment Adviser's responsibilities include the following:-

- Participating with the Trustee in reviews of this Statement of Investment Principles.
- Advising the Trustee, at their request, on the following matters:
  - Through consultation with the Scheme Actuary, how any changes within the Plan's benefits, membership, and funding position may affect the manner in which the assets should be invested.
  - How any changes in their Investment Managers' organisations could affect the interests of the Plan.
  - How any changes in the investment environment could present either opportunities or problems for the Plan.
- Undertaking project work, as requested, including:
  - Reviews of asset allocation policy.
  - Research into and reviews of Investment Managers.
- Advising on the selection of new managers and/or custodians.

Investment Managers

The Investment managers' responsibilities include the following:

- Providing the Trustee on a quarterly basis (or as frequently as required) with a statement and valuation of the assets and a report on their actions and future intentions, and any changes to the processes applied to their portfolios.

- Informing the Trustee of any changes in the internal performance objectives and guidelines of any pooled fund used by the Plan as and when they occur.
- Having regard to the need for diversification of investments, so far as appropriate for the particular mandate, and to the suitability of investments.

Scheme Actuary

The Scheme Actuary's responsibilities include the following:

- Liaising with the Investment Adviser regarding the suitability of the Plan's investment strategy given the financial characteristics of the Plan.
- Assessing the funding position of the Plan and advising on the appropriate response to any shortfall.
- Performing the triennial (or more frequent, as required) valuations and advising on the appropriate contribution levels.

Administrator

The Administrator's responsibilities include the following:

- Ensuring there is sufficient cash available to meet benefit payments as and when they fall due.
- Paying benefits and making transfer payments.
- Investing contributions not required to meet benefit payments with the Investment Managers according to the Trustee's instructions.