# The Nuclear Liabilities Fund Limited (the 'Fund')

## Statement of Investment Principles

January 2021

# Section 1: Introduction

1.1 The Nuclear Liabilities Fund (the 'Fund') is a fund set up by EDF Energy and the UK Government to hold and invest funds to meet the long-term costs of defuelling 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[1] 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[2] and allows the Trustees a longer investment time horizon 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. However, it should be noted that the maximum tenure of deposits offered is 6 months.

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 their Investment Adviser and Fiduciary Manager (currently Aon) 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 Portfolio to a Fiduciary Manager who monitors and oversees all of 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 for Business, Energy and Industrial Strategy.

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 Portfolio.

1 The National Loans Fund, established on 1 April 1968 and administered by HM Treasury accounts for government borrowing and lending.

[2] The liabilities to be met from the National Loans Fund are set out in the Funding Agreement between the Commissioners of HM Treasury, the Secretary of State for Business, Energy and Industrial Strategy and NLF dated 23 June 2020. These include qualifying costs of decommissioning, general administration costs, investment management costs, remuneration /fees / costs payable to employees, consultants, directors or service providers, and tax.

# 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 and the Investment Adviser.
- 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.
- Confirming the selection (and when necessary, dismissal) of 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 including monitoring their security and efficiency.
- Monitoring the performance of the Fiduciary Manager.

2.2 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

2.3 The Trustees have delegated day-to-day responsibility for the implementation of the investment strategy and the management of the assets in the Mixed Assets Portfolio 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.

2.4 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
- Instructing and liaising with the custodians to ensure the Fund's trading and liquidity needs are met, and to ensure the smooth running of the Portfolio

- Undertaking project work as required including reviews of the required 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

2.5 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.

- Where appropriate having responsibility for custody arrangements.

## Custodians

2.6 The responsibilities of the custodians (as appointed by the Investment Managers) and the Fund's appointed custodian include:

- The safekeeping of the underlying assets for the liquid portfolio

- Processing the settlement of all transactions

- Processing all dividends and tax reclaims in a timely manner

- Processing of all cash directions as authorised by the Trustees

- 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 qualifying nuclear decommissioning costs taking risks but within the bounds of prudence (the 'Required Return').

3.2 Analysis to identify the Required Return for the Mixed Assets Portfolio will be carried out on an annual basis by the Fiduciary Manager.

3.3 A measure of adequacy of the Fund's returns will be the comparison of the expected return of the Mixed Asset Portfolio to the Required Return. This analysis will be carried out quarterly by the Fiduciary Manager.

3.4 The Trustees recognise that low returns will result in claims falling on the UK Government. The risk of underperforming against the Required Return is mitigated by managing the volatility of the returns and other actions as set out in the assets section of the Risk Register.

3.5 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.

3.6 **Environmental, Social, and Corporate Governance considerations**

The Trustees' primary responsibility for the Fund is fiduciary; that is, to ensure that the Fund's investments produce the Required Return within a prudent and acceptable level of 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. As such, the Trustees acknowledge that an understanding of financially material considerations including ESG factors, and risks related to these factors, can contribute to the identification of investment opportunities and financially material risks. The ability of the Fund's investment managers to manage ESG risks is considered as part of the criteria for selecting and monitoring investment managers, the monitoring is undertaken as part of the Fiduciary Manager's quarterly reporting to the Trustees.

As part of their delegated responsibilities, the Trustees expect the Fund's investment managers to take into account corporate governance, social, and environmental considerations (including long-term risks posed by sustainability concerns, the transition to a low-carbon economy, and crystallisation of climate change risks) in the selection, retention and realisation of investments on behalf of the Fund. Any decision in this regard should not apply personal ethical or moral judgments to these issues but should consider the sustainability of business models that are influenced by them.

3.7 **Stewardship - Voting and Engagement**

The Trustees recognises the importance of their role as the primary steward of the Fund's capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which its investments reside. The Trustees recognise that promoting and effecting high standards of corporate governance protects the financial interests of the Fund and mitigates financially material risks, including those related to ESG.

The Trustees expect the Fund’s investment managers to use their influence as major institutional investors to carry out the Trustees’ rights and duties as a shareholder including voting, along with – where relevant and appropriate – engaging with underlying investee companies to promote good corporate governance, accountability, and positive change. Voting is delegated to the investment managers. The Trustees recognise 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.

The Trustees expect that their investment managers will provide details of their stewardship policy and activities on an annual basis. The Fiduciary Manager will engage with the investment managers where necessary for more information and report to the Trustees as appropriate, on an exceptions basis.

3.8 **Impact investing**

The Trustees have an aspiration to support the principles enshrined by the United Nations Sustainable Development Goals (‘UN SDGs’). The Trustees believe that supporting the UN SDGs is desirable from the perspective of supporting positive change and the 'just transition' to a sustainable economy, and may also give rise to future attractive investment opportunities.

Accordingly, when considering new investment opportunities for the Mixed Assets Portfolio, providing the Fund’s objectives can be met, the Trustees will seek to include investment opportunities which are aligned with the UN SDGs.

# 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, provider or group of undertakings and so as to avoid accumulations of risk (including counterparty risk) in the Mixed Assets Portfolio 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:

- Global equities
- Private Equity
- Growth Equity
- Infrastructure Debt
- Real Estate
- Infrastructure Equity
- Renewable Energy
- Credit instruments
- Government-led investments

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 Trustees' 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 (for example, the requirement to meet drawdowns required by the Fund's appointed illiquid investment managers) 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 prevent the use of certain types of investment. This is designed to promote transparency as per Risk Appetite Statement 8.

# Section 5: Monitoring

5.1 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.

5.2 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.

5.3 The Trustees have delegated to the Fiduciary Manager the setting of performance objectives and benchmarks (if appropriate) 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.

5.4 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.

# Section 6: Investment 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.

**Sufficiency risk**

- is measured by the Fund being able to meet the remaining nuclear decommissioning costs by achieving its Required Return
- is managed by designing the long-term strategic asset allocation and actively monitoring the Expected Return of the Mixed Assets Portfolio relative to the Required 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 relative to the size of a manager's mandate
- 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 (e.g. to meet liability payments; to meet cash drawdown requirements across the Liquid and Illiquid Portfolios; etc)
- 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 operational due diligence assessment of each manager holding
- Operational Due Diligence assessments are conducted for each Investment Manager on a regular basis 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 Return: they cannot render the Mixed Assets Portfolio free of risk.

6.3 The Trustees monitor these risks on an ongoing basis.

## 6.4 Investment Risk Appetite Statements

The Trustees have agreed a set of Investment Risk Appetite Statements which they use to consider and evaluate the investment risk exposures of the Fund. These Statements and the agreed Key Metrics against which to monitor each Statement are set out in the table below, along with the agreed Red/Amber/Green thresholds assigned. Further, the asset sections of the Risk Register set out the controls and steps taken to mitigate investment risks.

| | | | RAG status | | |
|---|---|---|---|---|---|
| | **Risk Statement** | **Key Metric** | **1** | **2** | **3** |
| 1 | High appetite to take a level of investment risk that maximises the probability of the Fund's sufficiency but within the bounds of prudence. | Probability of meeting the P80 liabilities in full | >60% | 40-60% | <40% |
| | | Expected Return less Required Return | 0.75%-1.50% | 0%-0.75% | <0% |
| 2 | High appetite for investments selected to deliver positive Environmental, Social and Governance (ESG) outcomes as well as to have a high degree of alignment to the United Nation's Sustainable Development Goals. | Where available, the number of managers with an ESG rating of 1. | All managers rated 2 or more | 1 manager rated 1 | >1 manager rated 1 |
| 3 | Low appetite for the failure of the Mixed Asset Portfolio to meet its return target in the next 3 years. | Probability that the return > Required Return – 2% | >80% | 50-80% | <50% |
| 4 | Low appetite for concentration of risk positions in the Mixed Asset Portfolio, while making meaningful allocations to each type of asset. | Risk Contribution by asset class | <20% | 20-30% | >30% |
| | | Maximum 20% across major asset classes | Max 20% across all asset classes | 1-3 asset classes above 20% | >3 asset classes above 20% |
| | | No. of managers who represent less than 2.5% of the total MAP | None | 1-2 | >2 |
| | | No. of managers who represent more than 10% of the total MAP | None | 1-2 | >2 |
| 5 | High appetite for illiquidity in the Mixed Assets Portfolio whilst there is a material allocation of assets to the liquid National Loans Fund. | Exposure to private markets which are not deemed to be 'liquid'. | >60% | 50-60% | <50% |
| | | Number of years of expected future liability cashflow covered by National Loans Fund | > 10yrs | 5-10yrs | < 5yrs |
| 6 | Low appetite for embarrassment and reputation risk, reflecting the desired standard of a public body. | Number of managers for the Fund who have failed Aon's ODD assessment | Low (No manager failed ODD) | Medium (up to 10% of managers failed ODD) | High (25% of managers failed ODD) |
| 7 | Medium appetite to focus NLF investments in the UK, supporting the UK Government. | Exposure to UK based investments at total Mixed Asset Portfolio level | >50% | 25%-50% | <25% |
| 8 | High appetite for transparency and understanding, and a low appetite for operational complexity (including taxation treatment). | Exposure to opaque structured finance instruments. | Low (No exposure) | Medium (Up to 20% of the portfolio exposed) | High (Over 20% of the portfolio exposed) |