Statement of Investment Principles: Defined Benefit Section

This is the Statement of Investment Principles ("the Statement") made by the Directors ("Trustees") of Finning Trustees Limited, Trustee of The Finning Pension Scheme ("the Scheme") in accordance with the Pensions Act 1995 (as amended). The Statement relates to the Defined Benefit Section; a separate statement covers the Defined Contribution Section.

This Statement is subject to periodic review by the Trustees at least every three years and more frequently as appropriate (for example, on a significant change in investment policy).

In preparing this Statement, the Trustees have consulted with Finning (UK) Ltd., the principal employer to the Scheme, and have taken, and considered, written advice from the Investment Practice of Hymans Robertson LLP.

Scheme objective

The primary objective of the Defined Benefit section of the Scheme is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependants, on a defined benefits basis.

The Trustees' over-riding funding principle for the Scheme is to set the employer contribution at a level which is sufficient to:

- recover any shortfall in assets relative to the value placed on accrued liabilities over the longer term; and
- ensure that there are always sufficient assets of the Scheme (at their realisable value) to meet 100% of benefits as they fall due for payment to members.

The value of liabilities is calculated on the basis agreed by the Trustees and principal employer, following consultation with the Scheme Actuary; the Trustees also consider the Scheme's funding position on a more stringent solvency/discontinuance basis. These funding positions are monitored regularly by the Trustees and formally reviewed at each triennial actuarial valuation, or more frequently as required by the Pensions Act 2004. The Statement of Funding Principles, which is agreed between the Trustees and the principal employer, sets out in more detail the Trustees' policy for securing its funding objective.

Investment strategy

The Trustees have translated their objectives into a suitable strategic asset allocation benchmark for the Scheme. The Trustees have delegated the 'day-to-day' management of Scheme assets to a number of authorised investment managers. Further details of the Scheme's investment strategy are provided in the Scheme's Investment Implementation Policy Document dated January 2020.

In Q1 2018, the Scheme set up an Investment sub-committee. The specific role and responsibilities of the ISC are set out in a separate terms of reference document.

The strategic benchmark is reflected in the choice and mix of funds in which the Scheme invests. The Scheme benchmark is consistent with the Trustees' views on the appropriate balance between seeking an enhanced long-term return on investments and accepting greater short-term volatility and risk.

The investment strategy takes due account of the maturity profile of the Scheme (in terms of the relative proportions of liabilities in respect of pensioners and non-pensioners), together with the level of disclosed surplus or deficit (relative to the funding basis used). It is intended that the investment strategy will be reviewed at least every three years following actuarial valuations of the Scheme and will normally be reviewed annually. In reviewing strategy, the Trustees will seek and consider written advice as required.

To achieve their objectives the Trustees have agreed the following:-

Choosing investment: Given the size and nature of the Scheme, the Trustees have decided to invest on a pooled fund basis. Currently the Trustees have appointed a number of investment managers; all of whom are authorised to undertake investment business.

A significant proportion of Scheme assets are managed on a passive (index-tracking) basis, the objective of which is to match, rather than exceed, the performance of the benchmark index of each fund in which investment is made. The investment manager of each fund in which investment is made selects stocks in such a way as to replicate, as closely as possible, the composition of the benchmark index.

The balance of Scheme assets is managed on an active basis, the objective of which is, over the medium to long term, to exceed the return achieved by the benchmark index.

The Trustee reviews the nature of Scheme investments on a regular basis, with particular reference to suitability and diversification. The Trustee seeks and considers written advice from a suitably qualified person when determining the appropriateness of each manager and mandate for the Scheme, particularly in relation to diversification, risk, expected return and liquidity. If, at any time, investment in a security or product not previously known to the Trustee is proposed, appropriate advice is sought and considered to ensure its suitability.

The Trustee recognises the long term nature of its liability profile and appoints its managers to invest in such a way that generates long term sustainable returns. The Trustee will carry out necessary due diligence on the underlying investment decision making process, to ensure the manager makes investment decisions over an appropriate time horizon aligned with the Scheme objective.

The duration of each mandate is determined by the Trustees at the inception of each mandate. For open-ended investments, the Trustees generally engage managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Trustees expect the minimum duration of the appointment will be three years, this being the period over which performance of the mandate can be appropriately evaluated although all mandates are subject to ongoing review against various financial and non-financial metrics, in addition to reconsidering their continued appropriateness within the investment strategy. For close-ended investments, the Trustees expect the term of the appointment to be the lifetime of the investment and will ensure that such term is appropriate for the Scheme.

In adopting this approach, the Trustees are satisfied that the portfolio is suitably diversified as regards asset class, geographic spread and the number of stocks held.

Kinds of investments to be held: The Scheme may invest in quoted and unquoted securities of UK and overseas markets including equities, fixed interest bonds, index-linked bonds, cash and property, either directly or through pooled funds. The Scheme may also make use of derivatives, contracts for difference and other derivatives (or in pooled funds investing in these products) for the purpose of efficient portfolio management or to hedge specific risks e.g. interest rate or inflation. The Trustees consider all of these classes of investment to be suitable in the circumstances of the Scheme.

Balance between different kinds of investments: The Scheme's active investment managers hold a mix of investments which reflects their views relative to their respective benchmarks. The manager of the passive funds in which the Scheme invests holds a mix of investments within each pooled fund that reflects, as closely as possible, their respective benchmark indices. Within each major market each manager will maintain a diversified portfolio of stocks through pooled vehicles.

Manager engagement: The Trustees appoint investment managers, each with a mandate that fulfils in part the needs of the investment strategy, and ensures that the benchmark, objective and management parameters for each mandate is aligned with the requirements of the Scheme.

The Trustees invest in pooled funds where the objectives of the fund and the policies of the investment manager will be evaluated by the Trustees to ensure that they are appropriate for the needs of the Scheme. The Trustees will take advice in determining the appropriateness of each manager and mandate for the Scheme. By investing in this manner, the Trustees are confident that the managers appointed will make decisions which are commensurate with the period over which the Trustees expect to be invested in each mandate.

Remuneration for each mandate is determined at the inception of each mandate based on commercial considerations and typically set on an ad valorem basis. Where appropriate to the nature of the mandate, the term of the mandate and the role the mandate plays within the investment strategy, the Trustees may consider and agree to a fee structure where the manager is incentivised to deliver outperformance relative to an agreed benchmark. The Trustees periodically review the fees paid to all of its managers against industry standards.

The Trustees review the performance of each of its managers and mandates on a regular basis against a series of metrics, including financial performance against the benchmark and objectives of the mandate, the exercise of stewardship responsibilities as set out in greater detail below, and the management of risks. Material deviation from performance or risk targets is likely to result in the mandate being formally reviewed. The Trustees draw input from their investment adviser to support any such review of and engagement with its investment managers. Where necessary, the Trustees will highlight any areas of concern identified during such reviews to the manager as part of its engagement process and request that the manager takes appropriate action. This may include concerns over performance, risk management, stewardship practices, investment process and operational issues and, where such concerns are raised, the Trustees will require the manager to demonstrate levels of improvement. Failure to achieve the desired improvements will result in the mandate being terminated.

The Trustees have expectations of the level of turnover within each mandate which are determined at the inception of the mandate, based on the Trustees' knowledge of the manager, investment process and the nature of the underlying portfolio. Whilst the Trustees expect financial performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustees also expect managers to report on at least an annual basis on the underlying assets held within the portfolio and details of any transactions over the period, including details of the costs associated with transactions. The Trustees will challenge the manager if there is a material deviation in portfolio turnover from expectations or historic experience within the mandate.

Risk: The Scheme is exposed to a number of risks which pose a threat to meeting its objectives. The principal risks affecting the Scheme are:

Funding risks:

- Financial mismatch – 1. The risk that Scheme assets fail to grow in line with the developing cost of meeting Scheme liabilities. 2. The risk that unexpected inflation increases the pension and benefit payments and Scheme assets do not grow fast enough to meet the increased cost.
- Changing demographics – The risk that longevity improves and other demographic factors change, increasing the cost of Scheme benefits.
- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting Scheme liabilities. Climate change is a particular systemic risk that has the potential to cause economic, financial and demographic impacts.

The Trustees measure and manage financial mismatch in two ways. As indicated above, they have set a strategic asset allocation benchmark for the Scheme. They assess risk relative to that benchmark by monitoring the Scheme's asset allocation and investment returns relative to the benchmark. They also assess risk relative to liabilities by monitoring the Scheme's funding position on a regular basis.

The Trustees keep under review mortality and other demographic assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation. The Trustees seek to mitigate systemic risk by investing in a diversified portfolio of assets and by taking into consideration a number of factors, including the historic performance correlations of different asset classes, when setting the strategic asset allocation benchmark. Nevertheless, it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset risks

- Concentration - The risk that significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Scheme cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Scheme's assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.
- Leverage – The risk that any leverage used in the Scheme's investments magnifies any losses that are incurred.
- Environmental, Social and Governance (ESG) risks – the extent to which ESG issues are not reflected in asset prices and/or not considered in investment decision making leading to underperformance relative to expectations.
- Climate risk - The extent to which climate change causes a material deterioration in asset values as a consequence of factors including but not limited to policy change, physical impacts and the expected transition to a low-carbon economy.

The Trustees measure and manage asset risks as follows.

The Scheme's strategic asset allocation benchmark invests in a diversified range of asset classes. The Trustees have put in place rebalancing arrangements to ensure the Scheme's "actual allocation" does not deviate substantially from its target. The Scheme invests in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, help reduce the Scheme's asset concentration risk. By investing across a range of assets, including liquid quoted equities and bonds, as well as property, the Trustees have recognised the need for access to liquidity in the short term.

The Scheme invests in a range of overseas markets which provides a diversified approach to currency markets; the Trustees also assess the Scheme's currency risk during their risk analysis. The Scheme has implemented a currency hedge, to hedge approximately 50% of the developed Overseas Equity holdings of the scheme.

The Trustees have considered the risk of underperformance by any single investment manager and have attempted to reduce this risk by appointing more than one manager and having a large proportion of the Scheme's assets managed on a passive basis. The Trustees assess the Scheme's managers' performance on a regular basis, and will take steps, including potentially replacing one or more of their managers, if underperformance persists.

The Trustees reduce the risk associated with using leverage by investing in pooled funds which have pre-defined leverage benchmarks, leverage limits and recapitalisation processes. The Trustees also manage leverage risk by only using these funds for a proportion of the Scheme's overall hedging.

The Trustee's approach to the consideration of ESG risks and climate risk is set out in further detail below.

Other provider risk

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Trustees take professional advice and consider the appointment of specialist transition managers.
- Custody risk - The risk of losing economic rights to Scheme assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.

The Trustees monitor and manage risks in these areas through a process of regular scrutiny of their providers, and audit of the operations they conduct for the Scheme, or have delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds).

Expected return on investments: Over the long term, the overall level of investment returns is expected to exceed the rate of return assumed by the Actuary in funding the Scheme.

Realisation of investments: The majority of the Scheme's investments may be realised quickly if required.

Consideration of financially material factors in investment arrangements

The Trustees recognise that the consideration of financially material factors, including ESG factors, is relevant at different stages of the investment process. The Trustees have explicitly acknowledged the relevance of ESG factors in framing their investment beliefs and these beliefs are reflected in the principles set out below and the broader implementation of strategy.

Strategic considerations

The strategic benchmark has been determined using appropriate long-term economic and financial assumptions from which expected risk/return profiles for different asset classes have been derived. These assumptions apply at a broad market level and are considered to implicitly reflect all financially material factors.

Given the inherent uncertainty, the Trustees have not made explicit allowance for the risks of climate change in setting their strategic benchmark.

Structural considerations

Given the discretion afforded to the active Investment Managers, the Trustee expects that their Investment Managers will take account of all financially material factors including the potential impact of ESG factors in the implementation of their mandate.

Selecting investment managers

Within active mandates, the Trustee has delegated responsibility for the consideration of stock specific issues to their individual Investment Managers. The Trustee has discussed the extent to which ESG issues, where relevant to the investment mandate, are integrated into the investment processes of their Investment Managers and are satisfied that the Investment Managers are following an approach which takes account of all financially material factors. The Trustees expect their managers to take into account all financially material factors in the selection of assets within their portfolios and to be able to demonstrate their approach when challenged.

In passive mandates, the Trustees recognise that the choice of benchmark dictates the assets held by the investment manager and that the manager has minimal freedom to take account of factors that may be deemed to be financially material. The Trustees accept that the role of the passive manager is to deliver returns in line with the benchmark and believe this approach is in line with the basis on which their current strategy has been set.

In selecting new investment managers for the Scheme, where relevant to the investment mandate, the Trustees explicitly considers potential managers' approach to responsible investment and the extent to which managers integrate ESG issues in the investment process as a factor in their decision making.

Stewardship & Engagement

The Trustee aims to meet with all their Investment Managers on a periodic basis. The Trustee provides their managers with an agenda for discussion, including issues relating to individual holdings and, where appropriate, ESG issues. Managers are challenged both directly by the Trustee and by their investment advisers on the impact of any significant issues including, where appropriate, ESG issues that may affect the prospects for return from the portfolio.

The Trustee has adopted a policy of delegating voting decisions on stocks to their Investment Managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. The Investment Managers are expected to exercise the voting rights attached to individual investments in accordance with their own house policy. Where relevant, the Trustee has reviewed the voting policies of their Investment Managers and determined that these policies are appropriate.

The Trustees do not engage directly with issuers but actively encourages its investment managers to engage with key stakeholders which may including corporate management, regulators and governance bodies, relating to their investments in order to consider the management of conflicts of interest and improve corporate behaviours, improve performance and mitigate financial risks. Where necessary, investment managers are expected to notify the Trustees of any issue on which it may be beneficial for the Trustee to undertake further engagement. The Trustees will review engagement activity undertaken by their investment managers as part of its broader monitoring activity.

Responsibility for investment decisions has been delegated to the investment managers which includes consideration of the capital structure of investments and the ongoing appropriateness of any investment made. Where managers are responsible for investing in new issuance, the Trustees expect the manager to engage with the issuer about the terms on which capital is issued and the potential impact on the rights of new and existing investors.

The Trustees separately consider any conflicts of interest arising in the management of the Scheme and its investments and has ensured that each manager has an appropriate conflicts of interest policy in place. Managers are required to disclose any potential or actual conflict of interest to the Trustees.

Investment managers report on voting and engagement activity to the Trustees on a periodic basis. The Trustees will monitor such activity and may periodically review and compare managers' voting patterns, particularly in relation to climate-related issues. The Trustees may also monitor investment managers' voting on particular companies or issues affecting more than one company. Where the Trustees deem it appropriate, they will raise issues of concern in respect of voting activity directly with their managers.

The Trustees will review the reporting provided by their investment managers on an annual basis and will, if appropriate, request the disclosure of additional information if it will assist the Trustees in their monitoring of managers or falls in line with evolving best practice. The Trustees have also requested that their investment adviser provide an annual ESG assessment of their investment strategy and appointed managers.

Consideration of non-financially material factors in investment arrangements

Given the objectives of the Scheme, the Trustees has not considered any non-financially material factors in the development and implementation of their investment strategy.

Additional Voluntary Contributions (AVCs): The Trustees give members the opportunity to invest in a range of vehicles at the members' discretion. The Trustees acknowledge the Pension Regulator's Code of Practice 13, "Governance and administration of occupational defined contribution trust based pension schemes" that was published in November 2013. They will assess the Scheme's AVCs relative to the qualify features associated with this Code.

Signed for, and on behalf, of Finning Trustees Limited, Trustee of The Finning Pension Scheme.

Director

25 August 2020

Date