Historic Royal Palaces Pension Scheme

Statement of Investment Principles

August 2020

1. **Introduction**

This Statement sets out the principles governing decisions about investments for the Historic Royal Palaces Pension Scheme ("the Scheme") in accordance with Section 35 of the Pensions Act 1995 (as amended by Section 244 of the Pensions Act 2004) and the Occupational Pension Schemes (Investment) Regulations 2005. The Statement is intended to affirm the investment principles that govern decisions about the Scheme's investments.

In preparing this Statement, the Trustees have consulted the employer (Historic Royal Palaces) to ascertain whether there are any material issues of which the Trustees should be aware in agreeing the Scheme's investment arrangements. The Trustees are committed to maintaining the accuracy of this Statement on an ongoing basis and will review the Statement at least every three years and without delay following a change in investment policy.

The Trustees' investment powers are set out within the Scheme's governing documentation and relevant legislation. If necessary, the Trustees will take appropriate legal advice regarding the interpretation of these.

2. **Investment Policy**

The investment policy falls into two parts: 1) the strategic management and 2) the day-to-day management of the assets.

The Trustees note that, according to the law, the Trustees have ultimate power and responsibility for the Scheme's investment arrangements. In considering the appropriate investments for the Scheme the Trustees have obtained and considered the written advice of Mercer Limited, whom the Trustees believe to be suitably qualified to provide such advice. The advice received and arrangements implemented are, in the Trustees' opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended).

The day-to-day management of the assets is delegated to a professional investment manager, Legal & General Investment Management ("L&G").

3. **Investment Objectives**

The Trustees' principal aim is to ensure that sufficient funds are available to provide benefits as and when required by the Scheme rules. Benefits will normally be paid out of contribution or income but, where necessary, the Trustees will realise appropriate funds to provide the benefits.

The next Actuarial Valuation is in March 2021. The Trustees will aim to minimise the volatility of the Scheme's funding position, while taking sufficient investment risk to have a reasonable expectation of achieving the investment objective.

The Trustees expect to generate a return, over the long term, of circa 1.6% per annum (before expenses) above that which would have been achieved had no investment risk been taken within the portfolio i.e. by investing solely in the matching portfolio (see the section on "Risk" below). It is recognised that over the short term performance may deviate significantly from the long term target. This level of expected outperformance remains in excess of the discount rate allowed for within the Technical Provisions basis[1].

4. Asset Allocation

During 2020, the Trustees implemented an increase in the interest and inflation rates hedging to 80% of the total Plan's Liabilities estimated by the Actuarial Valuation dated 31 March 2018. The investment strategy has been designed with the aim of meeting the investment objectives set out above, while also providing an adequate degree of risk diversification and sufficient liquidity to meet the liabilities of the Scheme as they fall due.

The Scheme is split into a Matching Portfolio and a Growth Portfolio. The purpose of the Matching Portfolio is to closely match changes in the value of Scheme liabilities; therefore, the split between growth and matching assets is not rebalanced but allowed to drift in line with market movements. As a result of this the overall expected return on the asset strategy may change over time relative to the gilt +1.6% target. Investments within the equity section are periodically rebalanced by L&G. L&G are responsible for the regular monitoring and implementation of this.

The current Matching Portfolio was restructured during 2020 to better match the characteristics of the Scheme liabilities. The Scheme targets a hedge ratio of 80% of the interest rate and inflation risk associated with the liabilities valued on a TP basis (gilts + 1.3%).

The Scheme's asset allocation as at 30 June 2020 is set out in the table below.

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[1] The discount rate basis used to calculate the Technical Provisions allows for 1.3% per annum asset outperformance relative to liabilities. This outperformance assumption is on a "prudent" basis, i.e. the Scheme Actuary needs to be comfortable that the Scheme's asset allocation has a good expectation of achieving this degree of outperformance. The asset class return assumptions used to develop the Scheme's investment strategy are by contrast based on central expectations - i.e. while the best estimate is that the assets will outperform the liabilities by 1.6% per annum, there is by implication a 50% chance the actual outperformance will be lower than this.

Asset Class	Proportion of Assets %	Allocation as at 30 June 2020 %
Growth Portfolio (Equity section)		**40.5**
UK Equity	34.3	
Overseas Equity	65.7	
*Europe ex-UK**	*19.1*	
*North America**	*19.2*	
*Japan**	*8.6*	
*Asia Pacific ex-Japan**	*9.4*	
Global Emerging Markets	*9.3*	
Total	**100.0**	

Asset Class	Proportion of Assets %	Allocation as at 30 June 2020 %
Growth Portfolio (Property section)		**12.7**
L&G LPI Property Fund	**100.0**	

Asset Class	Proportion of Assets %	Allocation as at 30 June 2020 %
Matching Portfolio		**46.8**
2034 Gilt	0.4	
2047 Gilt	3.1	
2060 Gilt	0.5	
2065 Gilt	2.5	
2068 Gilt	1.0	
2071 Gilt	2.1	
2038 Leveraged Gilt	1.1	
2045 Leveraged Gilt	0.4	
2055 Leveraged Gilt	2.1	
2060 Leveraged Gilt	1.2	
2024 Index-Linked Gilt	1.2	
2027 Index-Linked Gilt	25.7	
2030 Index-Linked Gilt	1.2	
2035 Index-Linked Gilt	0.4	
2050 Index-Linked Gilt	9.9	
2055 Index-Linked Gilt	1.8	
2058 Index-Linked Gilt	2.6	
2062 Index-Linked Gilt	5.9	
2068 Index-Linked Gilt	4.5	
2024 Leveraged Index-Linked Gilt	1.6	
2030 Leveraged Index-Linked Gilt	1.0	
2034 Leveraged Index-Linked Gilt	4.7	
2037 Leveraged Index-Linked Gilt	5.3	

2042 Leveraged Index-Linked Gilt	10.0
2050 Leveraged Index-Linked Gilt	3.3
2055 Leveraged Index Linked Gilt	5.2
2068 Leveraged Index-Linked Gilt	0.5
Sterling Liquidity Fund	0.6
Total	**100.0**

Figures may not sum due to rounding
* 50% Currency Hedged

5. Risks

There are various risks to which any pension scheme is exposed, which the trustees believe may be financially material to the Scheme. The Trustees' policy on risk management over the Scheme's anticipated lifetime is as follows:

The Trustees recognise that an asset portfolio can be identified which closely replicates the liability cashflows (the matching asset portfolio). This portfolio would normally include a combination of fixed interest and index-linked gilts. Given the relatively long timescale of the majority of the Scheme's cashflows, and in view of the continuing presence of a sponsoring employer, the Trustees however feel comfortable that a significant proportion of the assets of the Scheme should be invested largely in growth assets (e.g. equities and property), rather than matching assets. This decision is taken with the aim of achieving greater long-term investment returns.

The Trustees recognise that whilst increasing risk increases potential returns over a long period, it also increases the risk of a shortfall in returns relative to those required to cover the Scheme's accruing liabilities as well as producing more short-term volatility in the Scheme's funding position. The Trustees have taken advice on the matter and (in light of the objectives noted previously) have considered carefully the implications of adopting different levels of risk. The Trustees however view that the expected additional investment returns arising from such an investment strategy in the long term outweighs the risk to the Scheme from the mismatched investments.

With the exception of Property, the Trustees have determined that the Scheme's assets should be managed on a passive basis, rather than appointing investment managers who actively manage the portfolio. This serves to both minimise costs as well as minimising the risk that manager(s) will underperform their benchmarks. In the case of property, the Trustees have concluded that it is not possible to achieve exposure to the most suitable sector of the property market given the Scheme's liability profile (i.e. relatively low risk property with long leases and inflation-linked income streams) through passive management.

To help the Trustees ensure the continuing suitability of the current investments the Trustees periodically take advice from the investment adviser, receive quarterly reports from the investment manager and meet with the investment manager, usually on an annual basis.

The Trustees recognise the risks that may arise from the lack of diversification of investments. Subject to managing the risk from a mismatch of assets and liabilities, the Trustees aim to ensure the asset allocation policy in place results in an adequately diversified portfolio. Due to the size of the Scheme's assets and recognising the need to diversify, investment exposure is obtained via pooled vehicles.

Responsibility for the safe custody of the Scheme's assets is delegated to a custodian, who, as a consequence of the Scheme investing via a range of pooled funds, is appointed and maintained by the investment manager.

The majority of the Scheme's assets are liquid and can be realised for cash within one to two weeks. The exception is the property investment, which is subject to a nine-month notice period for redemptions. The size of the allocation to property (12.5% of total Scheme assets) however means that this does not impact the Scheme's ability to meet its current obligations.

The Trustees' willingness to take investment risk is dependent on the continuing financial strength of the employer and its willingness to contribute appropriately to the Scheme. The financial strength of the employer is periodically reviewed by the Trustees and the investment arrangements may be reviewed if there were to be significant deterioration.

6. Day-to-Day Investment Management

The Trustees have decided to invest the Scheme assets with Legal and General Assurance (Pensions Management) Ltd, an authorised insurance company which manages unit-linked tax exempt funds. The funds selected by the Trustees will be consistent with the above principles, and the Trustees may switch between funds later if circumstances change. Instructions must be made in writing and signed by a majority of Trustees. Legal and General Assurance (Pensions Management) Ltd has delegated investment management of the underlying assets to an associate company; Legal and General Investment Management Limited ("L&G"), which is authorised by the Financial Conduct Authority and regulated by the Prudential Regulation Authority.

The Principles of Operation attached to the insurance policy set out the terms under which the underlying assets are managed. The investment briefs, guidelines and restrictions under which L&G act have been agreed in writing by the Trustees.

The safekeeping of the underlying assets of the insurance policy is performed on behalf of L&G by custodian banks specifically appointed to undertake this function. These appointments are reviewed at regular intervals by L&G. In L&G's opinion, the contractual arrangements with the custodian banks offer a very high level of protection against negligence or default on the part of the custodian banks.

The Trustees have delegated the role of rebalancing the Scheme's equity assets to L&G. If the asset allocation within the equity portfolio moves outside its allowable ranges, L&G is responsible for rebalancing the assets back within the allocation ranges. The rebalancing ranges are set out in the documentation agreed with L&G. Given dealing costs and its relative illiquidity, the property portfolio will not form part of L&G's rebalancing mandate. Since the purpose of the Matching Portfolio is to match changes in the value of Scheme liabilities, the split between growth and matching assets, and the allocation between the different bonds within the Matching portfolio is not rebalanced either. The Trustees will however periodically review the allocation to the different elements of the Scheme's portfolio, to consider whether it continues to be appropriate.

The appendix to this document sets out the fees paid to the investment manager.

7. Aligning Manager Appointments with Investment Strategy

Investment manager has been appointed based on its capabilities and, therefore, its perceived likelihood of achieving the expected return and risk characteristics required for each asset class being selected for.

The Trustees look to their investment consultant for their forward looking assessment of a manager's ability to outperform over a full market cycle. This view will be based on the consultant's assessment of the manager's idea generation, portfolio construction, implementation and business management, in relation to the particular investment fund that the scheme invests in. The consultant's manager research ratings assist with due diligence and questioning managers during presentations to the Trustees and are used in decisions around selection, retention and realisation of manager appointments.

If the investment objective for a particular fund changes, the Trustees will review the fund appointment to ensure it remains appropriate and consistent with their wider investment objectives.

As the Trustees invest in pooled investment vehicles, they accept that they have no ability to specify the risk profile and return targets of the manager, but appropriate mandates can be selected to align with the overall investment strategy.

8. Other Assets

The Trustees believe that members of the Scheme should have individual choice of the investment funds used for their money purchase personal accounts, such as for money purchase AVCs or transfer values. Accordingly, members of the Scheme who historically paid Additional Voluntary Contributions are offered the option of investing in a variety of money purchase personal accounts with Aegon. There are a small number of members with historic Equitable Life (now transferred to Utmost) and Aviva investments.

The Trustees monitor the investment funds available on a regular basis and are comfortable that there are reasonable investment options available that will meet most members' needs. The Trustees do not offer any individual financial advice but provide the services of an Independent Financial Adviser.

9. Socially Responsible, Environmental and Ethical Investment

The Trustees take into consideration non-financial matters when assessing the overall investment strategy and managers, as such members' views on 'non-financial matters' (where "non-financial matters" include members' ethical views separate from financial considerations such as financially material ESG issues), are not explicitly taken into account in the selection, retention and realisation of investments.

The Trustees believe that environmental, social, and corporate governance ("ESG") factors may have material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustees also recognise that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration. The Trustees have taken into account the expected time horizon of the Scheme when considering how to integrate these issues into the investment decision-making process.

The Trustees have given L&G full discretion in evaluating ESG factors, including climate change considerations, and exercising voting rights and stewardship obligations attached to the investments, including undertaking engagement activities, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Code and UK Stewardship Code.

The Trustees have not set any investment restrictions on L&G in relation to particular products or activities, but may consider this in future.

As the assets of the Scheme are managed in pooled arrangements, they are subject to L&G's policy on social, environment and ethical considerations related to the selection, retention and realisation of investments. The Trustees have reviewed this policy and are satisfied that it corresponds with their responsibility to their beneficiaries.

The Trustees will also consider the investment consultant's assessment of how the investment manager embeds ESG into its investment process and the investment manager's policy on voting and engagement. The Trustees will use this assessment in decisions around selection, retention and realisation of manager appointments.

The Trustees review an annual stewardship monitoring report, which includes details of voting and engagement activities associate with each of the funds invested in. Through periodic meetings with the investment manager, they have the opportunity to challenge manager decisions that appear out of line with the investment fund's objectives or the objectives/policies of the Scheme.

Investment managers are aware that their continued appointment is based on their success in delivering the mandate for which they have been appointed to manage. If the Trustees are dissatisfied, then they will look to replace the manager.

10. Corporate Governance

As the assets of the Scheme are managed in pooled arrangements, the Trustees accept the assets are subject to L&G's own policy on corporate governance including decisions on voting shares. The Trustees are aware of this policy and are satisfied that it corresponds with their responsibilities to their beneficiaries.

11. Buying and Selling Investments

The Trustees have delegated the responsibility for buying and selling investments to L&G. As already referred to, the day-to-day activities which the investment manager carries out for the Trustees are governed by the agreements between them, which are reviewed from time to time to ensure that the operating instructions, guidelines and restrictions remain appropriate.

12. Monitoring of the Investment Manager

L&G will provide the Trustees with performance monitoring on a quarterly basis. The Trustees normally expect to meet with the investment manager on an annual basis and periodically receive advice from the investment adviser on the ongoing suitability of the investment manager.

Trustees receive investment manager performance reports on a quarterly basis, which present performance information over 6 months, 1 year and 3 years. The Trustees review the absolute performance, relative performance against a suitable index used as the benchmark, and against the manager's stated target performance (over the relevant time period) on a net of fees basis. The Trustees also receive 6-monthly investment reports from their investment consultant, which include the investment consultant's views on the capabilities of the investment manager and relevant updates. The Trustees' focus is on long-term performance but may put the manager 'on watch' if there are short term performance concerns. As noted above, the Trustee may review an appointment if:

- There are sustained periods of underperformance;
- There is a change in the portfolio manager;
- There is a change in the underlying objectives of the investment manager;
- There is a significant change to Mercer's rating of the manager.

If a manager is not meeting performance objectives, or their investment objectives for the mandate have changed, the Trustees may ask the manager to review their fees.

13. Portfolio Turnover Costs

The Trustees ask L&G to include portfolio turnover and turnover costs in their presentations and reports to the trustees.

The Trustees may engage with a manager if portfolio turnover is higher than expected.

14. Manager Turnover

The Trustees are long-term investors and are not looking to change the investment arrangements on a frequent basis and there is no set duration for the manager appointments. The Trustees will retain an investment manager unless:

- There is a strategic change to the overall strategy that no longer requires exposure to that asset class or manager;
- The manager appointment has been reviewed and the Trustees have decided to terminate – see policy statement on realisation of assets.

15. Compliance with this Statement

The Trustees, L&G (the investment manager) and Mercer Limited (the Trustees' investment adviser) each have duties to perform to ensure compliance with this Statement. These are:

The Trustees will review this Statement regularly on the advice of Mercer Limited and will record compliance with it at the relevant Trustees' meeting.

L&G, the investment manager, will prepare quarterly results to the Trustees including:

- A valuation of all investments held for the Scheme
- Records of all transactions together with a cash reconciliation
- A review of recent actions undertaken on behalf of the Scheme together with a summary of their current stated policy

Mercer Limited, the investment adviser, will provide the advice needed to allow the Trustees to review the Scheme's investment arrangements and assist with updating this Statement as required.

The Scheme Actuary will provide funding level updates to L&G on no less than an annual basis to facilitate monitoring of the dynamic derisking strategy.

Signed:

Date: 15 September 2020

The Trustees of the Historic Royal Palaces Pension Scheme

Appendix A

Fee Structure

1. Investment management fees paid to L&G are based on the market value of assets under management. The following fee arrangement has been agreed between the Trustees and L&G:

Fund	Fee per annum
UK Equities	10bps on first £10m
	7.5bps on the next £10m
	6bps on the next £30m
	5bps thereafter
North American Equities	20bps on first £1m
	17.5bps on next £1.5m
	15bps on the next £7.5m
	12.5bps on the next £20m
	10bps on the next £20m
	8bps thereafter
North American Equities (hedged)	22.5bps on first £1m
	20bps on next £1.5m
	17.5bps on the next £7.5m
	15bps on the next £20m
	12.5bps on the next £20m
	10.5bps thereafter
Europe (ex UK) Equities	25bps on first £1m
	22.5bps on next £1.5m
	20bps on next £7.5m
	17.5bps on the next £20m
	15bps on the next £20m
	12.5bps thereafter
Europe (ex UK) Equities (hedged)	27.5bps on first £1m
	25bps on next £1.5m
	22.5bps on next £7.5m
	20bps the next £20m
	17.5bps on the next £20m
	15bps thereafter
Japan Equities	22.5bps on first £1m
	20bps on next £1.5m
	17.5bps on the next £7.5m
	15bps on the next £20m
	12.5bps on the next £20m
	10bps thereafter

Japan Equities (hedged)	25bps on first £1m 22.5bps on next £1.5m 20bps on the next £7.5m 17.5bps on the next £20m 15bps on the next £20m 12.5bps thereafter
Asia Pacific (ex Japan) Equities	27.5bps on first £1m 25bps on next £1.5m 22.5bps on the next £7.5m 20bps on the next £20m 17.5bps on the next £20m 15bps thereafter
Asia Pacific (ex Japan) Equities (hedged)	30bps on first £1m 27.5bps on next £1.5m 25bps on the next £7.5m 22.5bps on the next £20m 20bps on the next £20m 17.5bps thereafter
Global Emerging Markets	45bps on first £5m 35bps on next £5m 30bps on remaining balance above £10m

Property (L&G LPI Property Income Fund)	40bps on first £7.5m 35bps on next £12.5m 30bps thereafter
Single Stock Gilt Funds	10bps on first £5m 7.5bps on next £5m 5bps on next £20m 3bps thereafter
Matching Core or Matching Plus range	24bps on first £25m 17bps thereafter

It should be noted that for overseas equities, holdings in the currency hedged and unhedged funds for each region are aggregated for the purpose of calculating the fee tier. This avoids paying higher fees as a result of splitting assets between currency hedged and unhedged funds.

2. Mercer Limited is remunerated on a fixed retainer basis for a specified range of services, while any services that do not fall within the retainer are charged for on a time cost basis, subject to budgets agreed with the Trustees.