Nuclear Liabilities Fund

The Nuclear Liabilities Fund

Statement of Investment Principles

19 June 2018

Section 1: Introduction

1.1 The Nuclear Liabilities Fund (the "Fund") is a fund set up by EDFE and government to hold and invest funds to meet the long-term costs of cleaning and decommissioning eight nuclear power stations in the UK.

1.2 The Fund is composed of two sections: assets held by the Trustees in the National Loans Fund and the Mixed Assets Portfolio. A substantial part of the assets of the Fund is held in the National Loans Fund where cash can be accessed at short notice and its security is backed by the government. It is used to meet the current and shorter-term liabilities of the Fund and allows the Trustees greater freedom in investing the balance of the Fund, known as the Mixed Assets Portfolio. The deposits in the National Loans Fund are reviewed on a monthly basis, balancing immediate cash flow needs and views on interest rates with the aim of maximising the interest which can be earned.

1.3 The Trustees are responsible for setting the investment objectives for the Fund, covering both performance and risk. The Trustees and the Investment Committee draw on advice from a Fiduciary Manager (currently BlackRock) when agreeing the types of investments and Investment Managers to be used in the day to day management of those assets.

1.4 The Trustees have delegated investment management responsibilities for the Mixed Assets to a Fiduciary Manager who monitor and oversee all the day to day investment management decisions within the remit of a strategy and the implementation decisions agreed by the Trustees and the Investment Committee.

1.5 The ultimate power and responsibility for the investment of the Fund's assets lies with the Trustees, subject to any policy set from time to time by the Secretary of State.

1.6 This Statement of Investment Principles provides more detail on the responsibilities of the Trustees and the investment objectives and principles which they have set for the Mixed Assets.

Section 2: Governance

Trustees

2.1 The Trustees are responsible for:

- Reviewing the Statement of Investment Principles and modifying it when appropriate.
- Appointing (and when necessary, dismissing) the Fiduciary Manager
- Conducting strategic investment reviews and agreeing the investment objectives
- Reviewing the types of asset which are used and the strategic asset allocation to those different types of assets
- Selecting (and, when necessary dismissing) the Investment Managers responsible for day to day investment decisions in managing the investment mandates used for different asset types
- Appointing (and, when appropriate dismissing) the firm or firms responsible for the custody of the Fund assets ("the Custodians") including monitoring their security and efficiency
- Monitoring the performance of the Fiduciary Manager.

2.2 The Trustees' primary responsibility for the Fund is fiduciary; that is, to ensure that the Fund's investments produce the required return within the policy regarding risk. However, good practice in terms of environmental, socially responsible and governance (ESG) issues is also taken into account.

The nature of investments is of concern to the Trustees as a source of both financial and reputational risk and the ability of Investment Managers to manage ESG risks is considered as part of the criteria for selecting and monitoring Investment Managers.

It is the Trustees' policy to be an active shareholder, and to exercise its rights (including voting rights) to promote and effect good corporate governance and mitigate ESG risks. Voting is delegated to the Investment Managers on a discretionary basis, but voting is to take into account the Combined Code appended to the Stock Exchange Listing Rules. It is, however, recognised that in the case of pooled and passive investments, the Investment Managers will select investments and exercise voting rights within the terms of the relevant pooled fund agreement.

2.3 The Trustees delegate some of the decisions to their Investment Committee, working within the investment objectives and risk appetite which they have agreed.

Fiduciary Manager

2.4 The Trustees have delegated day-to-day responsibility for the implementation of the investment strategy and the management of the assets to the Fiduciary Manager. The Fiduciary Manager will monitor and oversee the underlying Investment Managers, reporting to the Investment Committee and making recommendations on selection and de-selection.

2.5 The Fiduciary manager has responsibility for:

- Allocating the assets and the cash flow of the Mixed Assets Portfolio between investment mandates to maintain the Trustees' agreed strategic asset allocation and making tactical asset allocation decisions where they feel appropriate

- Providing recommendations to the Trustees on appointing (and dismissing) Investment Managers

- Performing day to day monitoring and oversight of underlying Investment Managers, reporting to the Investment Committee

- Undertaking project work as required including reviews of the required target return to meet the forecast decommissioning liabilities, the strategic asset allocation and the Investment Managers

- Assisting the Trustees in reviews of this Statement of Investment Principles

- Advising the Trustees on the appropriate investment response to any improvement or deterioration in circumstances

- Monitoring compliance with this Statement of Investment Principles

- Benchmarking the monthly National Loans Fund interest rates against the market and advising on the re-investment of monies.

Investment Managers

2.6 The responsibilities of the Investment Managers include:

- At their discretion, but within any guidelines given by the Trustees or Fiduciary Manager, implementing changes in the asset mix and, investment of funds and selecting securities within each asset class

- Provision of information required by the Fiduciary Manager for the proper management and oversight of the assets

- Having regard to the need for diversification of investments and to the suitability of investments.

Custodians

2.7 The responsibilities of the custodians (as appointed by the Investment Managers) include:

- The safekeeping of the underlying assets

- Processing the settlement of all transactions

- Processing all dividends and tax reclaims in a timely manner

- Dealing with corporate actions.

Section 3: Investment objectives of the Fund

3.1 The Mixed Assets Portfolio is designed to deliver a return that is sufficient for the Fund as a whole to meet the remaining nuclear decommissioning costs.

3.2 Analysis to identify the required target return for the Mixed Assets Portfolio will be carried out on a regular basis by the Fiduciary Manager at the request of the Trustees.

3.3 The Trustees recognise that low returns will result in claims falling on the UK Government. The risk of underperforming against the target return is mitigated by managing the volatility of the returns.

3.4 The Mixed Assets Portfolio also aims to:

- Benefit from the illiquidity premium which normally exists in capital markets for long-term investors who do not need to sell assets at short notice;
- Reduce risk by diversifying the investments across different types of asset which are expected to react differently in the range of economic scenarios which may present themselves in the longer term;
- Provide exposure to real assets in recognition that decommissioning costs escalate with inflation;
- Benefit from the active management of the investments, with skilled asset managers making investment decisions to gain returns which exceed market indices;
- Reduce the costs of the investments by having a stable investment strategy to reduce the costs of buying and selling investments and by requiring competitive fee rates from its Investment Managers.

Section 4: Strategic asset allocation

Suitability

4.1 The Trustees have set out a long-term strategic asset allocation for the Mixed Assets Portfolio based on advice from the Fund's Fiduciary Manager, which it considers is likely to achieve the dual objectives for return and volatility and the other objectives set out in the previous section.

Diversification

4.2 The strategic asset allocation is designed to ensure that the Mixed Assets Portfolio is invested consistent with the investment objectives and, in particular, that sources of risk are diversified.

4.3 Diversification includes investing to avoid excessive reliance on any particular asset, issuer or group of undertakings and so as to avoid accumulations of risk (including counterparty risk) in the Mixed Asset Fund as a whole.

4.4 Investment restrictions have been agreed with the Investment Managers to ensure the Fund avoids any undue concentration.

Asset classes

4.5 Consistent with the investment objectives described above, the Mixed Assets Portfolio will normally invest in the following asset types:

- UK equities
- Overseas equities
- UK and Overseas bonds
- Index-linked bonds
- Real Estate (debt and equity)
- Credit opportunities
- Cash
- Infrastructure assets (debt and equity)
- Other assets where illiquidity premia can be achieved

4.6 The Trustees will consider other asset types and investment management approaches and will approve investments where these are consistent with the overall objectives, taking advice from the Fiduciary Manager.

4.7 The Trustees have taken advice from the Fiduciary Manager to ensure that the strategic asset allocation is suitable for the Mixed Assets Portfolio given its investment objectives.

Liquidity

4.8 Based on advice from the Fiduciary Manager, the Trustees will ensure that the Fund holds sufficient liquidity in the Mixed Assets Portfolio to meet the required drawdowns from underlying Investment Managers. The Trustee's policy is that there should be sufficient investments in liquid or readily realisable assets to meet all cashflow requirements of the Mixed Assets Portfolio in the majority of foreseeable circumstances to avoid any realisation of assets that would disrupt the Mixed Assets Portfolio's overall investment objectives.

Investment restrictions

4.9 From time to time the Fund's Investment Managers may be given mandates that preclude the use of certain types of financial instrument, for example for complex financial instruments which lie outside the Trustees' risk appetite.

Section 5: Monitoring

1. The Trustees recognise the importance of monitoring the Fund's investment arrangements. Working with the Fiduciary Manager, the Trustees:

    - review the investment objectives for the Mixed Assets Portfolio at least annually
    - monitor compliance of the investment arrangements with this Statement of Investment Principles
    - review this Statement of Investment Principles annually.

2. The Trustees have delegated responsibility to its Fiduciary Manager the task of monitoring performance. The Fiduciary Manager will monitor and report on performance to the Trustees and make available sufficient information to enable evaluation, including:

    - assessing the quality of the performance and processes of the Investment Managers by reviewing the investment results and other information
    - maintaining and recommending amendments to this Statement of Investment Principles.

3. The Trustees have delegated to the Fiduciary Manager the setting of performance objectives and benchmarks with each Investment Manager. The Trustees accept that these objectives will be treated by the Investment Managers as targets only and the Trustees do not consider them an assurance or guarantee of the performance of each Investment Manager's portfolio or any part of it.

4. Through this process of monitoring the underlying Investment Managers, the Fiduciary Manager seeks to satisfy itself that the managers continue to carry out their work competently and have the appropriate knowledge and experience to manage the investments of the Fund.

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Section 6: Risk management

6.1 The Trustees recognise a number of risks involved in the investment of the assets of the Fund, as set out below.

Solvency risk

- is measured by the Fund being able to meet the remaining nuclear decommissioning costs by achieving its target return
- is managed by designing the long-term strategic asset allocation and actively monitoring the performance of the Mixed Assets Portfolio relative to the target return.

Manager risk

- is measured by the expected standard deviation of the prospective risk and return as set out in the Investment Managers' performance objectives
- is managed through diversification across Investment Managers and by the ongoing monitoring by the Fiduciary Manager both of the performance of the Investment Managers and of a number of qualitative factors supporting the Investment Managers' investment processes.

Liquidity risk:

- is measured by the level of cashflow required by the Mixed Assets Portfolio over a specified period
- is managed by the Fiduciary Manager actively allocating assets between Investment Managers and mandates to create the necessary liquidity.

Currency risk

- is measured by the level of non-GBP exposure at total portfolio level
- is driven by the unhedged non-GBP investments in the portfolio and is intended to act as a risk diversifier at total portfolio level consistent with expectations over the long-term horizon

Ownership risk:

- is measured by the ability for the Trustees to access and hold safe the assets of the Fund
- the Mixed Assets Portfolio's assets are managed primarily within pooled funds so custody-related risks are managed by the Investment Managers and checked by the Fiduciary Manager

Political risk:

- is measured by the susceptibility of the Mixed Asset Portfolio to suffer losses as a result of political events
- is managed through regular assessment of the levels of diversification within the existing investment policy.

6.2 These efforts to manage risk balance the need for risk control and the need for assets which are likely to achieve the required target return: they cannot render the Mixed Assets Portfolio free of risk.

6.3 The Trustees monitor these risks on an ongoing basis.