Cummins UK Pension Plan

Statement of investment principles - appendices

December 2023

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Introduction

This document is created for and maintained by the investment sub-committee (ISC) of the Trustee of the Cummins UK Pension Plan (the Plan).

The Trustee is responsible for the management of the Plan's investments and has established the ISC in recognition of the specialist, technical nature of investment management. The ISC has formal terms of reference, approved by the Trustee, to provide greater focus and the appropriate level of expertise to assist with and advise on investment matters for the Plan.

The majority of the ISC's members are Trustee directors. At any given time, the Plan is represented on the ISC by at least three Trustee directors, along with other, suitably experienced, individuals.

Appendix A: Additional voluntary contributions (AVCs)

- The Trustee provides a facility for members to pay AVCs into the Plan to enhance their benefits at retirement.
- At present, for both sections of the Plan, the Trustee offers members the facility to invest in a range of funds with Legal & General.
- Historical DB AVC arrangements with the Equitable Life Assurance Society and Prudential also exist, but they are not open to further contributions. Following the transfer of Equitable Life to Utmost, the Trustee moved these assets into the L&G Cash Fund, which is classed as a default AVC investment option for legislative purposes only.
- DB members can invest their AVCs in line with the options available in the DC Section.
- If AVC members don't make an investment choice, their AVCs are paid into the Lifestyle: cash focused option (details in Appendix B).
- The Trustee monitors the investment performance and reviews the appropriateness of the arrangements for AVCs from time to time.

Appendix B: Defined contribution (DC) Section

The Trustee seeks to acquire secure assets of appropriate liquidity which will generate income and capital growth which, together with new contributions from members and the employer, will provide a fund at retirement with which to target the appropriate ‘at retirement’ objective.

Members’ investment needs change as they progress towards retirement age. Younger members, specifically those with more than 10 years to retirement, have a greater need for real growth to attempt to ensure their investment accounts keep pace with inflation and, if possible, salary escalation. Younger members will also, all other things being equal, have a greater tolerance for volatility of returns, as they have a greater time to retirement in which markets may come back in line from any temporary low. Older members, specifically those with 10 years or fewer to retirement, will require a greater level of consistency in the amount of benefits that may be secured with their investment accounts. Members will also have differing personal preferences.

The Trustee’s policy is to seek to achieve the objectives by providing a range of funds, which together offer a suitable mixture of growth assets (such as equities which are expected to achieve above-inflation returns over the long term) and monetary assets (that are expected to achieve stable returns and/or returns in line with inflation). The Trustee recognises that the returns on growth assets, while expected to be greater over the long term than those on monetary assets, are likely to be more volatile.

The DC Section currently offers members two ways to invest: via a lifestyle strategy (including the Plan’s default) or using the self-select investment options.

Lifestyle options

The lifestyle options invest in two different funds provided by Legal & General, both of which aim for returns higher than inflation:

- Accelerated growth fund
- Moderate growth fund

The current growth funds are blended with the following underlying investment funds:

Accelerated growth fund	
LGIM MSCI All World Adaptive Capped ESG Index Fund	**40%**
LGIM RAFI Fundamental Global Reduced Carbon Pathway Equity Index Fund	**20%**
LGIM Low Carbon Transition Global Equity Index Fund	**40%**

Moderate growth fund	
LGIM Diversified Fund	**80%**
Accelerated growth fund	**20%**

If a member has more than 20 years until their target retirement date, their pension fund will be 100% invested in the accelerated growth fund. As a member moves to within 10-20 years of their target retirement date, they'll gradually invest in the moderate growth fund until they're 100% invested in this fund at 10 years from retirement.

- The lifestyle strategy de-risks at two points leading up to retirement. The first stage, as noted above, is at 20 years from retirement where investments are switched from the accelerated growth fund into the moderate growth fund. The second stage is at 10 years from retirement, at which point, members can choose a retirement outcome strategy if they wish.
- For members who remain in the lifestyle continued growth strategy, a proportion of the growth funds are switched over the 10 years to retirement into the pre-retirement fund and the cash fund so that at target retirement age, the assets are invested 50% in the moderate growth fund, 35% in the pre-retirement fund and 15% in the cash fund.
- Members will be asked to choose their target retirement age: between 55 and 75 years old.
- The default retirement age is based on the member's State pension age for members who don't select a target retirement age.

The Trustee has agreed to provide members at 10 years to retirement with a choice of three lifestyle investment options targeting different at-retirement objectives:

- Lifestyle: continued growth (the DC default)
- Lifestyle: annuity protection
- Lifestyle: cash focused

The default lifestyle option targets continued growth which aims to put members in the right position to make a choice that works for them as they reach their target retirement age. The table below shows the underlying funds at the point of retirement for each lifestyle option.

	Continued growth	Annuity protection	Cash focused
Moderate growth fund	**50%**	**15%**	**25%**
Pre-retirement fund	**35%**	**-**	**-**
Cash fund	**15%**	**25%**	**75%**
Annuity focused fund	**-**	**60%**	**-**

Self-select funds

The self-select funds are as follows:

- Cummins AAA-AA-A corporate bond all-stocks index fund
- Cummins Accelerated growth fund
- Cummins Amanah fund
- Cummins Annuity focused fund
- Cummins Cash fund
- Cummins Ethical global equity index fund
- Cummins Moderate growth fund
- Cummins Property fund
- Cummins UK equity index fund
- Cummins World emerging markets equity index fund
- Cummins World equity index fund (unhedged)
- Cummins World equity index fund (hedged)

Further details of the options and funds are available to members on the pensions website: **www.cumminsukpensions.co.uk**

The Trustee considers from time to time whether the range of funds being offered is appropriate.

Appendix C: Defined benefit (DB) Section

Objectives and long-term policy

The following table shows the current asset allocation for the DB Section.

	Asset allocation (excluding buy-in)	Asset allocation (including buy-in)
Matching assets	**77%**	**84%**
Buy and maintain credit	14%	10%
Unleveraged long-dated gilts	60%	44%
Buy-in	-	28%
Cash*	3%	2%
Growth assets	**23%**	**16%**
Private equity	10%	7%
Property and secure income	10%	7%
Diversifying assets	3%	2%
Total	**100%**	**100%**
Hedge ratios self-sufficiency basis (total, including buy-in)	-	~85%

*Includes £6m of expected proceeds from Credit Suisse redemption.

The Plan's investment strategy has a target expected return of around 1.0% per annum above the return on long-dated gilts, while providing a high level of hedging against changes in liability values.

Over time, the asset allocation will change as the remaining private market assets are redeemed, and as the allocation is tailored towards the Trustee's target end game.

In July/August 2012, the Trustee purchased a deferred-premium, pensioner buy-in insurance policy to address the interest rate, inflation and mortality risk associated with these liabilities. The buy-in provider, Legal & General Assurance Society, took on pensioner liabilities in July 2022. The buy-in is revalued each year.

In October 2022, the Trustee reviewed the investment strategy and agreed to implement a long-dated gilt mandate to achieve interest rate and inflation hedging on an unleveraged basis. In November 2022, the Trustee further agreed to redeem the majority of the Plan's private market mandates to improve liquidity and invest in long-dated gilts to increase the Plan's liability hedging. In June 2023, the Trustee agreed to continue monitoring the Plan's investments, funding position and the appropriateness of its long-term target.

The Plan has a strategic allocation to cash to manage liquidity needs. The Trustee considers this asset allocation to:

- include suitable investments
- be appropriately diversified
- provide a reasonable expectation of meeting the objectives.

The Trustee will review this policy regularly to ensure that it remains appropriate for the purposes of meeting the objectives.

Asset class assumptions

In June 2023, the Trustee, in conjunction with the investment consultant, reviewed the strategic asset allocation of the DB Section. The risk-and-return assumptions as at 31 March 2023 used in the analysis are shown below:

Asset class	Expected return over gilts (% p.a.)	Standard deviation (% p.a.)
Money market cash	0.0	0.5
Fixed interest gilts (18 years)	0.0	12.0
Index-linked gilts (25 years)	0.0	10.0
Corporate bonds (all stocks)	1.2	6.7
Private equity	4.8	28.0
Infrastructure	3.2	12.0
Commodities	3.0	20.0

As at 31 March 2023, the assumed expected return of gilts was 3.5% p.a. Assumptions were also made for the correlation between the different asset classes. The Trustee's expectations for future investment returns are consistent with the central assumptions shown, but the Trustee recognises that fluctuations from year to year can be very large.

The Plan's investment managers

The Trustee considers advice and recommendations from the investment consultant about suitable investment manager arrangements. The manager line-up and allocation may change from time to time.

Asset class	Manager	Benchmark index	Proportion of total Plan allocation
Liability-matching allocation*			**84%**
Buy and maintain credit	BlackRock	Absolute return[1]	10%
Unleveraged long-dated gilts	BlackRock	FTSE Actuaries UK Index-Linked and Conventional Gilts over 25 Years Indices	44%
Pensioner buy-in	Legal & General Assurance Services – insurance/annuity	Deferred premium (10 years)	28%
Cash	-	-	2%
Return-seeking allocation			**16%**
Private equity			7%
	Axiom Asia	Absolute return, with FTSE All World used as a comparator	
	CDH VGC Fund I		
	CDH VGC Fund II		
	SC Management (RECAP IV)		
	Cabot Square Capital		
Property and secure income			7%
Secure income assets	Towers Watson Investment Management	FTSE actuaries over 15-year index-linked gilts	-
Diversifying strategies			2%
Agriculture	Nuveen TIAA CREF (Global Agriculture II)	Absolute return[1]	-
Total			**100%**

[1] No benchmark has been specified by the investment manager and a suitable alternative has been suggested where relevant. Private equity fund benchmarks are shown as absolute return, with longer-term performance measured against the FTSE All World

*The buy-in price was £254 million. This translates to approximately 32% of the Plan's assets as at 21 July 2012. This will fluctuate over time and therefore the LDI portfolio will be rebalanced as required. The Plan also holds a legacy allocation in the Hayfin Direct Lending Fund LP which is in wind-down and is not consider a significant part of the Plan's investment strategy.

Investment performance objectives

The table below lists the DB Section's investment managers and their individual performance objectives.

Manager	Performance objective
Liability matching	
BlackRock Buy & Maintain credit	To invest in a diversified portfolio of primarily investment grade fixed income securities to deliver an attractive yield and spread whilst minimising losses from defaults.
BlackRock unleveraged gilts	To track the total return of the relevant benchmark indices.
Return seeking – private equity	
Axiom Asia	To achieve a Net Multiple of Capital of 2.00x and a double-digit Net Internal Rate of Return.
Cabot Square Capital	To achieve an Internal Rate of Return greater than 20%.
CDH VGC Fund I	To generate 2.5x – 3.0x Gross Multiple of Capital and 30% Gross Internal Rate of Return.
CDH VGC Fund II	To generate excess of 2.5x – 3.0x Gross Multiple of Capital and 30% Gross Internal Rate of Return.
SC Management (RECAP IV)	To achieve a gross leveraged compound annual Internal Rate of Return of 20%.
Return seeking – property and secure income	
Towers Watson Investment Management Secure Income Fund	To provide long term cash flows which seek a return target of inflation-linked Gilts plus 2-3% over rolling five-year period and a regular income distribution of 4%.
Return seeking – diversifying assets	
Nuveen TIAA CREF	To generate a return of 8% Internal Rate of Return.
Other	
Various managers – Cash	To exceed the seven-day SONIA benchmark over a rolling three-year period.
Hayfin (legacy fund)	To generate returns 8-10% of gross Internal Rate of Return and 6-7.5% Net Internal Rate of Return.

Other arrangements

Northern Trust provides custody and performance services to the Plan.

The DB Section's funding objectives

The actuarial valuation of the Plan as at 1 January 2021 revealed a funding surplus (the value of the assets less the technical provisions) of £56.9 million. The Plan's next triennial actuarial valuation is due as at 1 January 2024. The Trustee expects to review its investment strategy following the results.

In line with the agreed Schedule of contributions, the Company paid a contribution of £65 million after a deficit was reported in November 2022.

The Company will pay contributions in respect of future benefit accrual and to meet the Plan's administrative expenses (including PPF levies).

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