ROYAL AIR FORCE BENEVOLENT FUND STAFF PENSION SCHEME

STATEMENT OF INVESTMENT PRINCIPLES

1. Introduction

This Statement of Investment Principles has been drawn up by the Trustee of the Royal Air Force Benevolent Fund Staff Pension Fund ("the Pension Fund") in accordance with Section 35 of the Pensions Act 1995, amended by Section 244 of the Pensions Act 2004 and the Occupational Pension Schemes (Investment) Regulations 2005 (as amended) and the Pension Regulator's guidance for defined benefit pension schemes (March 2017).

This SIP has been prepared after obtaining and considering written professional advice from the Scheme's investment adviser, whom the Trustee believes to be suitably qualified and experienced to provide such advice. The advice considers the suitability of investments including the need for diversification given the circumstances of the Scheme and the principles contained in this SIP. The Trustee has consulted with the relevant Employer in producing this SIP.

2. Decision Making Process

The Trustees

The investment of the Pension Fund's assets is the responsibility of the Trustee and the Pension Fund Rules give the Trustee broad powers on investment. There are no restrictions (however expressed) on any power to make investments by reference to the consent of the Employer.

The Trustee's policy is to seek professional advice on investment strategy. They decide on the investment strategy after considering investment advice from an appropriately qualified investment specialist. The Trustee recognises that their level of investment expertise must be kept under review to be able to critically evaluate this advice.

The Trustee meets regularly and ensures that adequate time is set aside to discuss investment issues. In determining their investment strategy, the Trustee addresses the following:

- the need to consider a full range of asset classes,
- the risks and rewards of a range of alternative asset allocation strategies,
- the suitability of each asset class,
- the need for appropriate diversification, and
- the Pension Fund's Investment and Funding Objectives

The Investment Advice

When required, the Trustee will seek professional investment advice. This will be from a suitably qualified individual who has ability in and practical experience of financial matters and who has the appropriate knowledge and experience of the management of the investments concerned.

The Employer

The Trustee will consult with the Employer as part of the process for deciding on their investment strategy.

Delegation

The Trustees have a policy of delegating all day-to-day powers of investment to the Investment Manager who is authorised and regulated by the Financial Services Authority.

Implementation of the investment arrangements

The Trustee has limited influence over their investment manager's practices because all the Scheme's assets are held in pooled funds, but they encourage their managers to improve their practices where appropriate.

The Trustee's view is that the fees paid to the investment managers, and the possibility of their mandates being terminated, ensure they are incentivised to provide a high quality service that meets the stated objectives, guidelines and restrictions of the funds. However, in practice managers cannot fully align their strategy and decisions to the (potentially conflicting) policies of all their pooled fund investors in relation to strategy, long-term performance of debt/equity issuers, engagement and portfolio turnover.

It is the Trustee's responsibility to ensure that any manager's investment approaches are consistent with their policies before any new appointment, and to monitor and to consider terminating any existing arrangements that appear to be investing contrary to those policies. The Trustee expects investment managers, where appropriate, to make decisions based on assessments of the longer term financial and non-financial performance of debt/equity issuers, and to engage with issuers to improve their performance. They assess this when selecting and monitoring managers.

The Trustee evaluates investment manager performance by considering performance over both shorter and longer-term periods as available. It is expected that the duration of a manager's appointment will depend on strategic considerations and the outlook for future performance. Generally, the Trustee would be unlikely to terminate a mandate on short-term performance grounds alone.

The Trustee's policy is to evaluate their investment manager by reference to the manager's individual performance as well the role it plays in helping the Scheme meet its overall long-term objectives, taking account of risk, the need for diversification and liquidity. The manager's remuneration, and the value for money it provides, is assessed in light of these considerations.

The Trustee recognises 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 managers. The Trustee expects their investment consultant to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Pension Fund's investment mandates.

3. Investment Objectives

Funding Objective

The primary funding objective of the Pension Fund is to ensure, as far as possible, that there are sufficient assets to provide benefits to the Pension Fund members as and when they fall due.

The Pension Fund was closed to new members on 31 August 2005 and to further benefit accruals on 30 April 2014. This means that the future labilities of the Scheme can be estimated with greater accuracy than hitherto.

Investment Objectives

The Trustee's high-level objectives about investing the Pension Fund assets are to:

- achieve a return which is sufficient, over the longer term, to meet the Funding Objective
- adopt an approach that recognises the need to balance risk with the achievement of a satisfactory investment return

At times when the Scheme is underfunded the Employer is content for the Trustee to take some investment risk in the context of the above stated objectives.

Performance Objective

To reflect the investment objective, the Trustee has adopted a strategy which initially aims to deliver a best estimate return of 2.9% pa above gilts, net of fees, but as the Scheme matures the expected return will be tapered to a lower risk investment portfolio.

4. Investment Strategy

To achieve the performance objective, the Trustees have agreed for the time being to invest their assets in a diversified growth fund, passive global equities and a liability driven investment portfolio (which includes a cash holding to support leverage taken within that portfolio).

The Trustee, with the help of their advisers and in consultation with the Employer, reviewed the investment strategy in May 2022. The result of this review was that the Trustee agreed to adopt the follow strategic allocations and tolerance ranges around the Scheme's growth assets. We note there is no tolerance range in place on the LDI portfolio.

Asset class	Allocation (%)	Of growth assets (%)	Tolerance ranges (within growth portfolio)
Diversified growth	**35**	**47**	**+/- 5%**
Equities *(passive)*	**40**	**53**	**+/- 5%**
LDI portfolio	**25**	**N/A**	**-**
Total	**100**	**100**	

The LDI portfolio (which uses funds from LGIM's Matching Core Fund range) aims to reduce the impact of interest rate and inflation movements on the Scheme's funding position. The LDI funds within the LDI portfolio use leverage to give greater exposure to changes in interest and inflation rates than is possible with an unleveraged approach.

The Sterling Liquidity Fund is intended to be used to assist with the management of collateral which is a result of using leveraged LDI funds.

Whilst the correct split between LDI funds to achieve consistent interest rate and inflation hedging will change over time, the Trustee's investment adviser has provided advice on the appropriate starting point for this split. These are:

Fund	Allocation (%)
LDI Longer Real	**9**
LDI Short Real	**5**
LDI Short Nominal	**6**
LDI cash collateral	**5**
Total	**25**

The Trustee will review the split from time to time as market conditions change and to ensure sufficient assets remain held in the collateral allocation.

The assets are held within pooled funds and are fully and readily realisable.

The Trustee may from time to time decide to change the funds used within the overall investment strategy, and the investment allocation between the funds, as alternatives emerge, funds change, and the Pension Fund develops.

5. Expected Return

The Trustee expects the return on assets to be consistent with the investment objective and investment strategy outlined above.

The Trustee expects to generate a return over the long term, of about 2.9% per annum (net of expenses) above the return on gilts. This return is a 'best estimate' based on the investment strategy adopted, in the view of the investment consultant.

The Trustee recognises that over the short-term performance may deviate significantly from this long-term expectation. This 'best estimate' will also generally be higher than the estimate used for the actuarial valuation of the Pension Fund's liabilities. For this purpose, a more prudent estimate of returns will generally be used, agreed by the Trustee based on advice from the Scheme Actuary.

6. Investment Managers

The Trustees utilise two investment managers to manage the assets of the Pension Fund.

The Trustees have decided to invest in pooled funds. The Pension Fund does not invest directly in stocks, shares, bonds, derivatives etc.

The Trustees have decided to invest in pooled funds because:

- the Pension Fund is not large enough to justify direct investment in equities or bonds on a cost-effective basis;
- pooled funds allow the Pension Fund to invest in a wider range of assets, which serves to reduce risk; and
- pooled funds provide a more liquid form of investment than certain types of direct investment.

The investment managers at the date of this statement were Newton Investment Management Limited and Legal & General Investment Management. The Pension Fund's assets are invested in the following funds:

- Newton Real Return Fund, which has a target of LIBOR +4% p.a. (Gross of fees).
- Legal & General Low Carbon Transition Global Equity Index Fund GBP hedged (OFC), which aims to track the performance of the Solactive L&G Low Carbon Transition Global Index (less withholding tax where applicable) to within +/-0.60% p.a. for two years out of three.
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- Legal & General Matching Core Fund range, where the primary objective of the underlying funds is to hedge a portion of the Pension Fund's liabilities against changes in interest rates only (for nominal funds) or in interest rates and inflation expectations (for real funds).
- Legal & General Sterling Liquidity Fund, which aims to provide diversified exposure and a competitive return in relation to SONIA (Sterling Overnight Index Average).

7. Investment Monitoring

The investment managers provide the Trustee with quarterly reports setting out a valuation of the funds and a commentary on performance.

The investment managers periodically attend Trustee meetings in order to report on their activity and performance, to outline their views on future investment conditions, and to answer any questions the Trustees may have.

8. Corporate Governance

The Trustee recognises its responsibilities as owners of capital, and believes that good stewardship practices, including monitoring and engaging with investee companies, and exercising voting rights attaching to investments, protect and enhance the long-term value of investments. The Trustee has delegated to their investment manage the exercise of rights attaching to investments, including voting rights, and engagement with issuers of debt and equity and other relevant persons about relevant matters such as performance, strategy, capital structure, management of actual or potential conflicts of interest, risks and ESG considerations.

The Trustee wishes to encourage best practice in terms of activism. The Trustee accepts that by using a pooled investment vehicle the day-to-day application of voting rights will be carried out by the investment manager. Consequently, the Trustee expects the Pension Fund's investment managers to adopt a voting policy that is in accordance with best industry practice.

9. Responsible Investment

The Trustee has appointed authorised professional investment managers and have given them discretion in relation to the selection, retention and realisation of investments.

The Trustee believes that the consideration of financially material Environmental, Social and Governance (ESG) factors (including climate change) in investment decision-making can lead to better risk adjusted investment returns. The Trustee expects its investment manager to take financially material ESG factors into account when making investment decisions. On an ongoing basis, the Trustee assesses the ESG integration capability of its investment managers.

The Trustee believes that, to protect and enhance the value of the investments over the time horizon over which the benefits are paid, it must act as a responsible asset owner. The Trustee expects their investment managers to exercise ownership rights, including voting and engagement rights, in order to safeguard sustainable returns over this timeframe. On an ongoing basis, the Trustee assesses the stewardship and engagement activity of its investment manager.

Where ESG factors are non-financial (i.e. they do not pose a risk to the prospect of the financial success of the investment) the Trustee believes these should not drive investment decisions. The Trustee expects the investment managers, when exercising discretion in investment decision-making, to consider non-financial factors only when all other financial factors have been considered and in such circumstances the consideration of non-financial factors should not lead to a reduction in the efficiency of the investment. Members' views are not sought on non-financial matters (including ESG and ethical views) in relation to the selection, retention and realisation of investments.

10. Employer Related Investments

The Trustee's policy is not to hold any employer-related investments as defined in the Pensions Act 1995, the Pensions Act 2004 and the Occupational Pension Scheme (Investment) Regulations 2005.

11. Risks

The Trustee recognises that there are risks involved in the investment of the assets of the Pension Fund and have identified the following principal risks which have the potential to cause deterioration in the Fund's funding level:

- **Solvency risk:** The risk that the fund has insufficient assets to meet all its liabilities as they fall due.

- **Mismatching risk:** The risk of a significant difference in the sensitivity of asset and liability values to changes in financial and demographic factors.

- **Manager risk:** The failure by the investment managers to achieve the rate of investment return assumed.

- **Liquidity risk:** The risk of a shortfall of liquid assets relative to the Pension Fund's immediate liabilities.

- **Custodian risk:** The risk of failed or inadequate performance by the custodian.

- **Concentration Risk:** The risk that the performance of any single investment that constituted a large proportion of the assets would disproportionately influence the overall level of assets.

- **Political risk:** The financial risk that a country's government will suddenly change its policies.

- **Sponsor risk:** The possibility of failure of the Pension Fund's sponsoring employers.

- **Counterparty risk:** The risk that other parties in any trade or position will default, i.e. will renege on their contractual obligations, resulting in a financial loss to the Pension Fund.

- **Credit risk:** This is the risk that a borrower will cause a financial loss for the other party by failing to meet required payments for a contractual obligation. The Pension Fund is exposed to this risk to the extent the investment managers invest in bonds.

- **Interest rate risk**: The Scheme's assets are subject to interest rate and inflation risk because some of the Scheme's assets are held in bonds via pooled funds. However, the interest rate and inflation exposure of the Scheme's liabilities is far greater in magnitude and this risk is currently not fully matched by the Scheme's assets. The Scheme's LDI portfolio uses leverage to give greater exposure to changes in interest and inflation rates than is possible with an unleveraged approach and provides some protection against interest rate and inflation movements. The Trustees consider interest rate, inflation and overseas currency risks to be generally unrewarded investment risks.

- **Currency risk:** Whilst the majority of the currency exposure of the Scheme's assets is to Sterling, the Scheme is subject to currency risk because some of the Scheme's investments are held in overseas markets. The Trustees consider the overseas currency exposure in the context of the overall investment strategy, and believe that the currency exposure that exists diversifies the strategy and is appropriate. We note that the Scheme's currency exposure in its equity portfolio is hedged back to Sterling.

Due to the complex and interrelated nature of these risks, the Trustee considers the majority of these risks in a qualitative rather than quantitative manner as part of each formal investment strategy review. Some of these risks may also be modelled explicitly during the course of such reviews.

The policy of the Trustee is to monitor, where possible, these risks on a regular basis. The Trustee therefore considers:

- The actual funding level versus the Statutory Funding Objective.
- Actual performance versus the Pension Fund's investment and funding objectives.
- Investment manager's performance versus their benchmark and target.
- Any significant issues with the investment managers that may impact their ability to meet investment performance objectives set by the Trustee.

12. Fee Structures

The investment managers are paid a management fee on the basis of assets under management. The investment consultant, where appointed, is paid on a project basis which may be a fixed fee or based on time cost, as negotiated by the Trustee in the interests of obtaining best value for the Pension Fund.

12. Review of this Statement

The Trustee will review this Statement every three years and after any significant change in investment policy.

This Statement was reviewed, revised and approved by the Trustee in August 2022. The Statement will be next reviewed in August 2025, or sooner if required.