

Drax Power Group of the Electricity Supply Pension Scheme

Statement of Investment Principles (“SIP”)

Purpose of this Statement

This SIP has been prepared by the Group Trustees acting on behalf of the members of the Drax Power Group (“the Group”) of the Electricity Supply Pension Scheme (“ESPS”). This statement sets out the principles governing the Group Trustees’ decisions to invest the assets of the Group.

The Group’s investment objectives and strategy were derived from the Group Trustees’ Investment Beliefs, set out in Appendix A. The beliefs have been taken into account at all stages of planning, implementation and monitoring of the investment strategy.

The Group Trustees have also taken the Myners’ Principles into consideration when making decisions about the Group’s investment arrangements.

Details on the Group’s investment arrangements are set out in the Investment Implementation Document (“IID”).

Investment objectives

The Group Trustees invest the assets of the Group with the aim of ensuring that all members’ accrued benefits can be paid. The Group’s funding target is specified in the Statement of Funding Principles. The Group funding position will be reviewed on an ongoing basis to assess the position relative to the funding target and whether the investment arrangements remain appropriate to the Group’s circumstances.

The Group’s present investment objective is to achieve a return of around 2.1% per annum above the return on UK Government bonds.

The Group’s current investment strategy is invested according to the following broad asset allocation:

Asset Class	Proportion (%)	Expected Return (relative to fixed interest gilts)⁽¹⁾ %
Cardano Return Seeking Mandate	37.0	3.5
Direct Lending	10.0	4.0
Absolute Return Bonds	3.0	1.5
Long Lease Property	10.0	2.5
Liability Driven Investment (LDI) ⁽²⁾	40.0	0.2
Total	100.0	2.1

(1) 10 year assumptions as at 30 September 2018 (net of management fees).

(2) Includes an allocation to corporate bonds expected to be c.7% of Group assets.

Investment strategy

The Group’s investment strategy was derived following careful consideration of the nature and duration of the Group’s liabilities, the risks of investing in the various asset classes, the

implications of the strategy (under various scenarios) for the level of contributions required to fund the Group, and also the strength of the sponsoring company's covenant. The Group Trustees considered the merits of a range of asset classes, including various "alternative assets".

The Group Trustees recognise that the investment strategy is subject to risk, in particular the risk of a mismatch between the performance of the assets and the calculated value of the liabilities. This risk is monitored by regularly assessing the funding position and the characteristics of the assets and liabilities. The risk is managed by investing in assets which are expected to perform in excess of the liabilities over the long term, and also by investing in a suitably diversified portfolio of assets with the aim of minimising (as far as possible) volatility relative to the liabilities.

The Group Trustees have also considered a number of other risks set out in Appendix B.

The assets of the Group consist predominantly of investments which are traded on regulated markets.

Investment Management Arrangements

The Group Trustees have appointed several investment managers to manage the assets of the Group as listed in the IID. The investment managers are regulated under the Financial Services and Markets Act 2000.

All decisions about the day-to-day management of the assets have been delegated to the investment managers via a written agreement. The delegation includes decisions about:

- Realisation of investments;
- Social, environmental, ethical and governance considerations in selection, retention and realisation of investments;
- The exercise of rights (including voting rights) attaching to the investments.

The Group Trustees take investment managers' policies into account when selecting and monitoring managers. The Group Trustees also take into account the performance targets the investment managers are evaluated on. The investment managers are expected to exercise their powers of investment with a view to giving effect to the principles contained within this statement, so far as reasonably practicable.

The investment managers' remuneration is based upon a percentage value of the assets under management. The fees have been negotiated to be competitive and are reviewed on an ongoing basis. The Group's mandates for the Direct Lending funds are also subject to a performance related fee element.

As the Group's assets are invested in pooled vehicles, the custody of the holdings is arranged by the investment manager.

Investment Manager Monitoring and Engagement

The Group Trustees monitor and engage with the Group's investment managers and other stakeholders on a variety of issues. Below is a summary of the areas covered and how the Group Trustees seek to engage on these matters with investment managers.

Areas for engagement	Method for monitoring and engagement	Circumstances for additional monitoring and engagement
Performance, Strategy and Risk	<ul style="list-style-type: none"> • The Group Trustees receive a quarterly performance reports which details information on the underlying investments' performance, strategy and overall risks, which are considered at the relevant Trustee meeting. • The Group's investment managers are invited, in person, to present to the Group Trustees on their performance, strategy and risk exposures on an annual basis or more frequently if issues arise. 	<ul style="list-style-type: none"> • There are significant changes made to the investment strategy. • The risk levels within the assets managed by the investment managers have increased to a level above and beyond the Group Trustees' expectations. • Underperformance vs the performance objective over the period that this objective applies.
Environmental, Social, Corporate Governance factors and the exercising of rights	<ul style="list-style-type: none"> • The Group Trustees' investment managers provide annual reports on how they have engaged with issuers regarding social, environmental and corporate governance issues. • The Group Trustees receive information from their investment advisers on the investment managers' approaches to engagement. 	<ul style="list-style-type: none"> • The manager has not acted in accordance with their policies and frameworks. • The manager's policies are not in line with the Group Trustees' policies in this area.

Through the engagement described above, the Group Trustees will work with the investment managers to improve their alignment with the above policies. Where sufficient improvement is not observed, the Group Trustees may review the relevant investment manager's appointment.

Employer-related investments

The policy of the Group Trustees is not to hold any employer-related investments as defined in the Pensions Act 1995 and the Occupational Pension Schemes (Investment) Regulations 2005 except where the Group invests in collective investment schemes that may hold employer-related investments. In this case, the total exposure to employer-related investments will not exceed 5% of the Group's total value. The Group Trustees will monitor this on an ongoing basis to ensure compliance.

Direct investments

Direct investments, as defined by the Pensions Act 1995, are products purchased without delegation to an investment manager through a written contract. When selecting and

reviewing any direct investments, the Group Trustees will obtain appropriate written advice from their investment advisers.

Governance

The Group Trustees make all major strategic decisions including, but not limited to, the Group’s asset allocation and the appointment and termination of investment managers.

When making such decisions, and when appropriate, the Group Trustees take proper written advice. The Group’s investment advisers, Isio Group Limited, are qualified by their ability in and practical experience of financial matters, and have the appropriate knowledge and experience. The investment adviser’s remuneration may be a fixed fee or based on time worked, as negotiated by the Group Trustees in the interests of obtaining best value for the Group.

Compliance

This Statement has been prepared in compliance with the Pensions Act 1995, the Pensions Act 2004, and the Occupational Pension Schemes (Investment) Regulations 2005. Before preparing or subsequently revising this Statement, the Group Trustees consulted the sponsoring company and took appropriate written advice. The Statement is reviewed at least every three years, and without delay after any significant change in the investment arrangements.

Date: 23 September 2020

Appendix A – Investment Beliefs

1. Investment strategy is the most important decision and should be based on clear objectives

Our long term goal is to generate returns required to fund our members' current and future pensions.

Clear objectives are at the heart of our investment strategy. Risk tolerance, return requirement and time frame are our central considerations.

Our strategy should aim to achieve the objectives with a high degree of confidence across a range of possible economic scenarios.

2 There's more to robust portfolio construction than diversification alone

Excessive diversification can introduce inefficiency, cost and fail to protect our portfolio in a downturn.

Pay-off profile of assets: We tailor the expected payoff profile of the Group's investments around our required objectives.

Excess liquidity of our Group: We utilise excess liquidity in order to access any illiquidity premium (when illiquidity is rewarded), taking into consideration known cash flow requirements and the need for flexibility.

True diversification: We optimise true diversification of underlying risk drivers.

3 We aim to select the most appropriate opportunities in the market

A strategy that buys the right asset, at a fair price, will serve us better than buying the wrong asset at a cheap price.

We consider the most appropriate potential market opportunities in order to help us achieve our long-term objective.

4 A long term mind-set can be used to enhance returns

As a long term investor we pursue incremental growth that rewards adherence to our strategic plan, rather pursuing short term opportunities rewarding speculation.

We will mitigate or manage risks that we are not rewarded for.

Returns are more predictable over a longer time period, as risk is diversified across different economic cycles.

5 Excessive costs will erode performance

An appealing investment opportunity can be wholly undermined by too high a cost base.

Passive management, where viable, is considered the default approach.

Active management is employed where value-add can be expected with confidence.

6 Good governance improves our decision making

We continuously strive to enhance our knowledge of the investment opportunities and risks facing our Group.

We monitor the performance of our strategy and investment managers to improve our decision making.

7 Our investment process reflects our beliefs on responsibly investing.

We recognise that positive ESG factors can have a positive influence on the long term stability and returns of investments. However, mandates are selected with the purpose of maximising the chance of achieving the return objectives as set out in their mandates, which in combination aim to optimise the chance of achieving the Group's overall strategic objective.

The extent to which ESG and ethical considerations are taken into account in these decisions is delegated to the investment managers, acting within the guidelines and objectives set by the Group Trustees where practically possible.

Appendix B – Risks

A non-exhaustive list of risks and financially material considerations that the Group Trustees have considered and sought to manage is shown below.

The Group Trustees adopt an integrated risk management approach. The three key risks associated within this framework and how they are managed are stated below:

Risks	Definition	Policy
Investment	The risk that the Group's position deteriorates due to the assets underperforming.	<ul style="list-style-type: none"> Selecting an investment objective that is achievable and is consistent with the Group's funding basis and the sponsoring company's covenant strength. Investing in a diversified portfolio of assets.
Funding	The extent to which there are insufficient Group assets available to cover ongoing and future liability cash flows.	<ul style="list-style-type: none"> Funding risk is considered as part of the investment strategy review and the actuarial valuation. The Group Trustees will agree an appropriate basis in conjunction with the investment strategy to ensure an appropriate journey plan is agreed to manage funding risk over time.
Covenant	The risk that the sponsoring company becomes unable to continue providing the required financial support to the Group.	<ul style="list-style-type: none"> When developing the Group's investment and funding objectives, the Group Trustees take account of the strength of the covenant ensuring the level of risk the Group is exposed to is at an appropriate level for the covenant to support.

The Group is exposed to a number of underlying risks relating to the Group's investment strategy, these are summarised below:

Risk	Definition	Policy
Interest rates and inflation	The risk of mismatch between the value of the Group assets and present value of liabilities from changes in interest rates and inflation expectations.	To hedge c.75% of these risks on a gilts +0% basis.
Liquidity	Difficulties in raising sufficient cash when required without adversely impacting the fair market value of the investment.	To maintain a sufficient allocation to liquid assets so that there is a prudent buffer to pay members benefits as they fall due (including transfer values), and to provide collateral to the LDI manager.

Market	Experiencing losses due to factors that affect the overall performance of the financial markets.	To remain appropriately diversified and hedge away any unrewarded risks, where practicable.
Credit	Default on payments due as part of a financial security contract.	To diversify this risk by investing in a range of credit markets across different geographies and sectors. To appoint investment managers who actively manage this risk by seeking to invest only in debt securities where the yield available sufficiently compensates the Group for the risk of default.
Environmental, Social and Governance	Exposure to Environmental, Social and Governance factors, including but not limited to climate change, which can impact the performance of the Group's investments.	To appoint managers who account for ESG factors as part of their investment process. The Group Trustees monitor the managers in this regard on an ongoing basis.
Currency	The potential for adverse currency movements to have an impact on the Group's investments.	Hedge the currency risk on direct lending assets as much as practically possible.
Non-financial	Any factor that is not expected to have a financial impact on the Group's investments.	Non-financial matters are not taken into account in the selection, retention or realisation of investments.

Appendix C

The Group Trustees have the following policies in relation to the investment management arrangements for the Group:

<p>How the investment managers are incentivised to align their investment strategy and decisions with the Group Trustees' policies.</p>	<ul style="list-style-type: none"> • The Group Trustees invest in pooled funds which are aligned to the strategic objective. It is recognised that due to the nature of pooled funds, there is not scope for these funds to be specifically tailored to the Group Trustees' policies. • The Group's mandate with Permira is subject to a performance related fee.
<p>How the investment managers are incentivised to make decisions based on assessments of medium to long-term financial and non-financial performance of an issuer of debt or equity and to engage with them to improve performance in the medium to long-term.</p>	<ul style="list-style-type: none"> • The Group Trustees review the investment managers' performance relative to medium and long-term objectives as documented in the investment management agreements. These objectives being medium-long term in nature mean that the investment managers position their portfolios accordingly. • The Group Trustees monitor the investment managers' engagement and voting activity on an annual basis as part of the annual investment meeting. By doing this, it indirectly incentivises the investment managers to make decisions based on non-financial information.
<p>How the method (and time horizon) of the evaluation of investment managers' performance and the remuneration for their services are in line with the Group Trustees' policies.</p>	<ul style="list-style-type: none"> • The Group Trustees review the performance of the Group's investments on a net of cost basis to ensure a true measurement of performance versus investment objectives. • The Group Trustees evaluate performance over the time period stated in the investment managers' performance objective, which is typically 3 to 5 years. • Quarterly investment performance reports are produced documenting the performance of each of the Group's investment managers. • Investment manager fees are reviewed periodically to make sure that they remain competitive.
<p>The method for monitoring portfolio turnover costs incurred by investment managers and how they define and monitor targeted portfolio turnover or turnover range.</p>	<ul style="list-style-type: none"> • The investment managers are incentivised to minimise costs as they are measured on a net of cost basis. • The Group Trustees monitor portfolio turnover costs indirectly as part of its ongoing monitoring of the Group's assets and investment managers. • Where relevant, portfolio turnover costs are considered periodically, particularly for the Cardano mandate which is expected to be more active in its asset allocation and hence

	<p>experience higher turnover over time. The mandate also represents a sizeable proportion of overall Group assets (37% target allocation) whereby excessive turnover can have a reasonable impact on the overall Group asset return.</p>
<p>The duration of the Group's arrangements with the investment managers.</p>	<ul style="list-style-type: none"> • The Group Trustees are aware of the duration of the Group's arrangements with each of its investment managers (e.g. as part of ongoing monitoring). Ultimately, however, the duration of each arrangement is determined by its suitability and contribution to meeting the Group's overall investment objectives. • It is also considered in the context of the type of fund the Group invests in. <ul style="list-style-type: none"> ○ For open ended funds, the duration is flexible, and the Group Trustees will from time-to-time consider the appropriateness of these investments and whether they should continue to be held. ○ For closed ended funds, or funds with a lock-in period, the Group Trustees ensure the timeframe of the investment or lock-in is in line with the Group Trustee's objectives and the Group's liquidity requirements.