Duchy of Lancaster Staff Pension Scheme

Statement of Investment Principles

September 2020

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01 **Introduction**

This document constitutes the Statement of Investment Principles ('the SIP') required under Section 35 of the Pensions Act 1995 for the Duchy of Lancaster Staff Pension Scheme ('the Scheme'). It describes the investment policy being pursued by the Trustees of the Scheme and is in accordance with the Government's voluntary code of conduct for Institutional Investment in the UK ("the Myners Principles"). This SIP also reflects the requirements of the Occupational Pension Schemes (Investment) Regulations 2005.

The Scheme Actuary is Matthew Plail of XPS Pensions and the Investment Adviser is XPS Investment (collectively termed 'the Advisers').

The Trustees confirm that, before preparing this SIP, they have consulted with the Council of the Duchy of Lancaster ("the Duchy") and the Scheme Actuary and have obtained and considered written advice from the Investment Adviser. The Trustees believe the Advisers to be qualified by their ability and practical experience of financial matters and to have appropriate knowledge of the investment arrangements that the Scheme requires.

The Trustees are responsible for the investment of the Scheme's assets and arrange administration of the Scheme. Where they are required to make an investment decision, the Trustees always receive advice from the relevant Advisers first and they believe that this ensures that they are appropriately familiar with the issues concerned.

Given the size of the Scheme, the Trustees have decided that the most cost effective way of investing the Scheme assets is to invest in pooled funds managed by an organisation, rather than directly appointing an individual investment manager. Decisions about which pooled funds to invest in are made after receiving investment advice from an FCA regulated firm.

Declaration

The Trustees confirm that this Statement of Investment Principles reflects the Investment Strategy they have implemented. The Trustees acknowledge that it is their responsibility, with guidance from the relevant Advisers, to ensure the assets of the Scheme are invested in accordance with these Principles.

02 **Scheme governance**

The Trustees are responsible for the governance and investment of the Scheme's assets. The Trustees consider that the governance structure set out in this SIP is appropriate for the Scheme as it allows the Trustees to make the important decisions on investment policy, while day-to-day aspects are left to the managers of the pooled funds and significant decisions are made after consulting the relevant Advisers as appropriate. The responsibilities of each of the parties involved in the Scheme's governance are detailed in Appendix A.

The Trustees have decided not to appoint an Investment Sub-Committee to deal with investment matters.

03 Investment Objectives

The primary objective of the Trustees is to ensure that the accumulated fund, together with contributions payable by the Duchy and by the members in the future, are invested in such a manner that the benefits for each member can reasonably be expected to be paid from the Scheme as they arise.

The Scheme provides a pension which is based on final salary at the time of retirement. The rules of the Scheme further guarantee that pensions in payment will increase in line with price inflation. Thus the liabilities are linked to:

a. Wages and salary inflation prior to retirement for members in service;
b. Price inflation prior to retirement for deferred pensioners;
c. Price inflation once pensions come into payment.

The Scheme is a mature scheme and is closed to new members. The investment of the assets will have regard to the above liability characteristics and maturity profile of the Scheme.

A further objective ("the Performance Objective") of the Trustees is for the investment manager, or managers, to achieve over rolling 3-year periods a total return on investments which is at or above the performance targets set out in Appendix C where applicable, taking account of the cash flow requirements of the Scheme, as provided by the Scheme Administrator. This is a measurable objective that the Trustees can use to monitor the ongoing performance of the Scheme's investments to ensure the overall objective is met.

This objective is not framed relative to the performance of other pension funds or market indices.

04 **Asset Allocation Strategy**

Having considered advice from the Investment Adviser, and also having due regard for the objectives, the liabilities of the Scheme, the risks of and to the Scheme and the covenant of the Duchy, the Trustees have decided upon the target asset allocation between liability matching assets and growth assets shown in Table 1.

Table 1: Strategic asset allocation

Asset Class	% of total assets
Matching Assets	60
Growth Assets	40

The current funds chosen by the Trustees to implement the strategy are set out in Appendix C. Those funds have been chosen after seeking advice from the Investment Adviser as to their suitability in meeting the investment objectives. The Trustees, in conjunction with the Investment Adviser, will monitor the actual asset allocation of the Scheme.

Alignment of incentives

Based on the structure set out in the Appendix, the Trustees consider the arrangements with the Investment Managers to be aligned with the Scheme's overall strategic objectives. Details of each specific mandate are set out in pooled fund documentation with the Investment Manager.

The amounts allocated to any individual category or security will be influenced by the overall benchmark and objectives, varied through the Investment Manager's tactical asset allocation preferences at any time, within any scope given to them through any asset allocation parameters or guidelines set by the Trustees or governing the pooled funds in which the Scheme is invested.

The Trustees will ensure that the Scheme's assets are predominately invested in regulated markets to maximise their security.

The Investment Manager is incentivised to perform in line with expectations for their specific mandate because their continued involvement as part of the Scheme's investment strategy – and hence the fees they receive – is dependent upon them doing so. They are therefore subject to performance monitoring and reviews based on a number of factors linked to the Trustees' expectations.

The Trustees encourage the Investment Manager to make decisions in the long term interests of the Scheme. The Trustees expect engagement with management of the underlying issuers of debt or equity and the exercise of voting rights in line with the investment mandate guidelines provided.

This expectation is based on the belief that such engagement can be expected to help Investment Managers to mitigate risk and improve long term returns.

As covered in more detail in this document, as far as possible within the constraints of passive investment, the Trustees also require the Investment Manager to take ESG factors and climate change risks into consideration within their decision-making as the Trustees believe these factors could have a material financial impact in the long term. The Trustees therefore make decisions about the retention of the Investment Manager, accordingly.

Rebalancing policy

The Trustees, in conjunction with the Advisers, will monitor the actual asset allocation of the Scheme on a quarterly basis via the reporting provided by the Investment Managers. The Investment Managers have also been instructed to notify the Scheme Administrator (on behalf of the Trustees) if the actual allocation moves further than -/+ 3% from the strategic allocation, as a proportion of total assets. The Trustees will then delegate to the Scheme Administrator to make a decision as to whether to switch assets back to the strategy, or use this as an opportunity to realise assets in beneficial conditions, following consideration of advice.

The Trustees may, subject to market conditions, deliberately move away from their strategic asset allocation for short periods. However, the Trustees would intend to move back to the strategic asset allocation as market conditions change.

Rates of return

The rates of return expected over the very long term are detailed in Appendix B for each asset class.

Diversification

The Trustees have sought to achieve diversification by investing in multiple asset classes and by investing in pooled funds that track indices which, at the date of signing, the Trustees believe to provide sufficient diversification for the Scheme. The Trustees will monitor the strategy regularly to ensure that they remain comfortable with the level of diversification.

Suitability

The Trustees have taken advice from the relevant Advisers to ensure that the asset allocation strategy is suitable for the Scheme, given its liability profile, any legal requirements, regulatory guidance and specifications in the Trust Deed.

Liquidity

All of the assets are held in asset classes that are sufficiently liquid to be realised easily if the Trustees require (i.e. invested via units in a pooled fund with frequent dealing dates).

05 **Strategy Implementation**

The Trustees have decided to invest in funds managed by one Investment Manager; Legal and General Assurance (Pension Management) Limited ("LGIM"). Each of the pooled funds is passively managed against a specific mandate.

Mandate and performance objectives

The Trustees have received advice on the appropriateness of the Investment Manager's target, benchmark and risk tolerance from the Investment Adviser and believes them to be suitable to meet the Scheme's investment objectives. Each of the pooled funds has a specific investment mandate to match the benchmark detailed in Appendix C.

Manager Agreement

The Trustees have invested in pooled funds and as such there is no formal Manager Agreement setting out the scope of the Investment Manager's activities, its charging basis and other relevant matters.

Custody

The custodian of the pooled funds is appointed by those funds whilst the Scheme's holdings in pooled funds are held in dematerialised form.

06 **Monitoring**

Pooled Funds

The Trustees, with the assistance of the Advisers, will monitor the performance of the pooled funds against the agreed performance objectives.

The Trustees, or the Advisers on behalf of the Trustees, will receive regular reports from the providers of the pooled funds, which consider performance over the quarter, one and three year periods, and will consider these reports to ensure the funds continue to meet the investment objectives.

As part of this review, the Trustees will consider whether or not each investment fund:

- is being managed competently.
- has regard to the need for diversification of investments.
- has regard to the suitability of each investment and each category of investment.
- has been managed in accordance with the principles contained in this SIP, so far as is reasonably practicable.

If the Trustees are not satisfied with the performance of the funds they will ask the Investment Manager to take steps to rectify the situation. If the funds still do not meet the Trustees' requirements, they will look to use alternative funds after consultation with the Investment Adviser. The Investment Manager will also attend Trustees' meetings as requested.

Advisers

The Trustees will monitor the advice given by the Advisers on a regular basis.

Portfolio turnover costs

The Trustees have decided not to actively monitor the portfolio turnover costs of the funds in which they invest, as they do not believe this would be proportionate given their passively managed nature.

Investment manager duration

Appointments of Investment Managers are expected to be long term, but the Trustees will review the appointment of the Investment Manager in accordance with their responsibilities.

Other

The Trustees are required to review this SIP on a triennial basis, or, without undue delay, following any changes to the investment strategy.

07 Fees

Pooled Funds

Fund manager remuneration is considered as part of the manager selection process. It is also monitored regularly with the help of the Investment Adviser to ensure it is line with the Trustees' policies and with fee levels deemed by the Investment Adviser to be appropriate for the particular asset class and fund type.

The Trustees will ensure that the fees charged for the funds they use are consistent with levels typically available in the industry and the nature of services provided. The current fee basis for each of the Investment Manager's funds is set out in Appendix C.

The Trustees are aware of the Investment Manager's policy regarding soft commission arrangements. The Investment Manager discloses their fees, commissions and other transaction costs in accordance with the Financial Conduct Authority ('FCA') Disclosure Code.

Advisers

Fees paid to the Advisers are based either on actual time spent and hourly rates for relevant individuals, or on fixed fees agreed in advance for specifically defined projects.

Custodian

There is no custodian appointed directly by the Trustees.

Trustees

None of the Trustees, other than professional Trustees, are paid for their duties. Their expenses are met and they are given time off from their other employment duties to attend appropriate training, meetings with their advisers and the periodic Trustees' meetings.

08 **Risks**

The Trustees recognise a number of risks involved in the investment of assets of the Scheme:

i. The risk of failing to meet the objectives as set out in Section 3 – the Trustees will regularly monitor the investments to mitigate this risk.
ii. The risk of adverse consequences arising through a mismatch between the Scheme's assets and its liabilities. This is addressed through the asset allocation strategy and through regular actuarial and investment reviews and the funding target.
iii. Risk of lack of diversification of investments – addressed through investing in pooled funds with diversification requirements and through the asset allocation policy.
iv. Underperformance risk – managed by investing in passive funds and monitoring closely the performance of the pooled funds and taking necessary action when this is not satisfactory.
v. Country/political risk – addressed through regular monitoring of the investment environment, with the help of their Investment Adviser.
vi. Organisational risk – addressed through regular monitoring of the Investment Manager and the Advisers.
vii. Sponsor risk – the risk of the Duchy ceasing to exist, which for reasons of prudence, the Trustees have taken into account when setting the asset allocation strategy.
viii. Liquidity risk – investing in assets that are generally realisable at short notice, addressed through the use of pooled funds.
ix. Inflation risk – the risk of the Scheme's liabilities increasing due to inflation is managed by holding pooled funds whose returns are expected to be linked to inflation;
x. Interest rate risk – the risk of the Scheme's liabilities increasing due to falls in interest rates is managed by holding the majority of the assets in pooled funds whose return is linked to interest rates.

The Trustees will keep these risks under regular review.

09 Other Issues

Statutory Funding Requirement

The Trustees will obtain and consider proper advice on the question of whether the investments are satisfactory having regard to both the investment objectives and the requirement to meet statutory funding requirements. The funding position is reviewed periodically by the Scheme Actuary, with a full actuarial valuation every three years.

The Trustees will consider with the Advisers whether the results of these actuarial valuations suggest that any change to investment strategy is necessary to ensure continued compliance with the statutory funding requirement.

Corporate governance

The Trustees have considered corporate governance issues and agreed that they will have no specific policy in place. The Trustees have reviewed the Investment Manager's policy on corporate governance issues and have agreed that all corporate governance decisions are delegated to the Investment Manager, subject to the restrictions detailed earlier.

Social, environmental and ethical issues

The Trustees have considered their approach to environmental, social and corporate governance ("ESG") factors for the long term time horizon of the Scheme and believe there can be financially material risks relating to them. The Trustees have delegated the ongoing monitoring and management of ESG risks and those related to climate change to the Scheme's investment managers. As far as is possible within the restraints of passive investment, the Trustees require the Scheme's investment managers to take ESG and climate change risks into consideration within their decision-making and interactions with all the companies with which they invest.

The Trustees will seek advice from the Investment Adviser on the extent to which its views on ESG and climate change risks may be taken into account in any future investment manager selection exercises. Furthermore, the Trustees will monitor the processes and operational behaviour of the investment managers from time to time, to ensure they remain appropriate and in line with the Trustees' requirements as set out in this Statement.

Voting rights

As the Scheme invests in pooled funds, the Trustees acknowledge that they cannot directly influence the policies and practices of the companies in which the pooled funds invest. They have therefore delegated responsibility for the exercise of rights (including voting rights) attached to the Scheme's investments to the Investment Manager.

The Trustees encourage the Investment Manager to engage with investee companies and vote whenever it is practical to do so on financially material matters such as strategy, capital structure, conflicts of interest policies, executive pay, risks, social and environmental impact and corporate governance as part of their decision-making processes. The Trustees require the Investment Manager to report on significant votes made on behalf of the Trustees.

If the Trustees become aware of the Investment Manager engaging with the underlying issuers of debt or equity in ways that they deem inadequate or that the results of such engagement are mis-aligned with the Trustees' expectation, then the Trustees may consider terminating the relationship with that Investment Manager.

When considering the selection, retention or realisation of investments, the Trustees have a fiduciary responsibility to act in the best interests of the beneficiaries of the Scheme, although they have neither sought nor taken into account the beneficiaries' views on risks including (but not limited to) ethical, social and environmental issues. The Trustees will review this policy if any beneficiary views are raised in future.

Appendix A Responsibilities

Trustees

The Trustees of the Scheme are responsible for, amongst other things:

i. Determining the investment objectives of the Scheme and reviewing these from time to time.
ii. Agreeing an investment strategy designed to meet the investment objectives of the Scheme.
iii. Reviewing triennially the content of this SIP and modifying it if deemed appropriate, in consultation with the Advisers.
iv. Reviewing the suitability of the investment policy following the results of each actuarial or investment review, in consultation with the Advisers.
v. Assessing the quality of the performance and process of the Investment Manager by means of regular reviews of the investment results and other information, by way of written reports, in consultation with the Advisers.
vi. Appointing and dismissing investment manager(s), the performance measurer, custodian(s) and transition manager(s) in consultation with the Advisers.
vii. Assessing the ongoing effectiveness of the Advisers.
viii. Consulting with the Duchy when reviewing investment policy issues.
ix. Monitoring compliance of the investment arrangements with this SIP on an ongoing basis.
x. Advising the Advisers of any changes to Scheme benefits, significant changes in membership.

Investment Managers

The Investment Manager will be responsible for, amongst other things:

i. Managing the pooled funds passively so as to match the benchmark.
ii. Providing the Trustees with sufficient information each quarter to facilitate the review of its activities, including:
    - A full valuation of the assets and a performance summary.
    - A transaction report and a cash reconciliation.
    - Corporate actions taken by the Investment Manager.
    - Any changes to the process applied to the portfolio.
    - Future intentions in the investment management of the Scheme’s assets.
    - Any deviation of more than 3% from the agreed asset allocation
iii. Informing the Trustees immediately of:
    - Any serious breach of internal operating procedures.
    - Any material change in the knowledge and experience of those involved in managing the Scheme’s investments.

Investment Adviser

The Investment Adviser will be responsible for, amongst other things:

i. Participating with the Trustees in reviews of this SIP.

ii. Advising the Trustees how any changes within the Scheme's benefits, membership and funding position may affect the manner in which the assets should be invested.

iii. Advising the Trustees of any changes in the Scheme's Investment Manager that could affect the interests of the Scheme.

iv. Undertaking reviews of the Scheme's investment arrangements including reviews of the asset allocation policy and current Investment Manager, and selection of new managers/custodians/performance measurers, as appropriate.

v. Advising the Trustees as to which fund (s) to invest surplus funds into or to redeem from to meet payments and whether or not to rebalance if the asset allocation diverges from that set out in the SIP.

Scheme Actuary

The Scheme Actuary will be responsible for, amongst other things:

i. Performing the triennial (or more frequently as required) valuations and advising on the appropriate contribution levels.

ii. Commenting on the appropriateness of the investment strategy relative to the liabilities of the Scheme at the triennial valuations.

iii. Advising the Trustees and Investment Adviser of any changes to contribution levels and funding level.

Appendix B
Long Term Expected Rates of Return

Based on the expected long term rates of return before fees shown below for each asset class, the Trustees expect the asset classes to achieve the rates shown in Table 2 over the very long term.

Table 2 – Expected rates of return across different asset classes

Asset class	Expected Long Term Rate of Return above Gilts (% p.a.)
Index-Linked Gilts	-0.10
UK Equities	5.00

These returns are based on the expected return that each asset class might achieve on average over a long time period net of fees, based on expectations as at 30 June 2020. Actual returns on these asset classes may differ.

It is the Trustees' policy to assume that the expected return on index-linked gilts will be the same as that on nominal gilts.

Appendix C
Investment Manager

The Trustees have invested in pooled funds with one Investment Manager: Legal and General Assurance (Pension Management) Limited ("LGIM"). The investment strategy of each pooled fund is shown in Table 3.

Table 3: Investment Mandates

Asset Class	Fund	% of total assets	Investment Style	Benchmark	Performance Target
Index-Linked Gilts	2027 Index-Linked Gilt Fund	30%	Passive	2027 Single Stock Index-Linked	n/a
Index-Linked Gilts	2035 Index-Linked Gilt Fund	30%	Passive	2035 Single Stock Index-Linked	n/a
UK Equity	UK Equity Index Fund	40%	Passive	FTSE All Share	Track the performance of the FTSE All Share Index to within +/- 0.25% pa for two years out of three

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Registration

XPS Pensions Consulting Limited, Registered No. 2459442.

XPS Investment Limited, Registered No. 6242672.

XPS Pensions Limited, Registered No. 3842603.

XPS Administration Limited, Registered No. 9428346.

XPS Pensions (RL) Limited, Registered No. 5817049.

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Authorisation

XPS Investment Limited is authorised and regulated by the Financial Conduct Authority for investment and general insurance business (FCA Register No. 528774).