Statement of Investment Principles

International Power Group of the Electricity Supply Pension Scheme

1. Introduction

This Statement of Investment Principles (“SIP”) has been produced by the Trustee of the International Power Group of the Electricity Supply Pension Scheme.

It sets out our policies on various matters governing investment decisions for the International Power Group of the Electricity Supply Pension Scheme (“the Scheme”), which is a Defined Benefit (“DB”) Scheme.

This SIP replaces the previous SIP dated December 2021.

This SIP has been prepared after obtaining and considering written advice from LCP, our investment adviser, whom we believe to be suitably qualified and experienced to provide such advice. The advice considered the suitability of investments including the need for diversification given the circumstances of the Scheme and the principles contained in this SIP.

We have consulted with the relevant employer in producing this SIP.

We will review this SIP from time to time and will amend it as appropriate. Reviews will take place without delay after any significant change in investment policy.

This SIP contains the information required by legislation, and also considers the Pension Regulator’s guidance on investments.

2. Investment objectives

The primary objective for the Scheme is to ensure that the benefit payments are met as they fall due.

A secondary objective of the Scheme is to secure guaranteed benefits with an insurance company in the future.

In addition to these objectives, we have the following objectives:

- that the expected return on the Scheme assets is maximised whilst managing and maintaining risk at an appropriate level; and
- that the Scheme aims to be fully funded on a ‘gilts flat’ basis.

3. Investment strategy

With input from our advisers and in consultation with the employer, we reviewed the investment strategy, considering the objectives described in Section 2.

Our policy is to target the maximum expected return level subject to ensuring the level of investment risk is appropriate to reflect the Scheme’s circumstances.

Based on advice received from the Investment Adviser the Trustee has translated its objectives into a suitable strategic asset allocation benchmark for the Scheme, with a reasonable balance between holding assets that are expected to deliver long term growth; assets delivering income to help meet the Scheme’s cashflow needs; and assets designed to match movements in the value placed on the Scheme’s accrued liabilities.

As the Scheme matures over time, we intend to de-risk the investment strategy to reflect the change in the liability profile (ie switching from growth to matching assets).

We have put in place a mechanism to de-risk the investment strategy following improvements in the funding level. The objective of this mechanism is to lock in gains following better than expected investment experience. We review the de-risking mechanism on a regular basis.

We have a leverage management plan in place which sets out the assets directly available to support the Scheme’s LDI arrangements and the approach that is expected to be taken with regard to selling down any other assets to support the LDI arrangements. We review and update the plan periodically.

4. Considerations in setting the investment arrangements

When deciding how to invest the Scheme’s assets, it is our policy to consider a range of asset classes, taking account of the expected returns and risks associated with those asset classes, as well as our beliefs about investment markets and which factors are most likely to impact investment outcomes.

We take an integrated approach when assessing risk and reviewing the investment strategy. In particular we take account of: the employer covenant, contributions, funding targets, liability profile (including interest rate and inflation sensitivities and the extent to which they are hedged) and the level of expected return and risk now and as the strategy evolves.

The primary ways that we manage investment risk are via asset diversification, ensuring that we receive professional written advice prior to making any material

investment decision, and our ongoing monitoring and oversight of the investments. For the DB Section investment risk is measured using "Value at Risk". Further details of specific risks (for example equity risk, credit risk and currency risk) and how we measure and manage those risks is set out in Part 2 of Appendix 1.

In setting the strategy it is our policy to consider:

- our investment objectives, including the target return required to meet these
- the circumstances of the Scheme, including the profile of the benefit cash flows (and the ability to meet these in the near to medium term), the funding level, and the strength of the employer covenant
- the need for appropriate diversification between different asset classes to manage investment risk and ensure that both the overall level of investment risk and the balance of individual asset risks are appropriate

We also consider other factors that we believe to be financially material over time horizons relevant to the funding of the DB benefits, including environmental, social and governance ("ESG") factors and the risks and opportunities relating to climate change.

Our key investment beliefs, which influence the setting of the investment arrangements, are as follows:

- asset allocation is the primary driver of long-term returns
- costs may have a significant impact on long-term performance and therefore obtaining value for money from the investments is important
- investment managers who can consistently spot and profitably exploit market opportunities are difficult to find, and therefore passive management is usually better value
- risk-taking is necessary to achieve return, but not all risks are rewarded. Equity, credit and illiquidity are the primary rewarded risks. Risks that do not have an expected reward (such as interest rate risk, inflation risk or currency risk) should generally be avoided, hedged or diversified.

5. Implementation of the investment arrangements

Before investing in any manner, we obtain and consider proper written advice from our investment adviser as to whether the investment is satisfactory, having regard to the need for suitable and appropriately diversified investments.

We have limited influence over managers' investment practices because all the Scheme's assets are held in pooled funds, but we encourage our managers to improve their practices within the parameters of the fund they are managing.

Our view is that the fees paid to the investment managers, and the possibility of their mandate being terminated, ensure they are incentivised to provide a high quality service that meets the stated objectives, guidelines, and restrictions of their fund. However, in practice managers cannot fully align their strategy and decisions to the (potentially conflicting) policies of all their pooled fund investors in relation to strategy, long-term performance of debt/equity issuers, engagement, and portfolio turnover.

It is our responsibility to ensure that the managers' investment approaches are consistent with our policies before any new appointment, and to monitor and to consider terminating any arrangements that appear to be investing contrary to those policies. We expect investment managers to make decisions based on assessments of the longer term performance of debt/equity issuers, and to engage with issuers to improve their performance (or where this is not appropriate to explain why). We assess this when selecting and monitoring managers.

We evaluate investment manager performance over both shorter and longer term periods as available. Except in closed-ended funds where the duration of the investment is determined by the fund's terms, the duration of a manager's appointment will depend on strategic considerations and the outlook for future performance. If a manager is not meeting its performance objectives, we will consider alternative arrangements.

Our policy is to evaluate each of our investment managers by considering performance, the role it plays in helping to meet our overall long-term objectives, taking account of risk, the need for diversification and liquidity. Each manager's remuneration, and the value for money it provides, is assessed in light of these considerations.

We recognise that portfolio turnover and associated transaction costs are a necessary part of investment management. Since the impact of these costs is reflected in performance figures used in our assessment of the investment managers, we do not explicitly monitor portfolio turnover. We expect our

investment adviser to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Scheme's investment mandates.

6. Realisation of investments

We instruct disinvestments as required for benefit payments and other outgoings. Our preference is for investments that are readily realisable but recognise that achieving a well-diversified portfolio may mean holding some investments that are less liquid. In general, our policy is to use cash flows to rebalance the assets towards the strategic asset allocation, and also receive income from some of the portfolios where appropriate.

7. Financially material considerations and non-financial matters

We consider how ESG considerations (including but not limited to climate change) should be addressed in the selection, retention, and realisation of investments, given the time horizon of the Scheme and its members.

We influence the Scheme's approach to ESG and other financially material factors through our investment strategy and manager selection decisions. We expect all of our investment managers to take account of financially material factors (including climate change and other ESG factors) within the parameters of the mandates they are set. We seek to appoint managers that have the skills and processes to do this, and review how the managers are taking account of these issues in practice.

We encourage our managers to improve their ESG practices, although acknowledge that we have limited influence over managers' investment practices where assets are held in pooled funds and that the parameters of some pooled funds may limit the scope for significant incorporation of ESG factors.

Within each asset class, we considered investment options that give increased weight to ESG factors. We have chosen to invest the equity allocation in a passively managed fund that tracks an index with reduced exposure to climate-related risks and increased exposure to climate-related opportunities.

We do not consider matters that are purely non-financial in nature (eg matters relating to the ethical and other views of members and beneficiaries, rather than considerations of financial risk and return) in the selection, retention, and realisation of investments.

8. Voting and engagement

We recognise our responsibilities as owners of capital, and believe that good stewardship practices, including monitoring and engaging with investee companies, and exercising voting rights attaching to investments, protect and enhance the long-term value of investments and is in the best interests of our members.

We seek to appoint investment managers that have strong stewardship policies and processes, reflecting the principles of the UK Stewardship Code issued by the Financial Reporting Council.

Before deciding which manager to appoint, we carry out a detailed review of the manager's voting/stewardship activities and outcomes to determine how well they align with the Scheme's stewardship themes and priorities (see below). We also express our preferences regarding ESG and stewardship approaches with prospective managers, to check alignment.

We have delegated to the investment managers the exercise of rights attaching to investments, including voting rights, and engagement with relevant persons such as issuers of debt and equity, stakeholders and other investors about relevant matters such as performance, strategy, capital structure, management of actual or potential conflicts of interest, risks and ESG factors. We expect the managers to undertake voting and engagement in line with their stewardship policies, considering the long-term financial interests of investors.

We monitor managers' activities in relation to ESG factors, voting and engagement on a regular basis. We seek to understand how they are implementing their stewardship policies in practice to check that their stewardship is effective and aligned with our expectations.

We have selected some priority ESG themes to provide a focus for our monitoring of investment managers' voting and engagement activities. We review the themes regularly and update them if appropriate. We communicate these stewardship priorities to our managers periodically. Further detail is included in Appendix 2.

If our monitoring identifies areas of concern, we will engage with the relevant manager to encourage improvements. If improvement is not seen, the Trustee has the option of terminating the appointment.

Appendix 1: Policy towards risk

1. Risk capacity and appetite

Risk capacity is the maximum level of risk that we consider to be appropriate to take in the investment strategy. Risk appetite is how much risk we believe is appropriate to take in order to meet the investment objectives. Taking more risk is expected to mean that those objectives can be achieved more quickly, but it also means that there is a greater likelihood that the objectives are missed, in the absence of remedial action.

When assessing risk and reviewing the investment strategy, we consider:

- the strength of the employer covenant and how this may change over time
- the agreed journey plan and employer contributions
- the Scheme's long-term and shorter-term funding targets
- the Scheme's liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged
- the Scheme's cash flow and target return requirements
- the level of expected return and expected level of risk (as measured by Value at Risk ("VaR")), now and as the strategy evolves.

2. Approach to managing and monitoring risks

There are different types of investment risk that are important to manage, and we monitor these on a regular basis. These include, but are not limited to:

Risk of inadequate returns

A key objective is that the assets produce a sufficient long-term return in excess of the liabilities, and we have set an appropriate target return for the assets accordingly. There is a risk that the return experienced is not sufficient. This risk has been considered in setting the investment strategy.

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 (eg equities), could materially adversely affect the Scheme's assets. We believe that the Scheme's assets are adequately diversified between different asset classes and within each asset class. This was a key consideration when determining the Scheme's investment arrangements.

Equity risk

We believe that equity risk is a rewarded investment risk, over the long term. We consider exposure to equity risk in the context of the Scheme's overall investment strategy and believe that the level of exposure to this risk is appropriate.

Credit risk

The Scheme is subject to credit risk because it invests in bonds via pooled funds. This risk is managed by only investing in pooled funds that have a diversified exposure to different credit issuers, and only invest in bonds that are classified as "investment grade".

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. We consider the overseas currency exposure in the context of the overall investment strategy and believe that it diversifies the strategy and is appropriate. Furthermore, we manage the amount of currency risk by investing in pooled funds that hedge currency exposure or implement separate currency hedging arrangements.

Interest rate and inflation risk

The Scheme's assets are subject to interest rate and inflation risk because some of the Scheme's assets are held in bond funds and Liability Driven Investment ("LDI") funds. However, the interest rate and inflation exposure of the Scheme's assets provide protection (hedges) part of the corresponding risks associated with the Scheme's liabilities. Given that this should reduce the volatility of the funding level, we believe that it is appropriate to manage exposures to these risks in this manner.

Investment manager risk

This is the risk that an investment manager fails to meet its investment objectives. Prior to appointing an investment manager, we receive written professional advice, and we will typically undertake a manager selection exercise. We monitor the investments regularly against their objectives and receive ongoing professional investment advice as to their suitability.

Climate-related risks

Climate change is a source of risk, which could be financially material over both the short and longer term. This risk relates to the transition to a low carbon economy, and the physical risks associated with climate change (eg extreme weather). We

seek to appoint investment managers who will manage this risk appropriately, and we monitor how this risk is being managed in practice.

Other environmental, social and governance (ESG) risks

ESG factors are sources of risk, which could be financially material over both the short and longer term. These include risks relating to unsustainable or socially harmful business practices, and unsound corporate governance. We seek to appoint investment managers who will manage these risks appropriately and monitor how these risks are being managed in practice.

Illiquidity/marketability risk

This is the risk that the Scheme is unable to realise assets to meet benefit cash flows as they fall due, or that the Scheme will become a forced seller of assets in order to meet benefit payments. We are aware of the Scheme's cash flow requirements and believe that this risk is managed by maintaining an appropriate degree of liquidity across the Scheme's investments and by investing in income generating assets, where appropriate.

Counterparty risk

This is the risk that one party to a contract (such as a derivative instrument) causes a financial loss to the other party by failing to discharge a contractual obligation. This risk applies in particular for those contracts that are traded directly between parties, rather than traded on a central exchange.

In particular, L&G make use within its LDI Funds of derivative and gilt repos contracts and this fund is used to match efficiently a portion of the Scheme's liabilities. Counterparty risk is managed within the fund through careful initial selection and ongoing monitoring of trading counterparties, counterparty diversification and a robust process of daily collateralisation of each contract, to ensure that counterparty risk is limited, as far as possible, to one day's market movements.

Collateral adequacy risk

The Scheme is invested in leveraged LDI arrangements to provide hedging protection against adverse changes in interest rates and inflation expectations. From time to time, depending on market movements, additional cash may need to be invested in the LDI portfolio in order to support a given level of leverage. Collateral adequacy risk is the risk that the cash required to maintain the hedging protection is not available for use within the LDI portfolio within the required timeframe. A possible consequence of this risk materialising is that the Scheme's liability hedging could be reduced, potentially leading to a worsening of the Scheme's funding level.

To mitigate this risk, the Trustee has a leverage management plan in place, which is reviewed and updated periodically. This sets out clearly the assets directly available to support the Scheme's LDI arrangements and the approach that is expected to be taken with regards to selling down any other assets to support the LDI arrangements. As part of this leverage management plan, the Trustee periodically monitors the impact of movement in interest rates and inflation expectations and how that compares to the change that can be supported by the assets invested in the LDI arrangements and those directly supporting those arrangements.

The Trustee has also given consideration to what further measures could be taken should the assets referred to in the leverage management plan prove insufficient to support the LDI arrangements, for example, raising additional money from other Scheme assets and/or sourcing money from the employer in the short term.

Valuation risk

Some of the Scheme's assets (such as listed equities) can be valued regularly based upon observable market prices. For other assets (such as property), prices may only be estimated relatively infrequently using one or more of a range of approximate methods – eg mathematical models or recent sales prices achieved for equivalents.

At times of market stress, there is a risk for all assets that the valuations provided by investment managers do not reflect the actual sale proceeds which could be achieved if the assets were liquidated at short notice. This risk is particularly relevant for assets such as property.

We consider exposure to valuation risk in the context of the Scheme's overall investment strategy and believe that the level of exposure to this risk is appropriate.

Other non-investment risks

We recognise that there are other non-investment risks faced by the Scheme. We take these into consideration as far as practical in setting the investment arrangements.

Examples include longevity risk (risk that members live, on average, longer than expected) and sponsor covenant risk (risk that, for whatever reason, the employer is unable to support the Scheme as anticipated).

Both investment and non-investment risks can lead to the funding position materially worsening. We regularly review progress against the funding target.

Appendix 2: Stewardship

This section sets out our approach to stewardship. This includes monitoring the voting and engagement activities that our investment managers undertake on our behalf, engaging with them regarding our expectations in relation to stewardship, and encouraging improvements in their stewardship practices.

Stewardship priorities

We have selected some priority themes to provide a focus for our monitoring of investment managers' voting and engagement activities. We will review them regularly and update them if appropriate.

Our current priorities are climate change, business ethics and corporate transparency.

We chose these priorities because they are market-wide areas of risk that are financially material for the investments and can be addressed by good stewardship. Therefore we believe it is in our members' best interests that our managers adopt strong practices in these areas.

We write to our investment managers periodically to notify them of our stewardship priorities and remind them of our expectations of them in relation to responsible investment.

Manager selection

We aim to appoint investment managers that have strong responsible investment skills and processes. We therefore favour investment managers who are signatories to the Principles for Responsible Investment, the UK Stewardship Code as well as the Net Zero Asset Managers Initiative.

When selecting new managers, we consider our investment adviser's assessment of potential managers' capabilities in this area. If we meet prospective managers, we usually ask questions about responsible investment, focusing on our stewardship priorities.

Manager monitoring and engagement

We receive information regularly to enable us to monitor our managers' responsible investment practices and check how effective they're being.

This information includes metrics such as our investment adviser's responsible investment grades for each manager, whether they are signatories to responsible investment initiatives.

Periodically, the Trustee undertakes a more comprehensive review of our managers' responsible investment practices. This includes our investment adviser's qualitative responsible investment assessments for each manager and a summary of the managers' voting and engagement policies including in relation to our stewardship priorities.

Given that responsible investment is rapidly evolving, we expect most managers will have areas where they could improve. We therefore aim to have an ongoing dialogue with our managers to clarify our expectations and encourage improvements.

Implementation statement including most significant votes

Following the end of each Scheme year, we prepare a statement which explains how we have implemented our voting and engagement policies during the year. We publish it online for our members to read.

In the statement, we describe how our managers have voted on our behalf during the year, including the most significant votes cast. In choosing the significant votes, we have regard to whether the votes relate to one of our stewardship priorities.