STATEMENT OF INVESTMENT PRINCIPLES

Church of Scotland Pension Scheme for Ministries' Development Staff

September 2020

Church of Scotland

15 September 2020

The Church of Scotland Pension Scheme for Ministries' Development Staff (the Scheme).

Background

The employer is the Ministries Council.

1. Introduction

This document constitutes the Statement of Investment Principles for the Scheme. It has been prepared by the Trustees of the Scheme, having taken into account advice from the investment adviser and the scheme actuary.

It has been prepared in accordance with section 35 of the Pensions Act 1995 and associated regulations.

It is reviewed each year or after any significant change in investment policy.

2. Objectives

The Trustees are responsible for the stewardship of the Scheme's assets. Their main objectives are to ensure that:

- All beneficiaries receive the benefits to which they are entitled under the rules of the Scheme
- There are sufficient assets to meet the Scheme's liabilities as they fall due.

The Trustees have the strategic objective of being fully funded, on a prudent actuarial basis. This will allow them to run a low risk investment policy with limited call on the employers for additional deficit reduction contributions. They have consulted with the employers in setting these objectives.

3. Investment policy

The Trustees set investment policy. They consult with the employers and take advice from their scheme actuary and investment adviser. The investment policy is kept under review and updated (when necessary) following each actuarial valuation or significant change in circumstances.

The Trustees delegate responsibility for developing and implementing investment policy to the Investment Sub Group. It appoints, monitors the performance of, and removes investment managers. It sets and oversees asset allocation policy and directs how cash flow requirements are met from the different asset types, adjusting the portfolio as necessary. It monitors, reviews and recommends changes to the Trustees' policies in respect of investment, corporate governance, ethical and socially responsible investment and engagement.

4. Investment strategy

In setting the investment strategy, the Trustees take account of the employers' stated willingness to underwrite the liabilities of the Scheme, together with the guarantee approved by the General Assembly. The Trustees monitor the covenant of the Church of Scotland on a continual basis to assess its ability to support the Scheme in the event of unplanned investment experience, or other adverse outcome.

The strategy is set out in Appendix 1 and is reviewed regularly.

5. Investment management

The Trustees carry out due diligence and take advice from their investment adviser on the selection and monitoring of investment managers.

The Trustees delegate day to day investment decisions to suitably qualified independent investment managers, who are required to comply with this statement. Their activities are defined and constrained by management agreements. Investment managers have discretion to buy and sell investments within the terms of their agreements.

To aid diversification the Trustees employ investment managers with varying investment remits and styles, including active and passive.

Fund performance is reported and reviewed quarterly, with face to face meetings whenever required.

Fees are charged as a proportion of the assets under management. They are negotiated individually when an investment manager is appointed and kept under review. The Trustees take advice to ensure that fees are competitive and commensurate with the services provided.

6. Choosing Investments

The Trustees invest in a mix of matching and return seeking assets, balancing expected returns against volatility in the funding level.

Matching assets have characteristics which mean their cashflows are similar to those of future benefit payments. This helps reduce volatility in the funding level and the call on further contributions from the employers. Within the matching assets some use of leverage is made to help neutralise the impact on changes in the value of the liabilities while leaving scope for potential excess returns from the allocation to return seeking assets.

The types of investments held and the balance between them is deemed appropriate given the liability profile of the Scheme, its cash flow requirements, the funding level of the Scheme and the Trustees' objectives.

Return seeking assets are chosen seeking returns by employing more risk: in the case of multi asset funds, this is investment manager skill and for equities, which are actively managed, this is a combination of market risk and investment manager skill.

The Trustees exercise their powers of investment in a manner calculated to ensure the security, quality, liquidity and appropriateness of the portfolio as a whole. In order to avoid an undue concentration of risk a spread of assets is held. The diversification is both within, and across, the major asset classes.

The Trustees carry out due diligence and take advice from their investment adviser to ensure any new areas of investment are appropriate.

7. Arrangements with asset managers

The Trustees regularly monitor the Scheme's investments to consider the extent to which the investment strategy and decisions of the asset managers are aligned with the Trustees' policies, including those on non-financial matters. This includes monitoring the extent to which asset managers:

- make decisions based on assessments about medium- to long-term financial and non-financial performance of an issuer of debt or equity; and
- engage with issuers of debt or equity in order to improve their performance in the medium- to long-term.

The Trustees receive quarterly updates from their appointed investment adviser on various items including the investment strategy, performance, and longer-term positioning of the portfolio. The trustees focus on longer-term performance when considering the ongoing suitability of the investment strategy in relation to the Scheme's objectives, and assessment of the appointed asset managers.

The Trustees also receive annual stewardship reports on the monitoring and engagement activities carried out by their asset manager, which supports the Trustees in determining the extent to which the Scheme's engagement policy has been followed throughout the year.

Before appointment of a new asset manager, the Trustees will take advice from their investment adviser and will consider the extent to which the manager aligns with the Trustees' policies.

The Trustees reserve the right to express their expectations to the asset managers by various means (such as through a side letter, in writing, or verbally at Trustee meetings).

The Trustees believe that having appropriate governing documentation, setting clear expectations to the asset managers by other means (where necessary), and regular monitoring of asset managers' performance and investment strategy, is in most cases sufficient to incentivise the asset managers to make decisions that align with the Trustees' policies and are based on assessments of medium- and long-term financial performance.

Where asset managers are considered to make decisions that are not in line with the Trustees' policies, expectations, or the other considerations set out above, the Trustees will typically first engage with the manager but could ultimately replace the asset manager where this is deemed necessary.

There is typically no set duration for arrangements with asset managers, although the continued appointment all for asset managers will be reviewed periodically, and at least every three years.

8. Safe keeping of assets

Investment in collective funds gives the Trustees a right to the cash value of the units rather than to the underlying assets. The investment managers of the funds are responsible for the appointment and monitoring of the custodian of the fund's assets.

9. The balance between different types of investment

Asset allocation is driven by the specific characteristics of the Scheme, including its demography, the pattern of liabilities, the funding level and the risk tolerance of the Trustees and the employers. The Trustees have adopted an asset liability framework approach to setting the strategic asset allocation and protecting against risks such as interest rate risk.

The strategic asset allocation and the methodology used to set it is reviewed periodically to ensure that the framework and any changes to the strategic asset allocation are appropriate.

10. Sale of investments

The Scheme is now closed to new members and is maturing. This means the Scheme has a net cash out flow position. The Trustees direct which investments are to be sold, adjusting the portfolio from time to time to keep it in line with the strategic asset allocation.

All the assets of the Scheme are readily marketable.

11. Risk

The Trustees adopt an Integrated Risk Management approach, as set out by the Pensions Regulator in December 2015. This summarises the approach taken to quantify and manage all types of risk, including investment risk and others which impact on investment decision making.

The Trustees recognise the Scheme’s assets are exposed to a number of investment and operational risks. They give consideration to these risks when deciding investment policy, strategic asset allocation, the investment manager structure, the terms of their agreements and other aspects of the ongoing management of the Scheme.

The quality of the sponsor’s covenant is an integral consideration in determining the amount and nature of risk that is appropriate for the Scheme to take. It is kept under review.

Risks to the Scheme are captured and monitored in a series of risk reports, a process managed and overseen by the Trustees’ Risk sub-Group.

A variety of steps are taken by the Trustees to measure these risks. Asset allocation risk is assessed periodically by Value at Risk analysis, and triennially by scenario analysis at each actuarial valuation. The risk of investment manager underperformance is assessed by meeting and questioning the investment manager; reviewing written quarterly reports from each investment manager; comparing investment manager risk and return performance measures with those of a peer group.

12. Additional voluntary contributions (AVCs)

Members of the Scheme may pay AVCs, in accordance with separate provisions published by the Trustees. The funds in which members can choose to invest their AVCs are reviewed regularly, to ensure that they are well managed and represent good value. The Trustees have the right to vary the arrangements and take advice from their investment adviser in doing so.

The liabilities in respect of AVCs are equal to the value of the investments bought by the contributions.

13. Environmental, Social and Governance (ESG) considerations

In setting the Scheme's investment strategy, the Trustees' primary concern is to act in the best financial interests of the Scheme and its beneficiaries, seeking the best return that is consistent with a prudent and appropriate level of risk. These include:
▪ The risk that environmental, social and governance factors including climate change negatively impact the value of investments held if not understood and evaluated properly. The Trustees consider this risk by taking advice from their investment consultant when setting the Scheme's asset allocation, when selecting managers and when monitoring their performance.

Stewardship – Voting and Engagement

The trustees recognise the importance of their role as a steward of capital and the need to ensure the highest standards of governance and promotion of corporate responsibility in the underlying companies and assets in which the Scheme invests, as this ultimately this creates long-term financial value for the Scheme and its beneficiaries.

As part of their delegated responsibilities, where relevant the Trustees expect the Scheme's investment managers to**:**

- ▪ Where appropriate, engage with investee companies with the aim to protect and enhance the value of assets; and
- ▪ exercise the Trustees' voting rights in relation to the Scheme's assets.

The Trustees regularly review the continuing suitability of the appointed managers and take advice from the investment consultant with regard to any changes. This advice includes consideration of broader stewardship matters and, where relevant, the exercise of voting rights by the appointed managers. If an incumbent manager is found to be falling short of the standards the Trustees have set out in their policy, the

Trustees undertake to engage with the manager and seek a more sustainable position but may look to replace the manager.

The Trustees will engage with their investment managers as necessary for more information, to ensure that robust active ownership behaviours, reflective of their active ownership policies, are being actioned.

From time to time, the Trustees will consider the methods by which, and the circumstances under which, they would monitor and engage with an issuer of debt or equity, an asset manager or another holder of debt or equity, and other stakeholders. The Trustees may engage on matters concerning an issuer of debt or equity, including their performance, strategy, risks, social and environmental impact and corporate governance, the capital structure, and management of actual or potential conflicts of interest.

Members' Views and Non-Financial Factors

In setting and implementing the Scheme's investment strategy the Trustees do not explicitly take into account the views of Scheme members and beneficiaries in relation to ethical considerations, social and environmental impact,or present and future quality of life matters (defined as 'non financial factors'). However, where members share their views with the Trustees, these will be discussed at a relevant meeting of the appointed Trustees.

14. Cost Monitoring

Evaluation of Performance and Remuneration

The Trustees evaluate the performance of their investment managers relative to their respective objectives on a regular basis via investment reports and updates from the investment managers. The Trustees also review the remuneration of the Fund's investment managers on at least a triennial basis to ensure that these costs are reasonable in the context of the kind and balance of investments held.

Portfolio turnover

Targeted portfolio turnover is defined as the expected frequency with which each underlying investment managers’ fund holdings change over a year. The Trustees seek comment on this from their investment managers on an annual basis and consider this with input from their investment adviser.

15. Effective decision making

The Trustees recognise that decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. They also recognise that where they take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take.

The Trustees believe that given the scale of the Scheme that a separate Investment Sub Group (ISG) is appropriate. Therefore all investment decisions are discussed by the ISG with assistance from the Scheme’s investment advisor, where appropriate, before decisions are taken by the ISG where appropriate, or otherwise by the Board of Trustees.

Appendix 1: Investment beliefs

During the last few years as a result of mortality experience and investment performance the fund solvency situation has improved sharply. However the value of the liabilities – members' benefits - is still greater than the value of the assets. In consultation with the employer, the fund has maintained a proportion of assets in investments designed to provide higher returns than low risk assets - UK government gilts - whose future cash flows strictly match expected payments of benefits in the future. The balance of the fund remains in those low risk securities. The investment strategy is thus designed to produce returns which will continue to reduce the fund deficit over the medium to longer term.