VTB Capital plc (defined benefits) Scheme

Statement of Investment Principles – February 2021

1. **Background**

This Investment Statement ("the Statement") sets down the principles governing decisions about investments for the VTB Capital plc (defined benefits) Scheme (the "Scheme") to meet the requirements of the Pensions Act 1995 ("the Act") and subsequent legislation. Before preparing this Statement, the Trustee has consulted with VTB Capital plc (the "Bank" and/or "Company") and obtained and considered written professional advice from Mercer Limited ("Mercer" and/or "Investment Consultant"), the Investment Consultant.

The Trustee's investment responsibilities are governed by the Scheme's trust deed: a copy of the relevant clause(s), of which this Statement takes full regard, is available for inspection.

2. **Investment Policy**

The Trustee's key aims are (in order of priority):

- To make sure the obligations to the beneficiaries of the Scheme are met. In agreement with the Bank, the Trustee has a long term objective to buy out (or buy in) all of the Scheme's liabilities;

- To pay due regard to the Bank's interests on the size and incidence of employers' contribution payments; and

- To manage funding level volatility and associated risks to within reasonable levels.

3. **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; and

- Construct a portfolio of investments that is expected to maximise the return (net of all costs) given the targeted level of risk.

The Trustee is responsible for ratification of all decisions relating to investments unless otherwise delegated. When necessary, the Trustee obtains advice from their Investment Consultants, before making any decisions. 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).

The Trustee has delegated day to day investment decisions to their appointed investment managers.

4. Investment Objectives

In agreement with the Bank, the Trustee's long term target is to fully fund all of the Scheme's liabilities through buyout (or buy in).

The Trustee's objective is to invest the Scheme's assets in the best interest of the members and beneficiaries. Within this framework the Trustee has 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:

- To ensure the assets of the Scheme are sufficient to meet the liabilities as an ongoing scheme.
- To limit the volatility of future pension costs caused by volatility of asset returns relative to the liabilities.
- To limit the risk of cash calls on the Company in difficult trading conditions.
- To achieve a favourable return on the investments held against each manager's benchmark, with the benchmark set being consistent with the Actuary's long term assumptions in determining the funding level of the Scheme.
- To maintain the funding position of the Scheme on an ongoing basis to at least 100% on the Technical Provisions basis.
- Over the longer-term, to achieve and then maintain a funding position of the Scheme on a low risk solvency or equivalent basis of 100%.Additional objectives are as follows:
- To maximise a return on the total Scheme's assets relative to the level of risk considered appropriate.
- To pay due regard to the Company's interest in the size and incidence of contribution payments.

5. Risk Management and Measurement

There are various risks to which any pension scheme is exposed. The Trustee has considered the following risks:

- The risk of deterioration in the Scheme's funding level over the long-term.

- The risk of a shortfall of assets relative to the liabilities.

- The risk that investment managers, in their day-to-day management of the assets, will not achieve the rate of investment return expected by the Trustee. The Trustee has therefore decided to invest the Scheme's assets on a passive basis, which is also considered appropriate when set against the Trustee's investment policy and long term funding target of the Scheme.

The primary risk upon which the Trustee focuses is that arising through a mismatch between the Scheme's assets and its liabilities. The Trustee manages this risk by investing in a Liability Driven Investment ("LDI") portfolio in order to provide some protection against changes in the value of the liabilities due to changes in long term interest rates and inflation. In addition, the Trustee has funded a partial bulk buy-in annuity policy for a portion of the Scheme's pensioner liabilities. The risk arising from a mismatch of assets and liabilities is considered carefully as part of each asset/liability analysis, and monitored quarterly via investment monitoring reports provided by the Investment Consultant. The Trustee believes that the asset allocation policy in place provides an adequately diversified distribution of assets. This will be reviewed, in conjunction with the Bank, following each actuarial valuation or as circumstances dictate.

The Trustee recognises 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 short-term volatility in the Scheme's funding position. The Trustee has taken advice on the matter and (in light of the objectives noted previously) considered carefully the implications of adopting different levels of risk.

The Trustee also recognises 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 Trustee aims to ensure the asset allocation policy in place results in an adequately diversified portfolio. Due to the size of the Scheme's assets and recognising the need to diversify, investment exposure is obtained via pooled vehicles.

The documents governing the manager appointments include a number of guidelines which, among other things, are designed to ensure that only suitable investments are held by the Scheme. The managers are prevented from investing in asset classes outside their mandate without the Trustee's prior consent.

Arrangements are in place to monitor the Scheme's investments to help the Trustee check that nothing has occurred that would bring into question the continuing suitability of the current investments. To facilitate this, the Trustee receives regular reports from the investment manager and the Investment Consultant. These reports include an analysis of the overall level of risk and return, to ensure the risks taken and returns achieved are consistent with those expected. In addition, the Trustee utilises an online tool to monitor the Scheme's current and projected funding position across a number of matrices, as well as the Scheme's estimated Value at Risk (VaR) measure.

The safe custody of the Scheme's assets is delegated to professional custodians (via the use of pooled vehicles).

Currency risk will arise through investment in non-sterling assets, given that the Scheme's liabilities are denominated in sterling, because changes in exchange rates will impact the relative value of the assets and liabilities. As a result, the Trustee hedges 100% of the overseas currency exposure back to sterling, with the exception of emerging market exposure.

Investments may be made in securities that are not traded on regulated markets. Recognising the risks (in particular the potential inability to convert an asset back to cash quickly or the risk that a counterparty fails to meet its contractual obligations), such investments will normally only be made with the purpose of reducing the Scheme's mismatch risk relative to its liabilities or to facilitate efficient portfolio management.

Should there be a material change in the Scheme's circumstances, the Trustee will review whether and to what extent the investment arrangements should be altered; in particular, whether the current risk profile remains appropriate.

The Agreement with Legal & General Investment Management Limited ("Legal and General") includes a number of guidelines and restrictions which, among other things, are designed to ensure that only suitable investments are held by the Scheme. Legal & General are well aware of the absolute need to avoid any action that could be considered to be 'speculative', or 'trading' by the FCA or by the tax authorities.

6. Portfolio Construction

The Trustee has structured the Scheme's investments subject to the overriding constraint that at the total Scheme level, the expected level of risk is consistent with the investment objectives. The Trustee has appointed Legal and General to invest the assets on behalf of the Scheme.

There is a role for both active and passive management. Passive management will predominantly be used for one of a number of reasons, namely:

- To diversify and reduce risk.
- Invest in markets deemed efficient where the scope for active management to add value is limited.

There is a preference to invest via pooled funds.

Investment in securities issued by the Company or affiliated companies is limited to the extent that such securities may be represented within the pooled funds in which the Trustee invests.

The LDI portfolio will be invested in pooled physical gilts and index-linked gilts, as well as derivatives such as gilt and index-linked gilt repurchase agreements (“repo”), gilt and index-linked gilt total return swaps and interest and inflation rate swaps. Cash and gilts will also be held as collateral to back the derivative contracts. The investment manager is responsible for monitoring risks relating to counterparties, collateral adequacy and leverage levels on a day-to-day basis. This is supplemented by regular strategic reviews by the Trustee.

At the time of writing, the LDI portfolio targets a hedge of 90% of the Scheme’s interest rate and inflation related liability risks (measured as a proportion of the Scheme’s Gilts Flat liabilities).

7. Investment Strategy

The Trustee regards the choice of asset allocation policy as the decision which has most influence on the likelihood that they will achieve their investment objectives. The Trustee’s decisions on asset allocation policy are made on the advice of their Investment Consultant and in consultation with the Company.

In order to arrive at the current strategy, the Trustee has taken the Scheme’s overall liability profile into consideration and assessed the risk and return characteristics of a range of different investment strategies in relation to the Scheme’s liabilities.

In addition, the Trustee regularly reviews different investment types to assess whether they are appropriate in relation to the liabilities and objectives of the Scheme.

The strategic asset allocation is shown below. The Trustee believes that this strategy is currently appropriate for controlling the risks identified in section 5.

The table below sets out the Scheme’s target investment strategy (including the buy-in policy).

Asset Class	Strategy %	Range %
Buy-in*	35.0	-
LDI	26.0	16.0 – 36.0
Global Buy and Maintain Credit	29.2	18.0 – 40.0
Equities	9.8	5.0 – 15.0
Total	**100.0**	

* Includes buy-in policies with Sun Life and Pension Insurance Corporation
** 100% of the overseas currency exposure is hedged back to Sterling, with the exception of emerging markets.

8. Rebalancing and Cashflow Policy

There is no rebalancing between the buy-in policies and the Scheme's investments excluding the buy-in policies.

There is no automatic rebalancing between the LDI, buy and maintain credit and equity portfolios, however the Trustee reviews the asset allocation on a quarterly basis, and may decide to rebalance between asset classes as and when required in line with the strategic asset allocation as set out in section 7.

The Scheme holds an allocation to liquidity assets (cash and/or short dated gilts). This holding is considered separate to the wider strategic allocation, and is used for the purposes of: 1) helping to meet cashflow deficits when required; and 2) being an additional source of collateral for the leveraged LDI funds, for example if government bond yields were to rise significantly resulting in one or more of the leveraged LDI funds hitting their upper leverage limit and triggering a 'de-leveraging' event (resulting in a request for additional capital).

9. Investment Management

The Trustee delegates the day-to-day management of the assets to their appointed investment managers. The Trustee has taken steps to satisfy itself that the managers have the appropriate knowledge and experience for managing the Scheme's investments and that they are carrying out their work competently.

The Trustee has determined, based on expert advice, a benchmark mix of asset types and ranges within which the appointed investment manager may operate. The Trustee regularly reviews the continuing suitability of the Scheme's investments, including the appointed managers.

The assets are managed by Legal & General, who are regulated by the Financial Conduct Authority (the "FCA") and have full discretion to buy and sell investments on behalf of the Scheme, subject to the constraints of their mandates. As required by the Financial Services Act 1986 and the Pensions Act 1995, the Trustee has entered into a signed Agreement with Legal & General, the terms of which are consistent with the principles contained in this Statement.

The Agreement with Legal & General is in the form of an insurance policy with Legal and General Assurance (Pensions Management) Limited. Legal and General Assurance (Pensions Management) Limited is jointly regulated by the FCA and the Prudential Regulatory Authority ("PRA"). The investment of the assets under the policy is delegated to Legal & General.

The investment with Legal & General is in the form of an insurance policy whereby the insurer owns the underlying pooled fund units. The Trustee has no direct ownership of the underlying pooled funds or the underlying assets of the pooled funds. The safekeeping of the assets within the pooled funds is performed on behalf of the investment manager by a custodian bank specifically appointed to undertake this function, and whose appointment is reviewed at regular intervals by the manager. The custodian banks for the underlying funds at Legal & General are HSBC Securities Services, Citibank and Northern Trust.

The Agreement with Legal & General provides important protection for the Scheme and for the Trustee. It also sets out the terms, including performance objectives, risk parameters, and timescales, on which the specific mandates are managed. The investment briefs, guidelines and restrictions under which Legal & General work have therefore been agreed in writing.

Legal & General's mandate is set out below in more detail.

Legal & General

Equity portfolio

Legal & General passively manage equities for the Scheme through a pooled fund, the World Equity Index Fund (GBP Hedged). Their objective for the fund is to track the benchmark, the FTSE World GBP Hedged index, to within a tracking tolerance of ± 0.5% for two years out of three.

All overseas currency exposure is hedged back to sterling with the exception of emerging markets.

Buy and Maintain Credit portfolio

Legal & General manage a Global Buy and Maintain Credit fund for the Scheme. The performance objective of the fund is to capture the credit risk premium within a globally diversified portfolio, and preserve value over the credit cycle by avoiding defaults and securities experiencing a significant deterioration in credit quality.

As the Global Buy and Maintain Credit portfolio is managed using an unconstrained approach, there is no formal benchmark for the fund. Instead other metrics are used to keep track of whether the fund is performing in line with expectations, such as analysis of portfolio defaults (which are expected to be very low), turnover statistics, number of downgrades and upgrades, and the Weighted Average Rating Factor, a measure which tracks the credit quality of the portfolio over time and can be compared to changes in comparable broad market credit indices.

LDI portfolio

The objective of the Scheme's LDI portfolio is to hedge the interest rate and inflation risk associated with the Scheme's liabilities. The LDI mandate hedges c.90% of the Scheme's interest rate and inflation liability risks (measured on the Gilts Flat basis). There is no target allocation between the various LDI funds, as this would be expected to drift in line with the liabilities.

10. Additional Voluntary Contributions (AVCs)

AVCs are invested in funds with Prudential, Utmost, and BlackRock. With the assistance of the Scheme's Investment Consultant, these arrangements are reviewed as circumstances dictate (minimum yearly) to ensure that the investment performance achieved is acceptable relative to the relevant benchmark and the investment profiles of the funds remain consistent with the objectives of the Trustee.

11. Realisation of Investments

The investment manager has 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 and pooled fund prospectuses.

Under the terms of the trust deed the Trustee is responsible for setting the range of investments available for AVCs paid by members. Assets in respect of members' AVCs are held separately from the Scheme's assets.

The Trustee will review these arrangements periodically to ensure that they remain consistent with the needs of the members, and will seek advice from the Scheme Actuary and the Investment Consultant, where necessary.

12. Insured Pensions

A number of pensions in payment have been secured with annuities with Sun Life and PIC.

As far as practically possible, the Trustee will review periodically the financial strength of Sun Life and PIC.

13. Environmental, Social and Governance Issues (ESG), Stewardship, and Climate Change

The Trustee believes that ESG issues have an impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly require explicit consideration.

The Trustee accordingly considers these issues in the context of the anticipated time horizon over which the assets will be held.

The Trustee does not directly manage its investments and the investment manager has full discretion to buy and sell investments within the various portfolios, within the guidelines of its mandates. ESG considerations are however taken into account in the selection, retention and realisation of investments in the following ways:

- The Trustee considers the ESG research ratings published by its investment advisors, Mercer, when monitoring the Scheme's investment manager's capabilities. These ratings are also considered as part of any new selection of investment funds.

- In meetings with the Scheme’s investment manager, ESG issues are discussed and the manager is expected to discuss voting and engagement activities carried out on behalf of the Trustee for mandates where this is relevant.

- Whilst members’ views are not explicitly taken into account in the selection, retention and realisation of investments, the Trustee welcomes views from members.

The Trustee recognises that when the Scheme invests in pooled funds, it has no voting rights attached to the underlying investments. The Trustee has therefore given the 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 manager in accordance with its own corporate governance policies, and taking account of current best practice including the UK Corporate Governance Code and the UK Stewardship Code.

The Trustee is satisfied that this policy corresponds with its responsibilities to the beneficiaries of the Scheme.

Equity managers registered with the appropriate regulator are expected to report on their adherence to the UK Stewardship Code on an annual basis.

The Trustee has not set any investment restrictions on the appointed investment manager in relation to particular products or activities, but may consider this in future.

14. Investment Manager Appointment, Engagement and Monitoring

Aligning manager appointments with investment strategy

The investment managers are appointed based on their capabilities and, therefore, their perceived likelihood of achieving the expected return and risk characteristics required for the asset class being selected for.

The Trustee looks to its Investment Consultant for their forward looking assessment of a manager’s ability to perform in line with expectations over a full market cycle. This view will be based on the Investment Consultant’s assessment of the manager’s idea generation, portfolio construction, implementation and business management, in relation to the particular investment fund that the Scheme invests in. The Investment Consultant’s manager research ratings assist with due diligence and questioning managers during presentations to the Trustee and are used in decisions around selection, retention and realisation of manager appointments.

Some appointments are actively managed and an appointment will be reviewed following any period of sustained underperformance. The Trustee will review appropriateness of using actively managed funds (on an asset class basis) periodically, and receives updates on performance from the managers and Investment Consultant on a quarterly basis.

As the Trustee invests in pooled investment vehicles they accept that they have no ability to specify the risk profile and return targets of the investment manager, but appropriate mandates can be selected to align with the overall investment strategy.

Evaluating investment manager performance

The Trustee considers the Investment Consultant's assessment of how the investment manager embeds ESG into its investment process and how the investment managers' responsible investment philosophy aligns with the Trustee's responsible investment policy. This includes the investment managers' policy on voting and engagement. The Trustee will use this assessment in decisions around selection, retention and realisation of manager appointments.

The Trustee meets with the investment manager on a regular basis, normally at least annually as deemed appropriate. The Trustee will periodically review the decision made by the managers, including voting history (in respect of equities) and engagement activity, and may challenge such decisions where appropriate to try to ensure the best long term performance over the medium to long term.

If the investment objective for a particular manager's fund changes, the Trustee will review the fund appointment to ensure it remains appropriate and consistent with the Trustee's wider investment objectives.

The Trustee periodically reviews the stewardship monitoring reports from each of the managers, which includes details of voting and engagement activities associated with each of the funds invested in. This will aid the Trustee in challenging manager decisions that appear out of line with any of the investment funds' objectives or the objectives/policies of the Scheme.

The Trustee will review the investment managers' compliance against the UK Stewardship Code on an ongoing basis.

Investment managers are aware that their continued appointment is based on their success in delivering the mandate for which they have been appointed to manage. If the Trustee is dissatisfied, then they will look to replace the manager.

Time horizon

The Trustee receives investment performance reports on a quarterly basis. The Trustee reviews the absolute performance and relative performance against a suitable index used as the benchmark, on a gross of fees basis. The Trustee's focus is on long term performance but will put a manager on 'watch' if there are short term performance concerns.

If a manager is not meeting its performance objectives, over a sustained period of time, and after consideration of all relevant factors, the Trustee may take the decision to terminate the manager.

Portfolio turnover costs

The Trustee will review portfolio turnover and associated transaction costs on an annual basis.

The Trustee will engage with a manager if portfolio turnover is higher than expected. This is assessed by compared portfolio turnover across the same asset class, on a year-for-year basis for the same manager fund, or relative to the manager's specified portfolio turnover range in the investment guidelines or prospectus.

Duration of investment arrangements

The Trustee is a long-term investor and do not look to change the investment arrangements on a frequent basis.

There is no set duration for the investment manager appointments and currently the Scheme's investment are all in open-ended vehicles. The Trustee will retain an investment manager, unless:

- There is a strategic change to the overall strategy that no longer requires exposure to that asset class or manager; or

- The manager appointment has been reviewed and the Trustee has decided to terminate the manager.

15. Monitoring the Managers

The Trustees receive regular reports from Legal & General, which analyse the performance and strategic allocation of the Scheme's assets in detail. In addition, the Trustee aims to meet with Legal & General on an annual basis to gain a greater understanding of their performance.

16. Compliance with this Statement

The Trustee monitors compliance with this Statement annually and obtains written or verbal confirmation from the investment manager that it has given effect to the investment principles in this Statement so far as reasonably practicable and that, in exercising any discretion, the investment manager has done so in accordance with Section 4 of The Occupational Pension Schemes (Investment) Regulations 2005. The Trustee undertakes to advise the investment manager promptly and in writing of any material change to this Statement.

The Trustee of the VTB Capital plc (defined benefits) Scheme