FINAL

Statement of Investment Principles

British Coal Staff Superannuation Scheme

BCSSS
British Coal
Staff Superannuation Scheme

October 2020

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Statement of Investment Principles

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Contents

1. Introduction

1.1 Under Scheme rules, clause 10A(1), Coal Staff Superannuation Scheme Trustees Limited, as the Trustee of the British Coal Staff Superannuation Scheme (the "Scheme"), is required to prepare a statement of the principles governing investment decisions. This document has been issued by the Trustee of the Scheme.

1.2 This Statement is produced in compliance with the Scheme Rules and not the Pensions Act 1995 (as amended by the Pensions Act 2004) since the Scheme is exempt from this provision of the Pensions Act. In particular, investment managers are not under a statutory duty to comply with this Statement, but their duties and obligations are set out in an Investment Management Agreement between each manager and the Scheme. Before drawing up this Statement and establishing the Scheme's investment arrangements, the Trustee has:

- had regard to the principles underlying the provisions of the Pensions Act and the Occupational Pension Schemes (Investment) Regulations 2005 concerning diversification and suitability of investments;
- considered ongoing advice on the Scheme's investment arrangements and risk from Coal Pension Trustees Investment Limited (CPTI), the Trustee's investment adviser;
- consulted with the Guarantor.

1.3 The Trustee will review this document regularly, at least every three years, and without delay after any significant change in investment policy. The Trustee will consult with the Guarantor whenever it intends to amend this Statement.

1.4 The Trustee will refer to this document where necessary to ensure that it exercises its powers of investment so as to give effect to the principles as set out in it as far as is reasonable.

1.5 Copies of this Statement have been given to the Guarantor, the Trustee's investment adviser and the Scheme Actuary. Copies are available to members of the Scheme on request, and a summary of key investment information is included in the annual report to members.

2. Governance arrangements

2.1 The Trustee has ultimate responsibility for decision-making on investment matters. In order to ensure that investment decisions are taken only by persons or organisations with the skills, information and resources necessary to take them effectively, the Trustee delegates some of these responsibilities.

Committee of Management (COM)

2.2 The COM fulfils the function of the Board of the Trustee. A number of appointments to the Board require the approval of the Guarantor and have to satisfy an objective set of criteria covering skills, knowledge and experience.

2.3 Whilst COM takes ultimate responsibility for all investment decisions, those investment responsibilities which are retained directly by COM include, but are not limited to:

- Establishing a governance structure that ensures sufficient focus is devoted to investment matters and facilitates efficient investment decision making;
- Agreeing, as appropriate, suitable terms of reference for those groups within the governance structure, especially where authority to take and/or implement investment decisions has been delegated;
- Establishing the Trustee's funding objectives;
- Agreeing investment beliefs and key policies;
- Formulating a strategic investment framework which seeks to achieve the funding objectives;
- Establishing key metrics within the strategic investment framework, including return targets, income targets, liquidity constraints and diversification ranges;
- Setting the risk appetite and tolerances within which the Scheme's investment strategy should be managed;
- Monitoring the Investment Sub-Committee to ensure it operates in accordance with the agreed terms of reference;
- Monitoring performance of investments and taking steps to address shortfalls;
- Reviewing, as necessary, the content of this Statement in conjunction with the Scheme's advisors and in consultation with the Guarantor whenever it intends to amend it.

Investment Sub-Committee (ISC)

2.4 The Trustee has appointed an Investment Sub-Committee, to which it has delegated certain investment decision-making and oversight responsibilities.

2.5 The ISC's remit, as set out in separate Terms of Reference, is broadly to:

- Oversee the development of and make recommendations to the investment policies and strategy of the Scheme for approval, where relevant, by the COM; and
- Oversee efficient implementation of the investment strategy, including monitoring of investment performance, costs and investment risk.

Coal Pension Trustees Services Limited (CPT)

2.6 CPT, a company owned jointly by the Scheme and the Mineworkers' Pension Scheme (MPS), acts as the Scheme's Executive and provides investment implementation, operational and risk management services to the Trustee and helps the Trustee deliver its strategic objectives on a day to day basis.

2.7 Coal Pension Trustees Investment Limited (CPTI), authorised by the Financial Conduct Authority (FCA), is responsible for providing investment advice and investment management services to the Trustee. CPTI's responsibilities and authorities are set out in an Investment Management Agreement with the Trustee.

Investment Managers

2.8 The Trustee delegates responsibility for the day to day management of the assets to appointed investment managers. The investment managers are required to act in accordance with the objectives and restrictions set out in their investment management agreements. These objectives and restrictions are designed to ensure that investments are appropriately diversified and suitable for the Scheme, and to ensure that the managers align their decisions with the Trustee's investment policies.

3. Funding objectives, beliefs, framework and strategy

Objectives

3.1 The Trustee's primary funding objective is to pay all future member benefits from the Scheme's assets without requiring new funds from the Guarantor. To meet the objective, the Trustee plans to reduce risk over time, by targeting investing in a portfolio of assets ("de-risked portfolio") that delivers future payments and being fully funded relative to AA corporate bonds.

3.2 In addition, the future payments include payment of the Investment Reserve in full to the Guarantor by 2033 if the assets are sufficient. Therefore, the assessment of investment return required over the period to 2033 needs to be sufficient to cover both the payment of the Investment Reserve and risk reducing requirements.

Investment Beliefs

3.3 The Trustee has agreed core beliefs that set out a clear view on investment philosophy. These beliefs, which are reviewed periodically, are used to inform the investment process and can be summarised as follows:

i. To generate a sufficient long-term real return to permit future de-risking, the focus should be on quality investments, bought (and ultimately sold) at the right price.

ii. To get return you need to take risk; successful investors don't avoid risk, they accept it and manage it.

iii. BCSSS is a unique investor, investing according to its own needs. The Trustee will improve expectations of meeting its Objectives by focusing on the future and leading, not following.

iv. The ability to invest in complex and/or illiquid assets widens the Trustee's opportunity set and must be rewarded with extra net return over simpler/more liquid alternatives.

v. Long-term investment success should come from a focus on sustainability. In particular, environmental, social and governance ("ESG") factors can have a material impact on long-term investment returns. They should be considered before any investment is made.

vi. A strong governance structure with a well-informed governing fiduciary and an expert internal investment team gives BCSSS a competitive advantage over many other schemes.

Strategic Investment Framework

3.4 The Trustee has established a framework that sets out the key principles for achieving the investment objectives and managing risks, as follows:

- **Investment return objective,** which is based on the annual real returns required to achieve a de-risked portfolio in 2033 plus a margin.
- **Liquidity risk tolerance,** which recognises the need to sell assets to pay benefits and sets out minimum levels of liquidity required to mitigate the risk of permanent capital impairment and path of returns risk.
- **Headline diversification controls** for assets, recognising the requirement to generate returns but the need to avoid over-concentration of exposures.
- **Annual Investment Plans,** which set out the expected changes to asset allocations over the short term, recognising the market environment, emerging opportunities, changing risks and relative valuations.

Investment Strategy

3.5 Within the framework, the Trustee sets specific parameters from time to time, including:

- The minimum and target levels of annual income;
- The period over which the liquidity risk tolerance should cover all benefits;
- The triggers for using the liquidity portfolio to meet cash flow obligations;
- The strategy on borrowing to meet short term cash flow needs;
- Limits around the level of illiquid assets; and
- Specific asset class ranges.

4. Risk Management

4.1 The Trustee has an integrated approach to risk management, considering the assets, liabilities and the Guarantor.

4.2 The Scheme has a UK Government guarantee covering the members' benefits. The Trustee considers the security afforded by the guarantee and the views of the Guarantor, when formulating its investment strategy.

4.3 The primary liabilities of the Scheme are payments to members over many years into the future. The maturity of the Scheme means that the Scheme is significantly cash flow negative (the payments to members significantly exceeds the income from assets and any new contributions), which affects the Trustee's investment objectives and risks. Mortality and inflation are important risks to the liabilities. However, given the Scheme structure, the key liability risk is the returns on the Scheme's assets.

4.4 The Trustee recognises a number of risks involved in the investment of the assets of the Scheme and will continue to monitor these risks, making investment adjustments as appropriate. The high return target means that the Trustee invests in asset classes and markets with significant levels of risk. The nature of these can differ: market volatility, credit risk, currency and other risks. The key risks are described below.

Cash Flow and Liquidity

4.5 An important characteristic of the Scheme is the high level of regular payments out (as a proportion of the assets), management of cash flows and the availability of liquidity is therefore an important risk.

4.6 The Trustee monitors the income received from different assets, the level and liquidity of its bond portfolios, and the actual and predicted cash flows to and from its private assets.

4.7 The Trustee manages this risk by targeting income-producing assets, collecting all income, by holding sufficient liquid low risk assets to cover expected cash flows for a significant future period, by having temporary liquidity facilities available, and by establishing a clear plan for managing cash flows during a market event.

Private Assets and Illiquidity

4.8 The high return target and the need to diversify sources of risk and return means that the Trustee invests in a number of private markets. The market for some of these investments may be restricted or illiquid.

4.9 The Trustee monitors the total level of private assets, assesses the risks to future cash flows, and sets clear allocation limits.

Market and Manager Risk

4.10 The Trustee invests assets primarily through externally appointed investment managers. Risks can arise through the markets and manager mandates in terms of credit losses on individual investments, changes in asset values due to market movements, or effects on cash flows to or from investments.

4.11 The Trustee monitors the implementation of the investment strategy in detail and manages this risk by having clear limits on allocations to different sources of risk, avoiding concentration of risk within individual asset classes and mandates.

Currency Risk

4.12 The Trustee invests globally, whereas the liabilities are entirely denominated in sterling. Investments denominated in currencies other than the base currency carry the risk of exchange-rate movements. The Trustee has a foreign exchange hedging policy, whereby exposures to foreign currencies are hedged as appropriate. The Trustee monitors the policy and the risks that may arise to the market value and cash flows from both the policy and the underlying foreign investments.

5. Responsible Investment Policy

5.1 The Trustee has agreed a responsible investment policy, which covers long-term sustainability, the strategic consideration and integration of environmental, social and governance ("ESG") factors, and stewardship of the Scheme's investments. The Trustee agreed a responsible investment belief in 2018, which includes the view that "being a good steward of assets can lead to better risk adjusted returns".

5.2 The strategic considerations draw on the Sustainable Development Goals and cover:

- Resource efficiency;
- Just transition to a low carbon economy, which includes the financial effects of climate change;
- Equality; and
- Governance.

5.3 Strategic considerations from an ESG perspective are generally focused on global issues. However, the importance of local impacts from investments made, e.g. on communities, may also be critical. When new investments are considered, the Scheme, as far as practical, will consider whether there are any observable factors relevant to that investment that may have a positive or negative impact on members.

5.4 ESG factors should be properly managed and integrated into analysis and investment decision-making processes across the whole portfolio. The Scheme's assets are managed by third party investment managers. Therefore, the main focus for ESG factor integration is the evaluation and assessment of those external managers' policies and procedures in this area. Thoughtful manager selection and monitoring is crucial to ensure externally appointed investment managers employ best practice when integrating ESG into their investment decision-making processes.

5.5 External investment managers must be able to explain the ESG considerations included in making investment decisions. In particular, they must be able to demonstrate that where there is a material risk or return consideration to an underlying investment from one or more ESG factors, they are able to identify, model as appropriate, and consider the potential threats and/or opportunities to their investment case.

5.6 The Trustee subscribes to the UK Stewardship Code and has developed a Corporate Governance policy to guide its investment managers and other agents in the exercise of its ownership rights. The Trustee has appointed EOS at Federated Hermes (EOS) to assist in fulfilling its fiduciary responsibilities as a long-term investor in global equities and corporate bonds. The Trustee believes that oversight of its public equity and corporate fixed income holdings by EOS and also, by certain investment managers that it employs, enables it to implement a high standard of stewardship on behalf of the beneficiaries of the Scheme. For other investment classes CPTI undertakes due diligence and ongoing monitoring of the Scheme's investment managers on behalf of the Trustee, to ensure they are undertaking effective stewardship including in relation to environmental, social and governance considerations.

5.7 EOS will vote in accordance with this policy and where appropriate engage with corporate management to improve shareholder value and report on its activities. Providing no ongoing engagement activity is compromised, the Scheme will publish the results of these engagement activities.

5.8 The Trustee supports collaborative shareholder action and where applicable will communicate and collaborate with other shareholders, supported by EOS.

5.9 In addition, the Trustee recognises the challenges for a passive investment manager to take account of social, environmental or ethical considerations in the selection, retention and realisation of investments. However, a more activist stance such as engagement may at times be appropriate, at the investment manager's discretion.

5.10 The Trustee has developed policies to identify, manage and disclose any potential conflicts of interest that may arise in relation to the stewardship of the Scheme's investments. EOS is governed by its own conflicts of interest policy which requires that it identifies and manages actual or potential conflicts of interest between itself and its clients, or between different clients of EOS. In the event that a conflict occurs between EOS and its client then it is the client's interests that are put first.

5.11 The Trustee provides information to members through the Scheme website including an overview of the Responsible Investment Policy, UK Stewardship Code Compliance Statement, Corporate Governance Policy and Voting & Engagement Records. Members can also send queries to the Trustee on this topic. The Trustee also carries out regular member surveys and holds an Annual General Meeting for members, at which members are invited to submit questions. The Trustee has not directly asked members for views on ESG and Climate Risk.

6. Manager Monitoring and Implementation of Investment Strategy

6.1 The selection of investment managers is based on assessment of investment skill, taking into account beliefs, idea generation, portfolio construction, implementation and monitoring processes, resources and sustainability and governance practices.

6.2 Mandates are aligned to the strategic objectives of the Trustee. Performance expectations and investment guidelines are defined in Investment Management Agreements.

6.3 The Trustee monitors the investment managers' performance, compliance with the guidelines and ongoing alignment to the objectives. The primary focus is on performance over 3 years, 5 years and longer periods, consistent with the time horizon of the Trustee.

6.4 Investment management fees are aligned to the objectives for specific mandates. Fees paid are reviewed annually, as are execution and other investment costs.

7. Additional policies

Additional Voluntary Contributions (AVCs)

7.1 The Scheme has a number of members who paid AVCs into the Scheme to enhance their benefits at retirement. Members are able to select to invest their AVC payments in number of fund products, managed by a third-party provider, including; Discretionary, With Profits, Deposit and Retirement Protection. In practice only two funds are currently selected by members; With Profits and Discretionary.