Statement of Investment Principles

Drax 2019 Defined Benefit Pension Scheme

September 2020

1. INTRODUCTION

This document constitutes the Statement of Investment Principles (the 'SIP') required under Section 35 of the Pensions Act 1995 (the 'Act') for the Drax Corporate Limited Pension Scheme (the `Scheme'). It describes the investment policy, guidelines and procedures being pursued by the Trustees of the Scheme. This SIP has also been prepared to reflect the requirements of The Occupational Pension Schemes (Investment) Regulations 2005.

In accordance with the Act, the Trustees confirm that, before preparing the SIP, it has obtained and considered written advice from its appointed Investment Adviser, PricewaterhouseCoopers LLP (“PwC”) and has consulted with Drax Corporate Limited (the statutory sponsor of the Scheme).

The Trustees believe PwC to be qualified by its ability and practical experience of financial matters and to have appropriate knowledge and experience of the investment arrangements that the Scheme requires.

The Trustees are responsible for the investment of the Scheme's assets and arranging the administration of the Scheme. Where the Trustees are required to make an investment decision, the Trustees first receive and consider advice from PwC, to ensure that it has fully considered the implications of the decision(s) being taken.

In accordance with the Financial Services and Markets Act 2000 (`FSMA'), the Trustees are responsible for setting a general investment policy, but has delegated the day-to-day investment of the Scheme's assets to the Investment Manager.

The Investment Manager listed in Appendix A is authorised and regulated by the Financial Conduct Authority (`FSA') and provides the expertise necessary to manage the investments of the Scheme.

Declaration

The Trustees confirm that this SIP reflects the investment strategy for the Scheme. The Trustees acknowledge that it is their responsibility, with guidance from their Investment Adviser, to ensure the assets of the Scheme are invested in accordance with these principles.

2. SCHEME GOVERNANCE

The Trustees are responsible for the governance and investment of the Scheme's assets. In addition, the Joint Governance Group ("JGG") will assist with the Governance of the Scheme.

The remit of the JGG covers:

- Understanding and quantifying the main investment risks;
- Producing a plan for implementing agreed ideas;
- Establishing monitoring, reporting and intervention as the performance of the strategy is realised;
- Establishing future working arrangements for the identification, assessment and implementation of new opportunities;
- Documenting the vision and strategy; and
- Establishing a governance control framework that protects members' benefits.

The JGG will meet at least quarterly with where necessary monthly calls between meetings. Membership of the JGG will comprise:

- The Trustees;
- A dedicated representation from the Company;
- The Trustees' appointed investment adviser;
- The Company's appointed investment adviser.

The Trustees consider the governance structure set out in this SIP to be appropriate for the Scheme as it allows the Trustees to make the important decisions on investment policy, whilst delegating the day-to-day aspects of investment management to the Investment Manager as and where appropriate.

The responsibilities of each of the parties involved in the Scheme's governance are detailed in Appendix B.

3. INVESTMENT OBJECTIVES

The overall objective of the Trustees is to meet the benefit payments promised to members as they fall due.

The Trustees and Company have agreed a number of key long-term objectives which are set out in more detail in the Journey Plan but include:

1. Ensuring that all benefits due to members under the rules of the Scheme can be paid and that there is clear communication on the level of security provided by the Company;
2. Achieving the necessary expected return and risk targets;
3. Reaching a fully funded scheme on a prudent self-sufficiency basis over the next decade.
4. Ensuring the investment strategy remains appropriate to achieve the agreed funding objectives within the agreed timescales, with a level of risk that is acceptable to both the Trustees and Company;
5. Ensuring the suitability of the investments and ESG policies following the result of each actuarial valuation, investment review, or as required by legislation, in consultation with the advisers;
6. Maintaining accurate Scheme records and good governance.

The Trustees aim to meet the long-term objectives via the following measures:

- Ensuring the strategic asset allocation for the Scheme considers the liability profile and the Statutory Funding Objective;
- Monitoring the Investment Manager to ensure that they comply with the investment guidelines set for them and that there is a reasonable expectation that they can meet their performance objectives going forward; and
- Working with the JGG to consider opportunities to either reduce risk or enhance the return through the implementation of medium-term tactical asset allocation decisions.

4. INVESTMENT STRATEGY

4.1 General Policies

The Trustees are in the process of reviewing new investment strategies, including a liability matching investment strategy in the form of interest rate swaptions. The Scheme assets consist of the proceeds of the bulk transfer from the Scottish Power Pension Scheme. The bulk transfer was settled in May 2020.

4.2 Asset Allocation

The Trustees' approach to asset allocation is to allocate 100% of Scheme's assets into a short-duration gilt fund on a temporary basis. Details of the asset allocation as at the date of this SIP are set out at Appendix C.

4.3 Return Objective

A return on investments is required which, over the long term, is expected to be consistent with the Trustees' goal of meeting the Statutory Funding Objective.

Given the nature of the temporary investment being made, the long-term expected return is in line with short duration gilts. It is not expected that the Trustees will hold the short-duration gilt fund in isolation for a period of over six months.

5. STRATEGY IMPLEMENTATION

The investment is managed by one external investment manager. The investment manager is Legal & General Investment Management ("Legal & General"). More details are set out in Appendix B.

5.1 Mandates and Performance Targets

The Trustees have received advice on the appropriateness of the investment manager, benchmark and risk tolerances from the Investment Adviser and believes the investment to be suitable on a temporary basis to meet the Scheme's investment objectives.

5.2 Suitability

The Trustees have taken advice from the Scheme's Investment Adviser to ensure that the assets held by the Scheme and the proposed strategy is suitable given its liability profile, the Trustees' objectives, regulatory guidance and specifications in the Trust Deed. The Trustees recognise that the investment does not have suitable liability matching properties and is not expected to generate excess return relative to the gilt market to meet the liabilities of the Scheme. Therefore, the investment is made on a temporary basis whilst the strategic asset allocation is considered.

6. MONITORING

6.1 Investment Management

Trustees:

The Trustees will monitor the performance of the Investment Manager against the agreed benchmark.

The Trustees, in conjunction with advice from their investment advisor, will regularly review the activities of the Investment Manager to ensure they continue to perform in a competent manner and have the appropriate knowledge and experience to manage the assets of the Scheme.

Investment Adviser:

The Trustees have appointed PwC to provide periodic reporting on the performance of the Scheme's assets, and any developments with the underlying investment manager which could have an adverse impact on future returns and other ongoing strategy and implementation advice as is required.

Investment Manager:

Relationship with investment manager

The Trustees have investment management agreements in place with the investment manager, which set out the contractual relationship between the parties and govern key aspects, such as how the Trustees remunerate the investment manager, how the Trustees monitor the performance of the investment manager, the inception of the arrangements with the investment manager, and exit terms.

Incentivising investment managers

The Trustees will monitor the performance of the Scheme's investment manager against their agreed objectives, ESG policies and the financial requirements of the Scheme as a whole. The Trustees regularly review the activities of the investment manager and assess their ability to:

- Perform their functions competently
- Have appropriate knowledge and experience to manage the assets of the Scheme
- Have considered the need for diversification and sufficient liquidity
- Have considered the suitability of each investment according to their stated objectives (including ESG)

Where an investment manager consistently fails to meet benchmark performance and shows lack of alignment with the Scheme's objectives, the

Trustees may consider ending their relationship with the investment manager. This, along with the fees paid to investment manager, forms the incentivisation to managers to meet the requirements of the investment mandates.

Conflicts of interest

It is the responsibility of the investment manager to report internal conflicts of interest. Managers may for example separate their debt and equity teams and constrain themselves not to buy securities of their firm. However, there may be circumstances where the manager cannot fully align their strategy and decisions to the (potentially conflicting) policies of all their pooled fund investors.

Assessing medium to long-term performance of investments

The Trustees monitor how the investment manager makes decisions based on the medium to long-term financial and non-financial performance of investee companies. Where the Trustees have concerns they will raise this with the investment manager.

Monitoring performance and remuneration

The Trustees monitor the performance of their investment manager on a quarterly basis.

When assessing the performance of an investment manager, the Trustees consider:

• The investment manager’s financial performance against stated benchmarks and the rest of the market, both in terms of individual performance and their wider role in helping the Scheme meet its long-term objectives.

• Qualitative factors such as the service provided by the investment manager, including the quality of reporting.

Where the Trustees believe that an investment manager has performed poorly for a material period, they will carry out a formal review and look to replace the manager where necessary.

Monitoring portfolio turnover and costs

The Trustees will ensure that fees paid to the investment manager are consistent with the levels typically available in the industry and the nature of services provided.

The Trustees recognise that portfolio turnover and associated transaction costs are a necessary part of investment management and that the impact of portfolio turnover costs is reflected in performance figures provided by the investment manager.

The Trustees do not believe in setting a portfolio turnover target – being the frequency with which assets are expected to be bought and sold – because they believe that the investment manager has sufficient expertise to make judgement on the appropriate portfolio turnover. Some portfolio turnover is also inevitable as part of rebalancing processes in say index-tracking funds within actively managed mandates.

The Trustee monitors the costs incurred by the investment manager in buying and selling investments. The investment manager incorporates portfolio turnover and resulting transaction costs as appropriate in their reporting.

Duration of arrangements with Investment Managers

The duration of the Trustee's arrangements with investment managers will vary depending on the investment strategy and asset allocation of the relevant portfolio.

Appendix C provides a breakdown of investment manager fee and further information on the arrangements with the manager. These fees are based on a fixed annual management charge and/or a fee based on the size of the assets managed unless stated.

The investment manager will:

1. Select securities and undertake transactions in specific investments within each asset class to achieve the stated objective.
2. Provide the Trustees with sufficient information periodically to facilitate the review of its activities, including:

   a. A report of the strategy followed during the quarter

   b. The rationale behind past and future strategy

   c. A full valuation of the assets and performance summary

   d. A transaction report and cash reconciliation.

   e. How ESG factors have been incorporated into investment decisions i.e. evidence the manager is adhering to their stated ESG policies.

3. Informing the Trustees immediately of:

   a. Any changes to the management of the underlying investment strategy

   b. Any serious breach of internal operation procedures

   c. Any material change in the knowledge and experience of those involved in managing the Scheme's investments, including changes to key investment personnel

   d. Any breach of investment restrictions agreed within the stated client service agreement or fund prospectus.

6.2 Statement of Investment Principles (SIP)

The Trustees will review this SIP on a regular basis or following any changes to the investment strategy and modify it after consultation with the Investment Adviser and the Principal Employer. There will be no obligation to change this SIP or any adviser relationship as part of such a regular review. Following any changes to the investment strategy this SIP will require updating to reflect the revised investment strategy.

6.3 Trustees

The Trustees maintain a record of all decisions taken, together with the rationale in each case.

7. RISKS

The Trustees recognise that there are a number of risks involved with the current investment strategy.

The Trustees will monitor and review the Investment Manager's performance on a regular basis. The responsibilities of the Trustees, Investment Adviser and Scheme Actuary are set out in Appendix B.

The Trustees recognise that the following are some of the risks involved in the investment of assets of the Scheme:

- **Cashflow risk**

The risk of a shortfall of liquid assets relative to the immediate liabilities. The Trustees and its adviser will manage the Scheme's cash flows, taking into account the timing of future payments.

- **Financial mismatching risk**

The risk of a significant difference in the sensitivity of asset and liability values to changes in financial factors, in particular long-term inflation expectations and long-term interest rates. The Trustees will mitigate these risks by monitoring the key characteristics and setting appropriate hedging strategies.

- **Demographic risk**

Demographic factors include the uncertainty surrounding mortality projections such as future improvements in mortality experience. The Trustees recognise that there is currently no readily-tradable instrument to hedge this type of risk and that this risk may not be fully mitigated. The Trustees will measure liabilities using mortality assumptions recommended by the Scheme Actuary.

- **Manager risk**

The failure by the Investment Manager to achieve the rate of investment return assumed by the Trustees. This issue has been considered by the Trustees on the initial appointment of the Investment Manager and thereafter will be considered as part of the investment review procedures the Trustees put in place.

- **Concentration risk**

The risk that the performance of any single asset class or single investment that constituted a significant proportion of the assets would disproportionately influence the Trustees' ability to meet the objectives. The Trustees in due course will modify their investment strategy to seek the outperformance required to meet future liability payments, and will ,therefore, look to diversify the investment strategy.

- **Transition risk**

The risk of incurring inappropriate costs in relation to the transition of assets. The Trustees will mitigate this risk by using its Investment Advisor to help it implement transitions of assets effectively and efficiently.

- **Custody risk**

The Scheme's assets are invested in a pooled fund, with limited control or oversight of the custody arrangements for the underlying investment. The Trustees expect the investment manager to monitor the custody arrangement for the pooled fund it invests in. From time to time, the Trustees will seek confirmation from the investment manager that they are undertaking an appropriate level of monitoring of the custodial arrangement.

- **ESG risk**

Investment managers are expected to manage portfolios that adhere to stated policies concerning the suitability of any investments based on a consideration of ESG factors. The Trustees monitor manager adherence to these stated policies to ensure they remain aligned with those of the pension scheme.

The Trustees will keep these risks under regular review.

8. ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

The Trustees take into account financially material considerations, including those arising from Environmental, Social and Governance ('ESG') factors, through the selection and ongoing monitoring of the investment manager employed to manage Scheme assets.

The Trustees have delegated overall stewardship of the Scheme's underlying investments to the investment manager, including the exercise of the rights (including voting rights) attaching to the Scheme's investments and engagement with investee companies on their performance, strategy, capital structure, management of actual or potential conflicts of interest, and social, environmental and corporate governance risks. The Trustees may also as part of the asset allocation process, select investment managers to invest specifically in corporate debt or equity, or give diversified mandates where managers are able to invest in both debt and equity or investee companies. .

The Trustees will review the managers' stewardship policies and voting behaviours periodically to check that they are consistent with delivering an appropriate level of long term return for the Scheme.

These arrangements are periodically reviewed and the ESG activities of the manager are considered where the Trustees see fit. The Trustees, with help from their investment adviser, will seek to engage with the manager relating to their ESG policies and approach.

Where the Trustees do not believe a manager's approach to ESG matters is consistent with their goals to deliver an appropriate level of long-term returns for the Scheme and the manager has failed to respond to efforts to engage them, the Trustees may seek to switch the manager with a suitable replacement.

Currently the Trustees do not take into account non-financial matters such as member views. However, the Trustees may take such matters into account where they believe it would be prudent to do so. Where the Trustees do take into account non-financial matters, they will inform the Scheme's employer of their decision to do so, the nature of the non-financial matters taken into account and provide any other information which they feel is appropriate in respect of such a decision.

9. OTHER MATTERS

9.1 Statutory Funding Objective

The Trustees will obtain and consider proper advice on the question of whether the investments and investment strategy are satisfactory having regard to both the investment objectives and the requirements to meet the Statutory Funding Objective. The funding position is reviewed periodically by the Scheme Actuary, with a full actuarial valuation at least every three years.

The Trustees will consider with the Investment Adviser and the Scheme Actuary whether the results of these actuarial valuations suggest that any change to investment strategy is necessary to ensure continued compliance with the Statutory Funding Objective.

9.2 Corporate Governance

The Scheme's investments are implemented via pooled investment funds, in which the Scheme's investments are pooled with those of other investors. As such, direct control of the process of engaging with the companies that issue these securities, whether for corporate governance purposes, social, ethical or environmental factors, is delegated to the investment manager of each pooled investment fund. As such, the Trustees do not have a formal corporate governance policy. However, the extent to which these factors are taken into account in the selection, retention and realisation of investments is considered by the Trustees and their Investment Adviser as part of the process of selecting investment managers and specific funds in which to invest.

9.3 Realisation of Assets

The assets are held in a pooled fund, which can be realised easily if the Trustees so requires.

Where it is necessary to make payments out from the Scheme, in the first instance payments will be taken from any residual cash holding within the portfolio. Where there is insufficient residual cash, cash will be raised by the sale of investments of the Scheme. The policy for meeting cash realisation will be reviewed on a regular basis by the Trustees.

9.4 Custody

Details of the custodians used by the Investment Manager who provides services to the Scheme are set out in the agreement between the Investment Manager and the Trustees.

9.5 Conflicts of Interest

The Trustees will ensure that any conflicts of interest are managed at all times in the best interests of the Scheme.

Appendix A – Details of Scheme Advisors

Scheme Actuary:

Aon

Investment Adviser:

PricewaterhouseCoopers LLP ("PwC")

Investment Manager:

Legal & General Investment Management ("LGIM")

Appendix B – Responsibilities of each Party Involved in the Scheme

Investment Advisor

The Investment Advisor will be responsible for, amongst other things:

- Monitoring the performance of the Investment Manager relative to their respective benchmarks and targets as well as the asset mix versus the agreed asset allocation;
- Reporting to the Trustees on the performance of the Investment Manager and the Scheme as a whole, highlighting any developments within each organisation that could impact future performance;
- Undertaking reviews of the Scheme's investment arrangements including review of the asset allocation policy, ESG policy, the current investment managers, and advice on the selection of new managers, as appropriate.
- Assisting the Trustees with the annual review and update of this Statement;
- Periodically reviewing the overall investment strategy to ensure that it remains appropriate to meet the Scheme's long term funding objective;
- Keeping the Trustees notified of any developments within investment markets or legislation that may be of interest/relevance to the Scheme.

Scheme Actuary

The Scheme Actuary will be responsible for, amongst other things:

- Performing the triennial (or more frequently as required) valuations and advising on the appropriate contribution levels.
- Commenting on the appropriateness of the investment strategy relative to the liabilities of the Scheme at the triennial valuation.
- Advising the Trustees and the Investment Advisor of any changes to contribution levels and funding level.
- Proper accounting, preparation of the annual report, administration of the annual audit and other financial reporting as required.

Appendix C – Investment Strategy Asset Allocation

The temporary asset allocation of the Scheme is set out below.

The investment objective for the portfolio is to ensure high liquidity of the underlying fund. The long-term expected return is in line with short duration gilts.

The investment was made in May 2020.

Fee:

0.100% p.a. of the first £5m, plus

0.075% p.a. of the next £5m, plus

0.050% p.a. of the next £20m, plus

0.030% p.a. of the balance above £30m.

The benchmark for the Scheme is given in the table below:

Asset Class	Investment Manager	Fund	Target Allocation (%)	Benchmark
Short-duration gilts	Legal & General Investment Management	0-5 year Gilts Index Fund	100	FTSE Actuaries UK Conventional Gilts up to 5 Years Index