Arriva Passenger Services National Pension Scheme: Money Purchase Sections

Statement of Investment Principles

Scope of Statement

This Statement has been prepared in accordance with Section 35 of the Pensions Act 1995 (as amended by the Pensions Act 2004, and the Occupational Pension Schemes (Investment) Regulations 2005).

The assets of the Scheme are held in trust by the Trustee. The Trustee will review this Statement and the Plan's investment strategy no later than three years after the effective date of this Statement; without delay after any significant change in investment policy; and whenever the Trustee deems that a review is needed for any other reason. The effective date of this statement is 30 September 2020.

The Trustee reviews the continuing suitability of the statement's policies on an annual basis in conjunction with the writing of the Plan's Implementation Statements.

Scheme Overview

The Scheme comprises the following money purchase sections:

- Additional Voluntary Contributions;
- DC transfers-in (Clerical Medical)
- DC transfers-in (LGIM)

Consultations Made

The Trustee is responsible for the investment strategy of the Scheme and, where appropriate, has obtained written independent advice on the investment strategy for the Scheme and on the preparation of this Statement. This advice was provided by Aon Solutions UK Limited who are authorised and regulated by the Financial Conduct Authority.

The day-to-day management of the Scheme's assets has been delegated to investment managers who are authorised and regulated by the Financial Conduct Authority. A copy of this Statement will be provided to the investment managers appointed and is available to the members of the Scheme on request and on publicly accessible websites including:
https://www.mypensionline.com/arrivadbscheme/library.aspx

Effective decision making

The Trustee recognises that decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. It also recognises that where it takes investment decisions, it must have sufficient expertise and appropriate training to be able to evaluate critically any advice received. The Trustee receives regular investment training from its investment consultant and investment managers in order to make informed decisions.

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Money Purchase Sections

Section	Benefit basis	Investment manager/ provider	Open to new members?	Open to new contributions?
AVCs	DC AVC funds	Clerical Medical / Scottish Widows	Yes	Yes
DC Transfers-in	Pure DC	Clerical Medical	No	No
		LGIM	No	No

Objectives and Policy for securing objectives

The Trustee's primary objectives are:

- "Asset choice" – to ensure members have an appropriate choice of assets for investment; and
- "Return objective" – to enable members to benefit from investment in growth assets until they approach retirement, when they will be able to switch to matching assets which are more related to the purchasing cost of their income and cash in retirement.

The Trustee has taken into account members' circumstances, in particular the range of members' attitudes to risk, term to retirement and potential retirement choices.

The Trustee's investment strategy has been chosen to enable members to maximise the likelihood of achieving these objectives. Following due consideration, the Trustee is satisfied that these investment options meet the requirement of Regulation 4 of the Investment Regulations.

Arrangements with Investment Managers

The Trustee recognises that members have differing investment needs and that these may change during the course of members' working lives. The Trustee also recognises that members have different attitudes to risk, and also that different members may wish to target different forms of benefit at retirement.

The Trustee believes that members should be able to make their own investment decisions based on their individual circumstances. The Trustee regards its duty as making available a range of investment options sufficient to enable members to tailor their investment strategy to their own needs, allowing members to build their own bespoke diversified investment portfolio if they so wish.

The Trustee monitors the investment options made available to Scheme members, including the default investment option. This considers the extent to which the investment strategy and decisions of the appointed investment managers are aligned with the Trustee's policies, as set out in this statement. +

This includes monitoring the extent to which investment managers:

- make decisions based on assessments about medium- to long-term 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 Trustee is supported in this monitoring activity by its advisers.

The Trustee receives reporting and verbal updates from its advisers on various items including the investment strategy, performance, and longer-term positioning of the strategy. The Trustee focusses on longer-term performance when considering the ongoing suitability of the investment strategy in relation to the Scheme's objectives and assesses the investment managers over the long-term.

If and when a new investment manager is appointed, the Trustee endeavours to review any required governing documentation associated with the investment and consider the extent to which it aligns with the Trustee's policies. Where necessary, the Trustee will seek to express its expectations to the investment managers to try to achieve greater alignment.

The Trustee believes that having appropriate governing documentation, setting clear expectations to the investment managers (e.g. verbally or in writing at time of appointment), and regular monitoring of investment managers' performance and investment strategy, is in most cases sufficient to incentivise the managers to make decisions that align with the Trustee's policies and are based on assessments of medium- and long-term financial performance.

Where investment managers are considered to be making decisions that are not in line with the Trustee's policies, expectations, or the other considerations set out above, the Trustee will endeavour to first engage with the manager and in the event of a material misalignment, could ultimately replace the manager if deemed necessary.

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

The Trustee does not monitor the underlying investments made by the investment managers on its behalf against non-financial criteria.

Investment risk measurement and management

The Trustee recognises that members take the investment risk. The Trustee takes account of this in the selection and monitoring of investment managers and the choice of funds offered to members.

The Trustee monitors the risk arising through the selection or appointment of investment managers on regular basis in-line with regulatory requirements.

The Trustee has appointed Aon to alert it to any matters of material significance that might affect the ability of the investment manager to achieve its objectives.

The Trustee acknowledges that investment returns achieved outside the expected deviation may be an indication that the investment manager is taking a higher level of risk than indicated.

Choosing Investments

The investment options offered to members are deemed appropriate, given the nature of the membership. Day-to-day selection of stocks is delegated to the investment managers appointed by the Trustee. The Trustee takes professional advice when formally reviewing the investment managers or funds offered to members.

The Trustee recognises that the key source of financial risk in relation to meeting its objectives normally arises from the choice of funds offered to members and retains responsibility for the asset choice and (where lifestyle options exist) allocation pattern via an individual matrix and takes expert advice as required from its professional advisers. A full range of available asset classes will be considered on an ongoing basis. This will include consideration of so called 'alternative' asset classes.

AVC Section

For members who do not wish to make an active decision regarding the investment of their assets, a default investment option has been put in place following consideration of the Scheme membership.

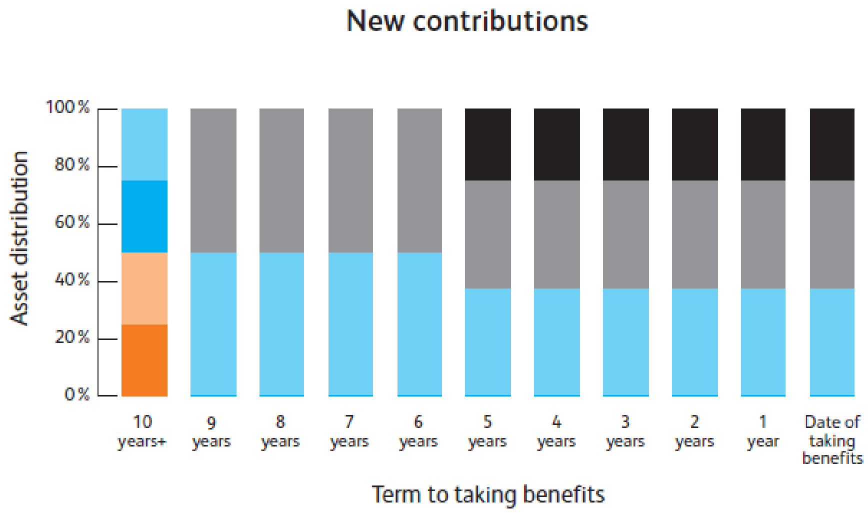
In setting this default investment option, the Trustee has reviewed the extent to which the return on investments (after deduction of any charges relating to those investments) is consistent with the objectives of the strategy, which is broadly to provide an appropriate risk/return profile given the needs of members.

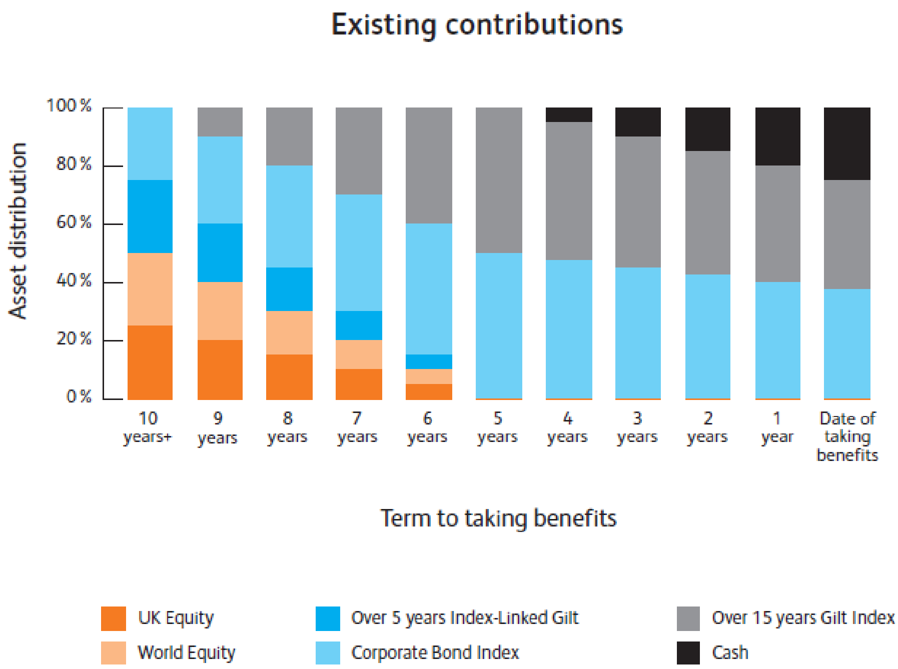
The Trustee reviews the appropriateness of the default investment option, as well as alternative investment options, in-line with regulatory requirements and may make changes from time to time. Members are advised accordingly of any changes.

Details of the default investment option is provided below.

<u>The BlackRock Cautious Lifestyle Option (the default investment option)</u>

The BlackRock Cautious Lifestyle Option initially invests 50% in global equities and 50% in index-linked gilts and corporate bonds. At 10 years to retirement the fund begins to reduce the amount invested in global equities and a higher proportion in index-linked gilts and corporate bonds. At retirement the lifestyle will have a 25% allocation to cash and 75% allocation to index-linked gilts and corporate bonds. The BlackRock Cautious Lifestyle Option glidepaths for new contributions and existing pension savings are shown below. The glidepath shows how the allocation of different funds changes as members approach retirement.





Default investment option: Rationale

The Trustee selected the BlackRock Cautious Lifestyle Option as the default investment option for the AVC section, as set out above, for those members of the Scheme who do not want to make a decision with regards their investments.

This choice of default investment option was taken following analysis of the existing membership of the Scheme. This analysis took into account factors such as age, projected fund values and likely retirement target.

The aim of the default investment option is to provide members with a diversified asset allocation during the accumulation of their retirement savings, and then to gradually de-risk their investment in the years approaching retirement, to reduce volatility.

The outcomes of the default investment option will be reviewed in-line with regulatory requirements.

DC transfers-in

The oversight exercised by the Trustee in respect of these sections meets the necessary regulatory requirements and is proportionate to the relatively small value that these arrangements represent as a proportion of any individual member's overall benefit entitlement.

Custody

Investment in pooled funds gives the Trustee rights to the cash value of the units rather than to the underlying assets. The underlying investment manager of each of the pooled funds is responsible for the appointment and monitoring of the custodian of the fund's assets.

Expected returns on assets

Over the long term the Trustee’s expectations are:

- for units representing “growth” assets, to achieve a return which provides a real return above the increase in price inflation over the same period. The Trustee considers short-term volatility in equity price behaviour as acceptable, given the general expectation that over the long-term equities will outperform the other major asset classes;
- for units representing monetary assets (corporate bonds and gilts), to achieve a rate of return which is expected to be approximately in line with changes in the cost of providing fixed income annuities or a cash sum at retirement.

Returns achieved by the investment managers are assessed against performance benchmarks set by the Trustee in consultation with its advisers and investment managers.

Potential Risks

The Trustee recognises that members take the investment risk. The Trustee takes account of this in the selection and monitoring of the investment manager and the choice of funds offered to members. and has considered risk from a number of perspectives.

The investment options made available to members have been chosen with the aim of enabling members to control the following risks:

- **Inflation risk**. The risk that the level of investment return over members' working lives will not keep pace with inflation and will not, therefore, secure an adequate retirement benefit.

- **Volatility risk**. The risk of significant short-term fluctuations in the value of members' invested capital which some members may be concerned about.

- **Capital risk**. The risk of a significant fall in the value of members' invested capital as they approach retirement.

- **Conversion risk**. The risk that relative market movements in the years just prior to retirement lead to a substantial reduction in benefits secured.

A number of other risks have also been considered when deciding on the investment options to make available to members:

- **Default investment option risk**. The risk of the default investment option being unsuitable for the requirements of some members. The Trustee has provided additional lifestyle and individual fund options in addition to the default investment option and has communicated to members the need to review their own requirements and circumstances before making any investment decisions.

- **Investment Manager Risk**. The risk that the selected investment managers underperform their objectives. The Trustee regularly reviews each fund's investment performance and takes ongoing advice from the investment adviser on the ongoing suitability of the funds and investment managers. The Trustee focuses on providing passive options that avoid active management risk.

- **Diversification Risk**. The Trustee has chosen funds that are constructed from well diversified portfolios of assets to reduce the stock specific risk faced by the Scheme.

- **Liquidity Risk**. Being forced to sell investments to pay benefits in unfavourable financial market conditions. The Trustee has invested in unitised pooled funds which are easily redeemable.

- **Geared or speculative investments using derivatives**. The Trustee has not invested in funds that are geared or make largely speculative use of derivatives.

- **Credit Risk**. The risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation. The credit risk the Scheme is exposed to arises from holdings in the underlying funds.

- **Market Risk**. The Scheme is subject to currency, interest rate and other price risk associated with the underlying investments. These risks can impact the valuations of the funds. The Trustee has selected a sufficient range of funds to be available to allow members to suitably diversify their investments to manage these risks. This is also considered when setting the lifestyle strategies. Further, the Trustee closely monitors the performance of the funds and receives formal reports from the investment adviser giving views on their continuing appropriateness, and that of the underlying investment managers.

- **The risk of fraud, poor advice or acts of negligence ("operational risk")**. The Trustee has sought to minimise such risk by ensuring that all advisers and third-party service providers are suitably qualified and experienced, and that suitable liability and compensation clauses are included in all contracts for professional services received.

Due to the complex and interrelated nature of these risks, the Trustee considers these risks in a qualitative rather than quantitative manner as part of each formal strategy review. The Trustee's policy is to review the range of funds offered and the suitability of the default investment option periodically.

These risks are considered as part of each formal strategy review. In addition, the Trustee's measure risk in terms of the performance of the assets compared to the benchmarks on a regular basis as part of each quarterly reporting cycle.

Realisation of Investment / Liquidity

The Trustee recognises that there is a risk of holding assets that cannot easily be realised should the need arise. The majority of assets held on behalf of members are realisable at short notice (through the sale of units in pooled funds).

Responsible Investment

In setting the Scheme's investment strategy, including the default investment option, the Trustee's 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. This includes 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 Trustee considers this risk by taking advice from their investment adviser when setting the Scheme's investment strategy (including the different options available to members), when selecting managers and when monitoring their performance.

Stewardship – Voting & Engagement

The Trustee invests in pooled funds and as such have delegated responsibility for the selection, retention and realisation of investments to the Scheme's investment managers in whose funds they invest.

The Trustee recognises the importance of its 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 creates long-term financial value for the Scheme and its beneficiaries.

As part of their delegated responsibilities, the Trustee expects 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 Trustee's voting rights in relation to the Scheme's assets.

The Trustee regularly reviews the continuing suitability of the appointed managers and takes advice from the investment adviser regarding any changes. Where appropriate, this advice includes stewardship matters and the exercise of voting rights by the appointed managers. If an incumbent manager is found to be falling short of the standards that the Trustee has set out in its Responsible Investment policy, the Trustee undertakes to engage with the manager and seek a more sustainable position (where possible) but may look to replace the manager.

The Trustee endeavours to review the stewardship activities of its investment managers in-line with regulatory requirements, covering both engagement and voting actions. The Trustee will review the alignment of its policies to those of the Scheme's investment managers and ensure the managers, or other third parties, use their influence as major institutional investors to carry out the Trustee's rights and duties as a responsible shareholder and asset owner. This will include voting, along with – where relevant and appropriate – engaging with underlying investee companies and assets to promote good corporate governance, accountability, and positive change.

In-line with regulatory requirements, the Trustee expects managers to provide aggregate voting information at a fund level and voting rationale for significant votes (defined as where votes were cast against management or where voting differed from the standard voting policy of the manager).

The Trustee will engage with its investment managers, as necessary, for more information to ensure that robust active ownership behaviours, reflective of its active ownership policies, are being actioned. From time to time, the Trustee will consider the methods by which, and the circumstances under which, it would monitor and engage with an issuer of debt or equity, an investment manager or another holder of debt or equity, and other stakeholders. The Trustee 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.

This advice includes consideration of broader stewardship matters and the exercise of voting rights by the appointed managers.

Members' Views and Non-Financial Factors

On a reactive basis, the Trustee considers views from members and other stakeholders, including views in relation to social and environmental impact, or views with respect to non-financial matters.

In setting and implementing the Scheme's investment strategy, the Trustee does 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").

The underlying funds that make up the default investment option or other accessible funds should not apply personal ethical or moral judgements as the sole basis for an investment decision.

Alignment with wider corporate sustainability policies and practices

Although cognisant of the Employer's policies, the Trustee is not currently looking to integrate its own policies and practices with those of the Employer. This position will be considered in-line with regulatory requirements.

Costs & Transparency

Adviser related costs

The Trustee's advisers are paid for advice received on the basis of the time spent on appropriate work. For significant areas of advice (for example large projects, such as a review of the lifestyle strategies), the Trustee may agree a project budget. These arrangements recognise the bespoke nature of the advice given, and that no investment decisions have been delegated to the adviser**.** These costs are not met by members and are not included in member borne costs.

Member borne costs

It is the Trustee's view that long term performance, net of fees, is the most important metric on which to evaluate its investment managers.

Investment managers are remunerated by the deduction of set percentages of assets under management. This is in-line with market practice and avoids a short-term approach to investment performance that may be the result of any performance-related fees. The Trustee therefore believes it is important to understand all the different costs and charges, which are paid by members (through a deduction from the unit price). These include:

- explicit charges, such as the annual management charge, and additional expenses that are disclosed by investment managers as part of the Total Expense Ratio ('TER');
- implicit charges, such as the portfolio turnover costs (transaction costs) borne within a fund. The Trustee defines portfolio turnover costs as the costs incurred in buying and selling underlying securities held within the fund's portfolio. These are incurred on an ongoing basis and are implicit within the performance of each fund.

The Trustee collects information on these member-borne costs and charges in-line with regulatory requirements, where available, and sets these out in the Scheme's annual Governance Statements which are made available to members in a publicly accessible location.

No specific ranges are set for acceptable costs and charges, particularly in relation to portfolio turnover costs. However, the Trustee expects its advisers to highlight if these costs and charges appear unreasonable when they are collected as part of the annual Governance Statement exercise.

In general, the Trustee believes that low cost passive funds offer good value for money, for members, and these should be used in a default investment option. However, it also believes that there can be opportunities for active managers to add value and accordingly may make available active funds either as part of the default investment option or on a self-select basis.