United States Air Force Pension and Life Assurance Scheme – United Kingdom

Statement of Investment Principles – June 2020

1. **Introduction**

The Trustees of the United States Air Force Pension and Life Assurance Scheme – United Kingdom (the "Scheme") have drawn up this Statement of Investment Principles (the "Statement") to comply with the requirements of the Pensions Act 1995 (the "Act") and subsequent legislation. The Statement is intended to affirm the investment principles that govern decisions about the Scheme's investments.

The Trustees have obtained and considered written professional advice from Mercer Limited (the "Investment Consultant") in preparing this Statement. The Trustees believe that the Investment Consultant meets the requirements of Section 35 (3) of the Pensions Act 1995. In matters where the investment policy may affect the Scheme's funding policy, input has also been obtained from the Scheme Actuary. The Trustees will obtain similar advice whenever they review this Statement.

The Trustees seek to maintain a good working relationship with United States Air Force (the "Sponsor"), and will discuss any proposed changes to the Statement with the Sponsor. However, the Trustees' fiduciary obligations to the Scheme's members will take precedence over the Sponsor's wishes, should these ever conflict.

Stewardship of the investment arrangements can be divided into three areas. The first, the strategic management of the assets, is fundamentally the responsibility of the Trustees, acting on expert advice from the Investment Consultant, and is driven by the Scheme's investment objectives as set out in Section 3 below. The second area is the day to day management of the assets which is delegated to a professional investment manager and is described in Section 6. The third area is the ongoing measurement and monitoring of the performance of the appointed managers against predetermined benchmarks. Again, this is the responsibility of the Trustees.

2. **Process for Choosing Investments**

The process for choosing investments is as follows:

- Identify appropriate investment objectives.
- Agree the level of risk consistent with meeting the objectives set.
- Construct a portfolio of investments that is expected to maximise the return (net of all costs) given the targeted level of risk.

In considering investments for the Scheme, the Trustees obtain and consider written advice from the Investment Consultant, who the Trustees believe to be suitably qualified to provide such advice. The advice received and arrangements implemented are, in the Trustees' opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended).

3. Investment Objectives

The Trustees' objectives are to invest the Scheme's assets in the best interest of the members and beneficiaries, and in the case of a potential conflict of interest in the sole interest of the members and beneficiaries. Within this framework the Trustees have agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Scheme is exposed. The Trustee's primary objectives are as follows:

i. To ensure that the Scheme can meet its obligations to members and other beneficiaries.

ii. To pay due regard to the Sponsoring Employer's position in relation to the size and incidence of the Sponsor's contribution payments.

At the latest actuarial valuation, the Actuary assumed that the Scheme will achieve an investment rate of return on assets which exceeds that available from gilts. Based on advice from the Investment Consultant about realistic long-term assumptions, the Trustees expect the investment return resulting from the strategy adopted by the Scheme to at least meet the prudent expectations of the Actuary.

4. Risk Management and Measurement

The Trustees are aware of and pay close attention to a range of risks inherent in investing the assets of the Scheme.

The Trustees' policy on risk management is as follows:

- The primary investment risk faced by the Scheme arises as a result of a mismatch between the Scheme's assets and its liabilities. This is therefore the Trustees' principal focus in setting investment strategy.

- The Trustees recognise that whilst increasing risk increases potential returns over a long period, it also increases the risk of a shortfall in returns relative to that required to cover the Scheme's liabilities, as well as producing more short-term volatility in the Scheme's funding position. The Trustees have taken advice on the matter and (in light of the objectives noted previously) considered carefully the implications of adopting different levels of risk.

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

- The risk that the returns of certain assets classes and sectors may be significantly affected by climate change and Environmental, Social and Governance ("ESG") risks. The Trustees take climate risk into account in the selection, retention and realisation of the Scheme's investment managers. The Trustees' policies on ESG risks are set out later on in this statement.

- The Trustees recognise that currency risk may also arise due to investment in overseas markets and looks to mitigate this through diversification across markets and by the use of currency hedging within the Scheme's equity portfolio. Investments are also made in sterling denominated funds where possible.

- The Trustees recognise the need for liquidity within the Scheme's investment strategy and therefore looks to invest in funds which are readily marketable. Where this is not the case, consideration is given to the overall liquidity of the Scheme's assets with the aim to ensure that there is sufficient liquidity to meet the Scheme's ongoing cashflow requirements.

The Trustees believe that the investment strategy provides adequate diversification both within and across different asset classes and sectors. The Trustees further believe that the current investment strategy is appropriate given the Scheme's liability profile.

In deciding to take investment risk relative to the liabilities, the Trustee has carefully considered the following possible consequences:

- The assets might not achieve the excess return relative to the liabilities anticipated over the longer term. This would result in the deterioration of the Scheme's financial position and consequently higher contributions than currently expected from the Sponsor.

- The relative value of the assets and liabilities will be more volatile over the short term than if investment risk had not been taken. This risk will therefore increase the likelihood of there being a shortfall of assets relative to the liabilities in the event of discontinuance of the Scheme. This consequence is particularly serious if it coincides with the Sponsor being unable to make good the shortfall.

- This volatility in the relative value of assets and liabilities may also increase the short-term volatility of the Sponsor's contribution rate set at successive actuarial valuations, depending on the approach to funding adopted.

The Trustees have taken advice on these issues from the Investment Consultant and the Scheme Actuary. It has also held related discussions with the Sponsor.

The Trustees' willingness to take investment risk is dependent on the continuing financial strength of the Sponsor and its willingness to contribute appropriately to the Scheme.

The Trustees believe that the risks set out above may be financially material to the Scheme, and has therefore adopted various policies in order to manage these risks over the Scheme's anticipated lifetime. However, the Trustees acknowledge that it is not possible to monitor all the risks listed above at all times and so seek to take on those risks they expect to be rewarded over time, in the form of excess returns, in a diversified manner.

The resulting combination of assets has been selected to be consistent with the investment objective, risk tolerance and return target detailed above. The investment manager for the Scheme must have regard to the need for diversification and suitability of assets. The arrangements with the investment manager include a number of guidelines and restrictions which among other things, are designed to ensure that only suitable investments are held by the Scheme.

Arrangements are in place to monitor the Scheme's investments to help the Trustees check that nothing has occurred that would bring into question the continuing suitability of the current investments. To facilitate this, the Trustees receive regular reports from the Scheme's investment manager. These reports include an analysis of the overall level of return, to ensure the risks taken and returns achieved are consistent with those expected. The Trustees also take advice from the Investment Consultant on the investment manager's performance, as required.

5. Investment Strategy

Investment policy can be considered in two parts: (1) the strategic management, the setting of which is one of the fundamental responsibilities of the Trustees and (2) the day-to-day management of the assets, which has been delegated to a professional investment manager.

Given the investment objectives the Trustees implemented an investment strategy comprising a portfolio invested 60% in growth assets and 40% in bonds. The Scheme's equity assets are geographically diversified with the aim of providing diversification in terms of the returns on those markets and industry sectors available for investment. Furthermore, 50% of developed overseas equity market exposure is hedged back to sterling through the use of currency hedged pooled investment vehicles.

The Trustees have decided to invest a proportion the bond portfolio in non-government bonds due to the potential return premium offered on these bonds over government bonds, having due regard to the additional credit risk inherent in non-government bonds.

The Trustees believe that the investment risk arising from the investment strategy is consistent with the overall level of risk being targeted.

The table below shows the investment strategy which has been agreed.

Asset Class	**Benchmark Allocation (%)**	
Equities	**50.0**	
UK	18.5	
Overseas (50% hedged)	31.5	
Bonds	**50.0**	
UK All Stocks index-linked Gilts	20.0	-
UK Over 15 Years fixed interest Gilts	10.0	
UK Corporate Bonds	20.0	
Total	**100.0**	

6. Day–to-Day Management of the Assets

6.1 Main Assets

The Trustees invest the equity and bond assets of the Scheme in pooled fund arrangements managed by State Street Global Advisors ("SSgA") on a passive basis. The Trustees have opted for a predominantly passive approach for the following reasons:

- Passive management carries less risk of a manager underperforming its respective benchmark (after fees).
- Ongoing monitoring requirements and management fees are significantly lower for passive management than for active management.

The Trustees have determined, based on expert advice, a benchmark mix of asset types and ranges within which the appointed investment manager may operate.

The Trustees regularly review the continuing suitability of the Scheme's investments, which may be adjusted from time to time. However, any such adjustments would be implemented with the aim of ensuring the overall level of risk is consistent with that being targeted.

The table below shows the funds in which the Scheme is invested together with their associated benchmarks.

Asset Class	Benchmark Allocation (%)	Rebalancing Range (+/- %)	Benchmark Index
Equities	**50.0**	-	
UK	18.5	+/- 2	FTSE All-Share Index
North America (50% hedged)	14.7	+/- 2	FTSE World North America Index (50% hedged)
Europe (ex UK) (50% hedged)	7.2	+/- 2	FTSE World Europe ex UK Equity Index (50% hedged)
Japan (50% hedged)	4.8	+/- 2	FTSE World Japan Index (50% hedged)
Asia Pacific (ex Japan) (50% hedged)	4.8	+/- 2	FTSE World Developed Pacific ex Japan Index (50% hedged)
Bonds	**50.0**	-	
UK All Stocks index-linked Gilts	20.0	+/- 2	FTSE A UK Index-Linked Gilts All Stocks Index
UK Over 15 Year fixed interest Gilts	10.0	+/- 2	FTSE A Over 15 Year Gilts Index
UK Corporate Bonds	20.0	+/- 2	Merrill Lynch Non Gilts All Stocks Index
Total	**100.0**	-	

The performance objective for each passive fund is to match the relevant benchmark return on a gross of fees basis.

6.2 Investment Manager Appointment and Ongoing Monitoring

In selecting the investment manager, the Trustees have taken advice from the Investment Consultant with regard to their perceived index-tracking capabilities and the fees for such capabilities. The investment manager is regulated by the Financial Conduct Authority.

The Trustees will seek guidance from the investment consultant on their forward-looking assessment of the manager’s ability to deliver upon its stated objectives over a full market cycle. This view will be based on the consultant’s assessment of the manager’s idea generation, portfolio construction, implementation and business management (amongst other things), in relation to the particular strategies that the Scheme invests in. The consultant’s manager research ratings assist with due diligence and (where available) are used in decisions around selection, retention and realisation of manager appointments.

The Trustees will review an appointment if the investment objective for a manager’s fund changes to ensure it remains appropriate and consistent with the Trustees’ wider investment objectives. As the Scheme invests in pooled investment vehicles, the Trustees accept that they have no ability to specify the risk profile and return targets of the manager, but appropriate mandates can be selected to align with the overall investment strategy.

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

The Trustees receive investment manager performance reports on a quarterly basis, which present performance information over 3 months, 1 year, 3 years and 5 years.

The Trustees review the absolute performance of the relevant funds, as well as their relative performance versus a suitable benchmark index and against the manager's stated performance targets (over the relevant time period). The Trustees' focus is on long term performance. However, as noted above, they may review a manager's appointment if:

- There are sustained periods of the manager failing to achieve its stated investment objectives.
- There is a change in the portfolio manager of a fund.
- There is a change in the underlying objectives of the investment manager.
- There is a significant change to the investment consultant's rating of the manager.

The Trustees are long term investors and are not seeking to change investment arrangements on a frequent basis. As the Trustees are invested in open-ended pooled funds, there is no set duration for the appointment of the investment manager. The Trustees will therefore retain an investment manager unless there is a strategic change to the overall strategy that no longer requires exposure to a particular asset class, or the Trustees decide to terminate the mandate following a review of the manager's performance or otherwise.

The Trustees do not actively monitor portfolio turnover costs. The Trustees will continue to monitor industry improvements concerning the reporting of portfolio turnover costs. In future, the Trustees may ask the manager to report on portfolio turnover cost.

6.3 Custodian

SSgA is responsible for the appointment and monitoring of the custodian of the assets held within the pooled funds in which the Scheme invests. The role of the custodian is to ensure the safe keeping of the assets within the pooled funds and to facilitate all transactions entered into by the appointed investment manager. The custodian is also responsible for record-keeping in relation to the assets held within SSgA's funds.

6.4 Rebalancing Policy

The rebalancing ranges set out in the table in section 6.1 above are used for the Trustees to monitor whether the Scheme's actual asset allocation is sufficiently closely aligned to the benchmark allocation. No automatic rebalancing currently takes place but the Trustees expect to implement rebalancing once again following the completion of ongoing investment strategy changes.

6.5 Realisation of Investments

In general, the Scheme's investment manager has discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments, since the Scheme's assets are invested in pooled funds. The Scheme's investment manager has responsibility for generating the cash required to meet benefit outgo as and when instructed by the Trustees. Cashflows will be applied in order to tighten the asset allocation to the benchmark.

6.6 Socially Responsible Investment and Corporate Governance

The Trustees believe that environmental, social, and corporate governance ("ESG") factors have a material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustees also recognise that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration.

The Trustees have given the appointed investment manager full discretion in evaluating ESG factors, including climate change considerations, as well as for exercising the voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code. The Trustees will review the investment manager's policies and engagement activities on an annual basis.

As the assets of the Scheme are invested in pooled vehicles, the Trustees accept that the assets are subject to the investment manager's own policies on social, environmental and ethical investment.

The Trustees increasingly consider how ESG, climate change and stewardship is integrated within investment processes in appointing new investment managers and monitoring existing the investment manager through the use of ESG ratings provided by the investment consultant. The Trustees will consider how a manager's approach to ESG integration, climate change, stewardship and responsible investment aligns with the Trustees' policies when determining future investment strategy decisions and manager or mandate appointments.

Member views, including their ethical views, are not taken into account in the selection, retention and realisation of investments. However this position may be reviewed in the future.

7. Additional Voluntary Contributions (“AVCs”)

Assets in respect of members’ Additional Voluntary Contributions (“AVCs”) are held in the SSgA Sterling Liquidity Fund.

8. Advisors to the Trustees

8.1 Actuary

Adam Tidey of Mercer Limited is the appointed Scheme Actuary.

The actuary performs a valuation of the Scheme at least every three years. The main purpose of the actuarial valuation is to assess the extent to which the assets cover the accrued liabilities and provide information to help determine the Participating Employers’ contribution rate.

8.2 Investment Consultant

Whilst the day-to-day management of the Scheme’s assets is delegated to an investment manager, all other investment decisions including strategic asset allocation and selection and monitoring of the investment manager is based on advice received from the Investment Consultant. Mercer Limited has been appointed for this purpose.

9. Fees

9.1 Manager fees

A fixed fee of 0.09% p.a. of assets invested is applicable to all of the Scheme’s assets invested with SSgA.

9.2 Investment Advisor Fees

The Investment Consultant typically works on the basis of either a fixed fee for particular projects, which is agreed in advance with the Trustees, or on a time cost basis.

10. Compliance with and Review of this Statement

The Trustees monitor compliance with this Statement.

The Trustees will review this Statement at least once every three years and without delay after any significant change to any aspects of the Scheme, its liabilities, finances and the attitude to risk of the Trustees and the Sponsor, which it judges to have a bearing on the stated investment policy. Any change to this Statement will only be made after having obtained and considered the advice of someone who the Trustees reasonably believes to be qualified by their ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of pension scheme investments. Any such review will also be carried out in consultation with the Principal Employer.

The Trustees of the United States Air Force Pension and Life Assurance Scheme