Somerfield Pension Scheme ("The Scheme")

Statement of Investment Principles – August 2017

1. *Introduction*

TCG Southern Trustees Limited, the Trustee of the Somerfield Pension Scheme (the "Trustee") has 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 seeks to take into account the principles underlying the (Myners) Code of Best Practice for pension scheme investment, which has been endorsed by the Government and the Pensions and Lifetime Savings Association. The Statement also seeks to take into account the Investment Governance Group ('IGG') principles for defined benefit pension schemes.

The Statement is intended to affirm the investment principles that govern decisions about the Scheme's investments.

The Scheme operates for the purpose of providing retirement and death benefits to eligible participants and beneficiaries in a defined benefit framework.

In preparing this Statement, the Trustee has consulted the Scheme's Principal Employer, Co-operative Group Limited ("the Group"), to ascertain whether there are any material issues of which the Trustee should be aware in agreeing the Scheme's investment arrangements. However, the ultimate power and responsibility for deciding investment policy lies solely with the Trustee.

The investment responsibilities and powers of the Trustee are governed by the Scheme's Trust Deed and Rules (a copy of which is available on request) and relevant legislation. According to the law, the Trustee has ultimate power and responsibility for the Scheme's investment arrangements.

The Trustee has established an Investment Committee to focus on investment matters. While the Trustee retains direct responsibility for setting investment objectives setting the Scheme's strategic benchmark and manager structure, it makes these decisions after considering recommendations from the Investment Committee. The role of the Investment Committee is set out in the Appendix.

The Trustee has also established a Manager Review Committee (in conjunction with other Co-operative Group pension schemes) to focus on and review the Scheme's investment managers. The Manager Review Committee is an advisory body that may make recommendations to the Investment Committee or Trustee regarding investment manager-related matters

2. *Process For Choosing Investments*

The process for choosing investments is as follows:

- Identify appropriate investment objectives;
- Consider the level of risk consistent with meeting the objectives set; and,

- Construct a portfolio of investments that is expected to maximise the return (net of all costs) given the Trustee's risk tolerance.

The Trustee has adopted a set of investment beliefs, and aims to choose investments and construct a portfolio of investments that is consistent with these beliefs. In considering the appropriate investments for the Scheme the Trustee has obtained and considered the written advice of Mercer, whom the Trustee believes to be suitably qualified to provide such advice. Where matters described in this Statement may affect the Scheme's funding policy, input has also been obtained from the Scheme Actuary. The advice received and arrangements implemented are, in the Trustee's opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended).

3. *Investment Objectives*

The Trustee's objective is 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 Trustee has agreed a number of objectives to help guide it in its 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:

- To target an expected return on the Scheme's portfolio of assets which exceeds the return required to improve the funding level of the Scheme on both a technical provisions basis and a gilt-based least risk basis. For the technical provisions basis, the Scheme Actuary used a discount rate assumption of gilts plus 0.5% at the most recent actuarial valuation. The Scheme's current strategy (as described in Section 6 below) is expected to achieve a return of c.1.0% p.a. above gilts.

- To limit to 1 in 6 the chance of the assets under-performing the liabilities by more than c.2.5% over any calendar year.

- To ensure that the interest rate and inflation sensitivity of the assets is very similar to that of the liabilities.

4. *Risk Management and Measurement*

The Trustee recognises a number of risks involved in the investment of the Scheme's assets. The Trustee will continue to monitor and aim to manage the key risks, principally:-

- **Solvency risk and mismatching risk** - addressed through the asset allocation strategy, through triennial actuarial valuations and the funding objectives.

- **Manager risk** - addressed through the diversification of the Scheme's assets across a range of managers with different styles and through the ongoing monitoring of the managers.

- **Liquidity risk** - the monthly benefit and expenses outgo is monitored to ensure that sufficient cash balances are available. Investment in illiquid assets is kept to an appropriate level, and a prudent approach is taken to maintaining suitable levels of collateral to support derivative programmes.

- **Counterparty risk** – where the Scheme enters into derivative transactions, either directly or via pooled funds, these will be collateralised as appropriate. Where possible, the Scheme will engage a range of counterparties (with counterparty selection for specific trades delegated to investment managers), with limits placed on exposure to any individual counterparty, to reduce the impact of a potential counterparty default.

- **Custody risk** – addressed by monitoring the custodian's activities and the creditworthiness of the custodian bank, and discussing the performance of the custodian with the investment managers when appropriate.

- **Political risk** – addressed through regular reviews of the actual investments relative to policy and through regular assessment of the levels of concentration in individual markets within the existing policy.

- **Corporate governance risk** – managed through regular reviews of stock concentration and regular discussions with the investment managers about sustainability risks.

- **Sponsor risk** – addressed by regular assessments of the ability and willingness of the sponsor to support the Scheme and to make good any deficit.

- **Leverage risk** – addressed by regular review of the size, amount and nature of any leveraged investments made by the Scheme's investment managers and monitoring of potential collateral requirements.

- **Currency risk** – addressed through hedging a portion of non-Sterling currency exposure as appropriate and where this risk is judged to be material.

- **Credit risk** – addressed through holding a diverse range of credit investments across a variety of issuers and sectors, with exposure limits in place, through having in place investment managers who assess the creditworthiness of the debt instruments in which the Scheme invests and through appropriate limits on credit quality.

- **Hedging Related Risks** – management of the majority of these risks is delegated to the Scheme's liability hedging manager. However, the Trustee also regularly reviews a range of liability hedging risks within quarterly reporting and other analysis.

Other risks are addressed through the Investment Restrictions or within the individual investment manager and custodian agreements.

5. *Portfolio Construction*

It is the Trustee's policy to consider a full range of asset classes either directly or via pooled funds which utilise a wide range of asset classes and investment management techniques, including but not limited to:

- Equities (UK and overseas, including emerging markets)

- Illiquid Credit

- Corporate Bonds
- Liability Driven Investments ("LDI")

The Trustee has adopted the following control framework in structuring the Scheme's investments:

- There is a role for both active and passive management. Passive management will be used for one of a number of reasons, namely:
  - To diversify risk
  - To invest in markets deemed efficient where the scope for active management to add value is limited
  - As a temporary home pending investment with an active manager
- To help diversify manager specific risk, multiple manager appointments are preferred where practical (e.g. corporate bonds and illiquid credit).
- At the total Scheme level and within individual manager appointments investments should be broadly diversified to ensure there is not a concentration of investment with any one issuer.
- The Trustee has a policy to consider the place for passive currency hedging for the Scheme's overseas assets. It has been agreed, in conjunction with its Investment Adviser, to leave non-Sterling currency exposure unhedged within the equity portfolio, but to target a 100% hedge of non-Sterling currency exposure within the credit portfolio.
- Investment in illiquid investments, such as illiquid credit assets, may be held in limited quantities. The proportion of such investments will be monitored at the total Scheme level.
- Investment in derivatives is permitted as agreed on a manager by manager basis as long as they contribute to a reduction in risk or facilitate efficient portfolio management.
- Investment may be made in securities that are not traded on regulated markets. Recognising the risks (in particular liquidity and counterparty exposure), the Trustee will look to ensure that the assets of the Scheme are predominantly invested on regulated markets.
- No investment in securities issued by the Scheme's Sponsoring Employer or affiliated companies will be made directly (i.e. this excludes any such securities held within a pooled fund in which the Scheme invests).
- No investment by an appointed investment manager in the securities issued by the relevant manager's company, or any affiliated companies, will be made (other than any such securities held within a pooled fund in which the Scheme invests).

6. *Investment Strategy*

The Trustee recognises that it is not necessarily possible, or even desirable, to select investments that exactly match the liabilities. Given the ongoing commitment of the Group to the Scheme, a degree of mismatching risk can be accepted on the basis that it is also acceptable to the Group.

The Trustee has decided to set an investment strategy, which is expected over the medium term to produce investment returns to meet the investment objectives, while limiting the risk inherent in the mismatch between assets and liabilities to an acceptable level to the Trustee and to the Group.

The Investment Adviser provided advice on an appropriate investment strategy with input from the Scheme Actuary and the Group on the acceptable degree of mismatch between the assets and liabilities.

At the time of writing, the Trustee is in the process of implementing a series of changes to the Scheme's investment arrangements. The rationale for these changes is to continue to aim to meet the investment objectives as set out in Section 3, with lower costs and more transparency / flexibility than the previous arrangements.

The target investment strategy as agreed by the Trustee is shown in the table below. (This target strategy is subject to change over time and the Scheme's actual asset allocation is likely to be different to the target allocation set out for the next few years as the investment strategy is implemented.)

Asset Class	**Target Allocation (%)**
Equities	8.0
Illiquid Credit	10.0
Corporate Bonds	15.0
Liability Hedge Portfolio	67.0
Total	**100.0**

The Scheme may continue to have legacy holdings not listed in the above over the short to medium term but these are in the process of being redeemed. As such, the above should be seen as an indicative medium term target that the Trustee is working toward.

The Trustee has agreed that rebalancing should occur on a pragmatic basis, whereby cashflows either into or out of the Scheme will be used to broadly maintain the asset allocation in line with the target investment strategy noted above (albeit cashflows into / out of illiquid credit assets will be opportunity dependent).

In addition, the overall asset allocation will be monitored via the regular performance reports provided by the investment adviser, who will propose further rebalancing if deemed appropriate (particularly if the portfolio's long term expected return moves sufficiently far away from the required level).

7. *Expected Return*

The expected excess return from the Scheme's investment policy is 1.0% p.a. above a gilt based measure of the liabilities. The Trustee believes that the expected excess return is sufficient to meet the investment objectives outlined.

8. *Day- to-Day Management of the Assets*

In compliance with the Financial Services and Markets Act 2000, day to day management of the assets is delegated to professional Investment Managers who are all regulated by the Financial Conduct Authority ("FCA") or the relevant authority in the domicile country. The Investment Managers have full discretion to buy and sell investments on behalf of the Fund subject to the terms and conditions contained with the documentation governing their appointment.

9. *Realisation of Investments*

The investment managers have discretion in the timing of realisation of investments and in considerations relating to the liquidity of those investments within parameters stipulated in the relevant appointment documentation.

The Trustee monitors the allocation between the appointed managers and between asset classes as appropriate. This includes consideration of the split within the broad asset classes shown above and the selection, monitoring and termination of the underlying investment managers.

10. *Additional Assets*

The Trustee is responsible for the investment arrangements of Additional Voluntary Contributions ("AVCs") paid by members in the past and various immediate annuity contracts. The Trustee reviews the investment performance of the chosen AVC providers on a regular basis and takes advice as to the providers' continued suitability.

11. *Socially Responsible Investment and Corporate Governance*

The Trustee believes that good stewardship and environmental, social and governance ("ESG") issues may have a material impact on investment returns. For those assets of the Scheme invested in pooled funds, the Trustee cannot directly influence the policies and practices of companies in which the pooled funds invest. As such, the Trustee has given these investment managers full discretion when evaluating ESG issues and in exercising rights and stewardship obligations attached to the Scheme's investments.

Similarly, the Scheme's voting rights are exercised by its investment managers in accordance with their own corporate governance policies, and taking account of current best practice including the UK Corporate Governance Codes and the UK Stewardship Code.

Equity managers who are registered in the UK are expected to report on their adherence to the UK Stewardship code on an annual basis.

12. ***Professional Investment Advice***

The Trustee has appointed Mercer Limited to provide advice on all aspects of investments relating to the Scheme.

13. ***Review of this Statement***

The Trustee will review this Statement annually and without delay after any significant change in investment policy. The Investment Advisers will provide the advice needed to allow the Trustee to review and update this Statement as required. In addition, no change will be made to the Statement unless the proposed changes to investment policy have been approved by the Trustee and recorded in the minutes of a Trustee meeting.

Signed: ____________________ Date: 3 - 10 - 2017

CPV MARTIN

Name: INDEPENDENT TRUSTEE SERVICES LTD

Signed: ____________________ Date: 3 - 10 - 2017

Name: TOM TAYLOR

Signed on behalf of TCG Southern Trustees Limited

Appendix: Division of Duties and Responsibilities

Duties and Responsibilities	Executed By
▪ Overall responsibility for the Scheme's investments. ▪ Define the terms of appointment of the Investment Committee. ▪ Appoint the members of Investment Committee.	The Trustee
▪ Recommend the Investment Adviser to the Trustee. ▪ Recommend investment objectives to the Trustee. ▪ Recommend strategic framework to the Trustee. ▪ Monitor the Investment Adviser. ▪ Make day-to-day decisions relevant to the operation of the Scheme's investment strategy.	The Investment Committee
▪ Monitor appointed Investment Managers and other service providers.	The Manager Review Committee
▪ Perform asset liability modelling exercises, as required. ▪ Advise on the strategic framework. ▪ Advise on the selection of the Investment Managers. ▪ Monitor the Investment Managers, providing both qualitative and quantitative input to the Investment Committee. ▪ Advise on the implementation of mandates. ▪ Advise on the Statement of Investment Principles.	The Investment Adviser
▪ Operate within the conditions set down by the Investment Management Agreement. ▪ Select individual investments with regard to their suitability and diversification. ▪ Supply the Trustee with sufficient information each quarter to allow the review of activity.	The Investment Managers