

## STATEMENT OF INVESTMENT PRINCIPLES

This is the Statement of Investment Principles made by the Trustees of the Newcastle Building Society Pension and Assurance Scheme (“the Scheme”) in accordance with the Pensions Act 1995 (as amended).

It is subject to periodic review by the Trustees at least every three years and at other times, as appropriate, and immediately on any significant change in investment policy.

In preparing this Statement, the Trustees consulted with the Principal Employer to the Scheme (The Newcastle Building Society) and have taken and considered written advice from the Investment Practice of Hymans Robertson LLP.

### **Scheme objective**

The primary objective 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’ overriding 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 having consulted the Principal Employer and considered the advice of 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 an investment manager.

The strategic benchmark is reflected in the choice and mix of funds in which the Scheme invests. The Scheme’s 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 bases 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 investments**

Given the size and nature of the Scheme, the Trustees have decided to invest on a pooled fund basis. The Trustees have appointed one investment manager Legal and General Investment Management Limited (“L&G”) which is authorised to undertake investment business.

The majority of Scheme assets are managed on a passive (index-tracking) basis by L&G. The objective of this passive allocation is to match, rather than exceed, the performance of the benchmark index of each fund in which investment is made. For each passive fund in which an investment is made, L&G selects stocks and securities in such a way as to replicate, as closely as possible, the composition of the benchmark index for that fund. The passive assets are invested in a mix of equities and UK government bonds (leveraged and unleveraged).

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 of each fund in which investment is made. The Scheme's active investments with L&G are through their Diversified Growth Fund ("DGF") and Maturing Buy & Maintain Credit funds - as at 30 June 2023, these accounted for c.£7.1m (9.8% of the Scheme's assets) and c.£22m (30.3% of the Scheme's assets) respectively. For the DGF, the majority of the exposure to different asset classes is achieved through L&G index funds. The DGF's asset allocation is systematically rebalanced on a monthly basis to reflect the fund's predetermined target asset allocation.

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. The Trustees review the performance of Scheme investments on a regular basis.

### **Manager engagement policy**

The Trustees have appointed L&G to deliver returns in line with a specific target or benchmark, which overall will align to deliver the broader Scheme investment strategy. The Trustees ensure that all manager engagements have clearly defined benchmarks, objectives and management parameters.

Remuneration for each mandate is determined at the inception of each mandate based on commercial considerations and typically set based on the value of assets under management. 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 agree to a fee structure where the manager is incentivised to deliver outperformance relative to an agreed benchmark.

The Trustees review the nature of Scheme investments on a regular basis, with particular reference to suitability and diversification. The Trustees seek and consider written advice from a suitably qualified person when determining the appropriateness of each 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 Trustees is proposed, appropriate advice is sought and considered to ensure its suitability. The Trustees recognise 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 Trustees 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 engages 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 their continued appropriateness within the investment strategy.

The Trustees monitor L&G's performance against their respective benchmarks or return targets on a semi-annual basis over a long term time horizon. L&G are expected to provide explanation for any significant deviations away from the benchmark or return target.

### Kinds of investments to be held

The Scheme may invest in quoted and unquoted securities of UK and overseas markets including equities, (levered and unlevered) fixed interest bonds, (levered and unlevered) index linked bonds, cash, property and commodities, either directly or through pooled funds (this includes the diversified growth fund). The Scheme may also invest in hedge funds and 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. The Trustees consider all of these classes of investment to be suitable in the circumstances of the Scheme.

The Trustees' policy is not to hold any employer-related investments as defined in the Pensions Act 1995, the Occupational Pension Schemes (Investment) Regulations 2005 and the Occupational Pension Schemes (Investment) (Amendment) Regulations 2010.

### Balance between different kinds of investments

The Scheme's active investment managers will 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.

### 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 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, diversified growth funds, bonds and cash, 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 Trustees have considered the risk of underperformance by any single investment manager and have attempted to reduce this risk by investing a large proportion of the Scheme passively. The Trustees assess the Scheme’s manager’s performance on a regular basis and also conduct an annual review of the investment manager’s audit reports and internal controls.

The Trustees do not expect managers to take excess short-term risk and will regularly monitor the manager’s performance against the benchmarks and objectives set on a short, medium and long terms basis.

The Trustees’ 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.

### **Portfolio turnover**

The Trustees have expectations of the level of turnover within each mandate which is determined at the inception of the mandate, based on the Trustees' knowledge of the manager, investment process and the nature of the portfolio. Whilst the Trustees expects performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustees expects 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. The Trustees will challenge the managers if there is a sudden change in portfolio turnover or if the level of turnover seems excessive.

### **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.

#### *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*

Within actively managed fund the manager has discretion and therefore the Trustees expect 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.

Within active mandates, the Trustees have delegated responsibility for the consideration of stock specific issues to their individual Investment Managers. The Trustees have 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.

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.

#### *Selecting investment managers*

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.

### **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.

### **Stewardship**

The Trustees recognise that stewardship encompasses the exercise of voting rights, engagement by and with investment managers and the monitoring of compliance with agreed policies.

#### *Voting and engagement*

The Trustees have 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 Trustees have reviewed the voting policies of their Investment Managers and determined that these policies are appropriate.

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.

#### *Monitoring*

The Trustees aim to meet with their Investment Managers on a periodic basis. The Trustees provide 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 Trustees 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.

### **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 are considering the Scheme's AVCs relative to the qualify features associated with this Code.

Signed for and on behalf of the Trustees of the Newcastle Building Society Pension and Assurance Scheme

Mick Thompson  
Chair of Trustees