Statement of Investment Principles for the HSBC Bank (UK) Pension Scheme – DC Sections

1. Introduction

This Statement of Investment Principles ("SIP") sets out the policy of the HSBC Bank Pension Trust (UK) Limited ("the Trustee") on various matters governing decisions about the investments of the HSBC Bank (UK) Pension Scheme ("the Scheme"). The Scheme consists of three sections; the HBUK Section, the HSBC Global Services Section and the HSBC Bank plc Section. Each section provides Defined Benefit ("DB") and Defined Contribution ("DC") benefits. This SIP covers the DC benefits of all three sections, and replaces the previous SIP dated September 2019. For details on the Scheme's DC investment arrangements, please see the separate Investment Policy Implementation Document ("IPID").

The SIP is designed to meet the requirements of Section 35 (as amended) of the Pensions Act 1995 ("the Act"), the Occupational Pension Schemes (Investment) Regulations 2005, and the Occupational Pension Schemes (Charges and Governance) Regulations 2015.

This SIP has been prepared after obtaining and considering written professional advice from LCP, the Scheme's DC investment adviser, whom the Trustee considers to be suitably qualified and experienced to provide such advice. The advice takes into account the suitability of investments, including the need for diversification, given the circumstances of the Scheme, and the principles contained in this SIP. The Trustee has consulted with the relevant employers in producing this SIP.

The Trustee will review this SIP from time to time and, with the help of its advisers, will amend it as appropriate. These reviews will take place as soon as practicable after any significant change in investment policy, or in the demographic profile of the relevant members, and at least once every three years.

Appendix 1 sets out details of the respective key responsibilities of the Trustee, platform provider, investment adviser and investment managers. It also contains a description of the basis of remuneration of the investment adviser and the investment managers.

Appendix 2 sets out the Trustee's policy towards risk measurement and management.

2. Investment objectives

The Trustee's primary objectives are to provide members with access to:

- an appropriate range of investment options, reflecting the membership profile and the variety of ways that members can draw their benefits in retirement; and
- a default investment option that the Trustee believes to be reasonable for those members that do not wish to make their own investment decisions. The Scheme's default options' objectives are to generate returns significantly above inflation whilst members are some distance from retirement, but then to switch automatically and gradually to lower risk investments as members near the taking of their DC pot.

3. Investment strategy

The Trustee has made available a range of investment funds for members. Each member is responsible for specifying one or more funds for the investment of their account, having regard to their attitude to the risks involved. If a member does not choose an investment option, their account will be invested into a default option, deemed most appropriate to them, which is managed as a "lifecycle" strategy (ie it automatically combines investments in proportions that vary according to the time to retirement age).

The Scheme has different default strategies for members, depending on the type of benefits they have. The default options have been designed to be in line with what the Trustee believes to be the best interests of the majority of the members based on the demographics of the Scheme's membership.

For members with only DC benefits, the main default option targets flexible income drawdown at retirement, since the Trustee believes that most of these members will wish to take their benefits in this form. Therefore, the initial growth phase is invested to target a return significantly above inflation, and then in the 20 years before retirement, it switches gradually into less risky assets, with the asset allocation at retirement being designed to be appropriate for members who wish to flexibly take their benefits through an income drawdown arrangement or remain invested in the Scheme. This default lifecycle continues to move into less risky assets in the 5 years following a member's target retirement age; providing further gradual de-risking for members who may not have updated their target retirement age despite deciding to retire at an older age.

For members with both DC and DB benefits in the Scheme, known within the Scheme as Hybrid members, the main default option targets a cash lump sum at retirement, because the Trustee believes that most of these members will wish to take their DC benefits in this form. Similar to the main default for DC members, the initial growth phase targets a return significantly above inflation, and then in the 20 years before retirement, it switches gradually into less risky assets, into an asset allocation at retirement designed to be appropriate for member taking a cash lump sum. This default lifecycle for Hybrid members also continues to move into less risky assets in the 5 years following a member's target retirement age; providing further gradual de-risking for members who may not have updated their target retirement age despite deciding to retire at an older age.

In addition to the two main defaults, the Scheme also currently offers an alternative lifecycle strategy; one designed to be appropriate for members who wish to purchase an annuity at retirement. This strategy was the previous main default for DC members of the Scheme and, as members did not make a choice to invest in this strategy, this lifecycle continues to be considered a default by the Trustee for the purpose of fulfilling legislative requirements.

As well as the three lifecycle strategies noted above, the Scheme also makes use of a temporary fund called the Cash - active (ex-Property) Fund. This fund was introduced as a result of a decision taken to temporarily close the Property – active Fund (due to the suspension of trading by two of the underlying managers) so that contributions could be redirected into the Cash - active (ex-Property) Fund until such time as the Property – active Fund could reopen. As members' contributions are to be directed into this fund without them making an active selection, this fund will be treated as a default for the purpose of fulfilling legislative requirements. The objective of the fund is 'To protect the absolute value of the investment by investing in deposits and other short-term money market instruments. The fund aims to perform in line with the benchmark.

The Trustee also operates four legacy lifecycle strategies known as Capital Lifecycle, Cash Lifecycle, Flexicycle and Lifecycle 2. Whilst closed to new member investment, members invested at the time of closure are able to continue to contribute to these strategies. The Cash Lifecycle is a legacy version of the existing main defaults for Hybrid members of the Scheme and, as members did not make a choice to invest in this strategy, this lifecycle also continues to be considered a default by the Trustee for the purpose of fulfilling legislative requirements. Flexicycle uses a similar strategy structure to the lifecycles but allowed members some flexibility to choose between a number of funds to invest in during the growth phase and the de-risking phase, and decide when to switch between the phases. Members invested in Flexicycle when it was closed to new member investments are no longer able to amend their fund selections within the strategy. Lifecycle 2 makes greater use of active management and has an asset allocation at retirement suitable for members looking to purchase an annuity at retirement.

The Trustee will monitor the relevant members' behaviour to check whether assumptions made about how members will access their benefits are borne out in practice.

4. Considerations made in determining the investment arrangements

When deciding how to invest the Scheme's assets, the Trustee considers a number of risks, including, but not limited to, those set out in Appendix 2. Some of these risks are more quantifiable than others, but the Trustee has tried to allow for the relative importance and magnitude of each risk.

The Trustee considered a wide range of asset classes for investment, and the expected returns and risks associated with those asset classes.

In determining the investment arrangements, the Trustee also takes into account:

- the best interests of all members and beneficiaries;
- the profile of the membership and what this is likely to mean for the choices members might make upon reaching retirement;
- the risks, rewards and suitability of a number of possible asset classes and lifecycle strategies and whether the return expected for taking any given investment risk is considered sufficient given the risk being taken;
- the need for appropriate diversification within the default strategies and other lifecycle options to ensure that, for each such option, both the overall level of investment risk and the balance of individual asset risks are appropriate;
- the need for appropriate diversification within the other investment options offered to members; and
- the Trustee's investment beliefs about how investment markets work and which factors are most likely to impact investment outcomes.

The Trustee's key investment beliefs are set out below:

- active management can only be profitably harnessed by skilful managers in selected asset classes, and where appropriate skilful managers can be identified by the Trustee, its Pension Scheme Executive and its advisers;
- mandates that either access non-mainstream markets and/or systematically replicate active managers more cheaply (known as 'Smart beta'), are preferable solutions for some asset classes;
- environmental (including climate change risks), social and governance issues are all important factors in investment decision making;
- both qualitative and quantitative factors should be taken into account in evaluating investment risk, so that risk can be properly accessed and, where practical, managed;

- any conflict of interest between the Trustee, as asset owners, and their agents (advisors, fund managers, Pension Scheme Executive) should be monitored and managed;

- there are exploitable risk premiums over the long term from; equities, credit, illiquid assets and selected emerging markets;
- there can be a first mover advantage for investors who are able to react swiftly to new investment opportunities;
- the Trustee's governance budget (money and time) should be focussed on investment decisions that will have the greatest positive effect on member outcomes;
- the Trustee believes investment delivering an appropriate risk adjusted return can also have a social impact;
- DC communications should be tailored to maximise the probability of individual members making well-informed investment decisions;
- investment management costs and fees, including transaction costs, should be transparent; and
- The Trustee aims to accommodate DC members who wish to invest in active funds.

The Trustee's key investment beliefs and understanding of the Scheme's membership are reflected in the design of the default and other lifecycle options, and in the range of other funds made available to members.

5. Implementation of the investment arrangements

Before investing in any manner, the Trustee obtains and considers proper written advice from its investment adviser on the question of whether the investment is satisfactory, having regard to the need for suitable and appropriately diversified investments.

Details of the investment managers are set out in the separate IPID.

The Trustee has entered into a contract with a platform provider, who makes available to members a range of eighteen different funds that can be accessed through three distinct structures; Lifecycle, Flexicycle or Freechoice. There is no direct relationship between the Scheme and the underlying investment managers of the DC investment funds.

The investment managers' primary role is the day-to-day investment management of the Scheme's investments. The managers are authorised under the Financial Services and Markets Act 2000 (as amended) to carry out such activities.

The Trustee and investment managers to whom discretion has been delegated exercise their powers to giving effect to the principles in this SIP, so far as is reasonably practicable.

The Trustee selects the investment managers with an expectation of a long-term arrangement, which encourages active ownership of the underlying assets, which is discussed further in Section 7. When assessing a manager's performance, the focus is on longer-term outcomes, and the Trustee would not expect to terminate a manager's appointment based purely on short term performance. However, a manager's appointment could be terminated within a shorter timeframe due to other factors such as a significant change in business structure, the investment team or agreed contractual terms.

Alignment between a manager's management of each pooled fund's assets and the Trustee's policies and objectives are a fundamental part of the appointment process of a new manager. The following steps are taken to encourage alignment between the Scheme and the managers:

- Before investing, the Trustee will seek to understand the manager's approach to sustainable investment (including engagement). The Trustee has limited influence over managers' investment practices because all the Scheme's assets are held in pooled funds, however the Trustee will ensure the investment objectives and guidelines of the vehicle are consistent with its own objectives, set out in Section 7.
- To maintain alignment, managers are provided with the most recent version of the Scheme's SIP which includes the Trustee's policy on sustainable investment, on an annual basis and are required to explicitly confirm that the assets are managed in line with the Trustee's policies as outlined in those documents.
- Should the Trustee's monitoring process reveal that a manager's portfolio is not aligned with the Trustee's policies, the Trustee will engage with the manager further to encourage alignment. This monitoring process includes specific consideration of the sustainable investment/ESG characteristics of the portfolio and managers' engagement activities. If, following engagement, it is the view of the Trustee that the degree of alignment remains unsatisfactory, the manager will be terminated and replaced.

Managers are paid an ad valorem fee, in line with normal market practice, for a given scope of services which includes consideration of long-term factors and engagement. The Trustee reviews the costs and value for money incurred in managing the Scheme's assets annually, which includes the costs associated with portfolio turnover. In assessing the appropriateness of the portfolio turnover costs at an individual manager level, the Trustee will have regard to the actual portfolio turnover and how this compares with the expected turnover range for that mandate.

6. Realisation of investments

The investment managers have discretion over the timing of realisation of investments of the Scheme within the portfolios that they manage, and in considerations relating to the liquidity of investments.

The Trustee's policy is to invest in funds that offer daily dealing to enable members to readily realise and change their investments.

7. Environmental, social and governance ("ESG") and other financially material considerations

As stated in section 4, one of the Trustee's investment beliefs is that Environmental (including Climate Change risks), social and governance risks are all important factors in investment decision making.

In setting the investment strategy for the Scheme's default investment options, and the alternative lifecycle strategies, the Trustee's primary objective is to generate returns significantly above inflation whilst members are some distance from retirement and to switch gradually to lower risk investments as members approach their target retirement date.

ESG factors, including climate change can have a material financial impact on the value of the default investment options, and the alternative lifecycle strategies, over the time horizon applicable to members invested in them. The Trustee therefore believes that by taking such factors into account in its investment process, the Scheme is better positioned to deliver on its objectives.

The Trustee takes account of ESG factors when setting the asset allocation for the default investment options, and the alternative lifecycle strategies, and when selecting (and monitoring the performance of) its appointed investment managers. For most of the Scheme's investments, the Trustee expects the investment managers to invest with a long time horizon, and to use their engagement activity to drive improved performance over these periods.

The Trustee adopts the following approach in relation to the selection (and monitoring) of investment managers:

- In relation to funds where the investment manager is permitted to make active decisions about the selection, retention and realisation of investments the Trustee expects the investment managers to take steps to ensure financially material considerations (including climate change and other ESG considerations) are implicitly incorporated into the investment decision-making process where permissible within applicable guidelines and restrictions. The Trustee undertakes regular reviews to ensure the policy is being carried out effectively and in line with evolving good practice. Within some asset classes, where it is possible in the context of DC operational constraints, the Trustee considers investment options that give increased weight to ESG considerations. An investment fund that explicitly combines investment return with climate factors in the selection, retention and realisation of assets is included in the lifestyle strategies provided to the DC members of the Scheme (with the exception of Lifecycle 2 and some members within Flexicycle) and is also available as a Freechoice option. The Trustee regularly monitors the performance and ESG risk mitigation offered by this investment option and would consider replacing the fund should either the performance or ESG-related objectives of the fund become misaligned with Trustee beliefs or expectations.

The Trustee recognises climate change as a systematic, long-term material financial risk to the value of the Scheme's investments. Therefore, the Trustee has a fiduciary duty to consider climate change risk when making investment decisions. Within the context of its fiduciary responsibility, the Trustee is supportive of the Paris Agreement to avoid dangerous climate change by limiting global warming to well below 2°C above pre-industrial levels and pursuing efforts to limit it to 1.5°C. In this context, the Trustee:

- Expects its appointed investment managers to be cognisant of climate change risks and opportunities within their investment processes as applied to the assets of the Trustee. Investment managers are further expected to annually report on how these risks and opportunities have been incorporated into the investment process within applicable guidelines and restrictions;
- Has a preference for 'Engagement' rather than 'Exclusion' as a method of incorporating climate change risks into an effective fiduciary framework. However, the Trustee expects investment managers to independently consider whether exclusion or engagement is more appropriate within their investment process;
- Encourages the further development of asset classes that are supportive of achieving the well below 2°C target provided they are all based within the primary fiduciary framework;
- Supports the Task Force on Climate-related Financial Disclosures (TCFD) and aims to incorporate its recommendations into the Scheme's reporting, subject to data availability;
- Supports the further development of effective climate change risk metrics to enhance the ability of all stakeholders in the investment chain to assess and minimise such risks;
- Supports the Transition Pathway Initiative and will use the analysis to review material exposures to the world's largest emitters and inform impactful engagement strategies through its asset managers, in line with the Trustee's investment beliefs;

- Recognises that 'Climate Change' will be subject to much further analysis and subsequent policy changes in the coming years. The Trustee is supportive of adopting an evolving policy in order to ensure all relevant developments are captured; and

- Is supportive of policy initiatives that, in its opinion, contribute towards achieving the well below 2°C target.

The Trustee will support Responsible Investment organisations or initiatives where in doing so will help the trustee achieve at least one of the following goals:

- Help to implement new Responsible Investment solutions in a proportionate and practical way with a clear focus on excellence and continuous improvement;

- Influence government policy, market developments and pension funds with respect to Responsible Investment;

- Improve the risk and return characteristics of investments to improve the financial outcomes for members;

- Improve transparency in reporting, being generous with knowledge and helping to shape new ideas within Responsible Investment.

Currently the Trustee is associated with the following organisations:

- A member of the Institutional Investor Group on Climate Change ("IIGCC")

- A member of the Cambridge Institute for Sustainability Leadership ("CISL")

- A signatory to the Principles for Responsible Investment ("PRI")

- A supporter of the Transition Pathway Initiative ("TPI")

- A supporter of Climate Action 100+

The Trustee recognises that it cannot support all organisations or initiatives and so will review its associations periodically. The Trustee will disclose successes and learnings from its associations on an annual basis.

The Trustee also has a policy of avoiding investments in controversial weapons manufacturers on grounds of financial risk, as it believes this is in the best financial interests of the Scheme and its members. Where the financial implications of excluding controversial weapons manufacturers (either due to increased costs to members or reduced investment opportunities) are, in the opinion of the Trustee, greater than the financial risks of including them, some exposure to controversial weapons manufacturers may be maintained. The Trustee has a policy of requesting that each of its appointed fund managers' report on an annual basis as to their exposure to controversial weapons manufacturers, if any.

8. Members' Views and Non-Financial Factors

The Trustee does not take into account any non-financial matters (ie matters relating to the ethical and other views of members and beneficiaries, rather than considerations of financial risk and return) in setting the investment strategy for the Scheme's default investment options. However, it recognises the importance of offering a suitable range of investment options for members who wish to express an ethical preference in their pension saving.

The Trustee has made the following Freechoice options available to members who would like to invest in funds with specific non-financial considerations:

- Sustainable & Responsible Equities – Active
- Shariah Law Equities – Passive

The Trustee keeps up to date with other fund options available in the market via updates from its investment advisors.

9. Stewardship

The Trustee has examined how rights, including voting rights, attached to investments should be exercised. The Trustee recognises its responsibilities as shareholders being the owners of capital, and believes that good stewardship practices including monitoring and engaging with investee companies, and exercising voting rights attaching to investments, protects and enhances asset owner value in the long term.

The Trustee has delegated to its investment managers the exercise of rights attaching to investments, including voting rights, and engagement with issuers of debt and equity and other relevant persons about relevant matters such as performance, strategy, risks, capital structure, conflicts of interest and ESG considerations. The Trustee expects its investment managers to exercise ownership rights and undertake monitoring and engagement in line with the managers' general policies on stewardship, which reflect the recommendations of the UK Stewardship Code issued by the Financial Reporting Council, and which are provided to the Trustee from time to time, taking into account the financial interests of the beneficiaries.

The Trustee seeks to appoint managers that have strong stewardship policies and processes. While the Trustee chooses managers with an aim to align their beliefs on stewardship, and there is a degree of influence, the Trustee has less direct influence over the managers' policies on the exercise of investment rights where assets are held in pooled funds; this is due to the collective nature of these investments.

The Trustee monitors and regularly reviews the ownership rights that it has delegated to its investment managers as well as how the investment managers have voted and engaged with the companies in which they invest. This process is to ensure the policy is also being carried out effectively and in line with evolving good practice.

Version adopted at a meeting of the Trustee board on 24 June 2020.

Responsibilities, decision-making and fees

The Trustee has decided on the following division of responsibilities and decision-making for the Scheme. This division is based upon the Trustee's understanding of the various legal requirements placed upon it, and its view that this division allows for efficient operation of the Scheme overall, with access to an appropriate level of expert advice and service. The Trustee's investment powers are set out within the Scheme's governing documentation.

1. Trustee

In broad terms, the Trustee is responsible in respect of investment matters for:

- setting the investment strategy, in consultation with the employers;
- developing a mutual understanding of investment and risk issues with the employers;
- reviewing the investment policy as part of any review of the investment strategy;
- setting the policy for rebalancing between asset classes;
- appointing (and, when necessary, dismissing) investment managers, investment advisers and other service providers;
- monitoring the exercise of the investment powers that they have delegated to the investment managers and monitoring compliance with Section 36 of the Act;
- formulating a policy on taking account of non-financial factors when making investment decisions and a policy on voting rights;
- communicating with members as appropriate on investment matters, such as the Trustee's assessment of its effectiveness as a decision-making body, the policies regarding responsible investment and how such responsibilities have been discharged;
- putting effective governance arrangements in place and documenting these arrangements in a suitable form;
- reviewing the content of this SIP from time to time and modifying it if deemed appropriate; and
- consulting with the employers when reviewing the SIP.

The Trustee has delegated responsibility for a number of investment matters to an Asset and Liability Committee ("ALCo"). This committee is responsible for selecting, monitoring the performance of and, when required, replacing investment managers and ensuring that the high-level strategy and beliefs set by the Trustee are implemented effectively.

The Trustee has appointed a Chief Investment Officer ("CIO") to the Pension Scheme Executive. It is the responsibility of the CIO to liaise with the Scheme's advisers to ensure that the procurement of legal and investment advice and their input to the Trustee's decision making process are optimised from the Trustee's perspective.

2. Platform provider

The investment platform provider will be responsible for:

- providing access to a range of funds managed by various investment managers; and

- providing the Trustee with regular information concerning the management and performance of the assets.

3. Investment managers

In broad terms, the investment managers will be responsible for:

- managing the portfolios of assets according to their stated objectives, and within the guidelines and restrictions set out in their respective investment manager agreements and/or other relevant governing documentation;
- taking account of financially material considerations (including climate change and other ESG considerations) as appropriate when managing the portfolios of assets;
- exercising rights (including voting rights) attaching to investments and undertaking engagement activities in respect of investments;
- providing the investment platform provider with regular information concerning the management and performance of their respective portfolios; and
- having regard to the provisions of Section 36 of the Act insofar as it is necessary to do so.

The custodians of the portfolios (whether there is a direct relationship between the custodian and the Trustee or not) are responsible for safe keeping of the assets and facilitating all transactions within the portfolios.

The Trustee, the CIO and its adviser will have regular meetings with the investment managers and platform provider to ensure they continue to carry out their work competently and have the appropriate knowledge and experience to manage the investments of the Scheme.

4. Investment adviser

In broad terms, the investment adviser will be responsible, in respect of investment matters, as requested by the Trustee, for:

- advising on a suitable fund range and default strategies for the Scheme, and how material changes to legislation or within the Scheme's benefits and membership may impact this;
- advising on the selection, and review, of the investment managers; and
- participating with the Trustee in reviews of this SIP.

5. Fee structures

The Trustee recognises that the provision of investment management and advisory services to the Scheme results in a range of charges to be met. These platform, investment management and advisory charges are met entirely by the Employers and are not deducted from members' assets. Depending on the fund invested in, members are liable for paying the additional expenses charged by the investment managers. The Trustee monitors the level of additional expenses charged by managers to ensure that they remain appropriate.

The Trustee has agreed Terms of Business with the Scheme's investment advisers, under which work undertaken is charged for by an agreed fixed fee or on a "time-cost" basis.

6. Performance assessment

The Trustee is satisfied, taking into account the external expertise available, that there are sufficient resources to support its investment responsibilities. The Trustee believes that it has sufficient expertise and appropriate training to carry out its role effectively.

It is the Trustee's policy to assess the performance of the Scheme's investments, investment providers and professional advisers from time to time. The Trustee will also carry out periodically an assessment of its own effectiveness as a decision-making body and will decide how this may then be reported to members.

Policy towards risk, risk measurement and risk management

The Trustee considers that there are a number of different types of investment risk that are important for the Scheme. These include, but are not limited to:

1. Volatility and the risk of inadequate returns

As members' benefits are dependent on the investment returns achieved, it is important that investment options are available which can be expected to produce adequate real returns over the longer term. It is also important that members are offered a range of funds with varying levels of return and consequent volatility to allow members to invest according to their individual risk tolerances and circumstances. Members are offered lifecycle strategies that reduce risk by moving to less volatile assets as they approach retirement.

On this basis, equity and equity-based funds, which are expected to provide positive returns above inflation over the long term, have been made available to members and feature in the growth phase of the default strategies. To reduce the chance of a sharp deterioration in members' benefits close to retirement, the Trustee has made the default options in the form of lifecycle strategies that gradually reduce investment risk as the member approaches their target retirement date.

2. Inflation risk

There is a risk that a member's investments won't grow quickly enough to sufficiently outpace inflation (the cost of living). Even if they do grow in value, if they don't grow quicker than inflation then their real value goes down. This can happen with low capital risk funds, like a cash fund. It is measured by examining periodically the long-term performance of different assets relative to inflation.

It can be managed by investing in growth assets that are expected to produce returns that exceed long term inflation within both the default and Flexicycle arrangements and the range of funds available to members to choose

3. Risk from lack of diversification

This is the risk that failure of a particular investment, or the general poor performance of a given investment type, could materially adversely affect the Scheme's assets. The Trustee believes that the Scheme's default strategies are adequately diversified between different asset classes and within each asset class, and that the options provide a suitably diversified range for members to choose from. This was a key consideration when determining the Scheme's investment arrangements.

4. Investment manager risk

This is the risk that an investment manager fails to meet its investment objectives. Prior to appointing an investment manager, the Trustee receives written advice from a suitably qualified individual, and will typically undertake an investment manager selection exercise. The Trustee and its adviser monitor the investment managers on a regular basis.

5. Liquidity/marketability risk

This is the risk that core financial transactions, such as investing members' contributions, are not processed promptly due to lack of liquidity in the investments. The Trustee manages this risk by only using pooled funds with daily dealing within the default strategies and diversifying the strategy across different types of investment.

6. Risk from excessive charges

While the Employers cover the cost of management fees, members are still liable for the additional expenses charged by investment managers. If the additional expense charges together with other charges, for example transaction costs, are excessive, then the value of a member's account will be reduced unnecessarily. The Trustee is comfortable that the additional expenses and other charges payable by members are in line with market practice and assess regularly whether these represent good value for members.

7. Credit risk

This is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The Scheme is subject to credit risk because it invests in bonds via pooled funds. The Trustee manages its exposure to credit risk by only investing in pooled funds that have a diversified exposure to different credit issuers. The Scheme invests in some funds which invest in bonds that are classified as both "investment grade" and "non-investment grade"; the latter carrying greater credit risk but having a higher yield to compensate investors.

8. Market switching risk

The risk is that, where members choose to switch between investment funds, they are exposed to a cost of switching which is variable according to the conditions prevailing in the relevant markets at a particular point in time. It is measured by looking at the underlying spreads of the fund options. It is managed by the fund managers looking for best execution when implementing trades.

9. Currency risk

Whilst the majority of the currency exposure of the Scheme's assets is to Sterling, the Scheme is subject to currency risk because some of the Scheme's investments are held in overseas markets. The Trustee considers the overseas currency exposure in the context of the overall investment strategy, and believes that the currency exposure that exists diversifies the strategy and is appropriate. Furthermore, the Trustee manages the amount of currency risk by offering lifecycle strategies that invest in pooled funds with various levels of hedged currency exposure.

10. Annuity conversion risk

When a member retires, they may use their account to secure an annuity. The cost of buying an annuity varies from time to time and depends partly on the price of bonds. It is measured by examining periodically the correlation of different assets to annuity prices.

It is managed in the default strategies by the Income Lifecycle switching funds into Fixed Income Bonds as the member approaches retirement.

11. Securities lending risks

Through the act of securities lending, investors lend securities (such as stocks or bonds) to a third party (the borrower). The borrower gives the lender collateral in the form of cash, stocks, or bonds. In addition to providing the collateral plus a cash margin, the borrower pays the lender to borrow the securities. The process provides investment markets with liquidity, and allows security holders the chance to achieve additional returns on their portfolios, but incurs a number of risks.

- Counterparty risk – the risk that lenders or their lending agents may default on their loan and be unable to return the securities borrowed;
- Cash reinvestment risk – when the lender receives cash as collateral, this cash is often reinvested. The lender's objective is to generate income; however the lender is then also exposed to additional investment risks including the potential loss of principal;
- Non-cash collateral risk – the additional risk involved in receiving assets other than cash as collateral; and
- Operational risk – the risk of engaging in securities lending. For example, market or exchange problems, miscommunication between parties, incorrect records, etc.

The Trustee manages this risk by ensuring that, where possible, investment managers' policies toward securities lending are in line with the Trustee's beliefs.

12. Climate change risk

Climate change risk is considered to be a systemic risk by the Trustee, though it is difficult to measure with a simple number.

Climate change risk is managed through a combination of both positive and negative tilts where appropriate (Global Equities) as well as a robust engagement policy via the Trustee's appointed fund managers. See the detailed climate change policy in section 7 – Consideration of financially material and non-financial factors.

13. Other environmental, social and governance (ESG) risks

ESG factors are sources of risk to the Scheme's investments which could be financially material over both the short and longer term. The Trustee seeks to appoint investment managers who will manage these risks appropriately on its behalf and regularly reviews how these risks are being managed in practice.