29 February 2024

Statement of Investment Principles for the Alfa Laval Limited Pension Scheme

1. Introduction

This Statement of Investment Principles ("SIP") sets out the policy of the Trustees of the Alfa Laval Limited Pension Scheme ("the Trustees") on various matters governing decisions about the investments of the Alfa Laval Limited Pension Scheme ("the Scheme"), a Defined Benefit Scheme. This SIP replaces the previous SIP dated August 2021.

The SIP is designed to meet the requirements of Section 35 (as amended) of the Pensions Act 1995 ("the Act"), the Occupational Pension Schemes (Investment) Regulations 2005 (as amended) and the Pensions Regulator's guidance for defined benefit pension schemes (March 2017).

This SIP has been prepared after obtaining and considering written professional advice from LCP, the Scheme's investment adviser, whom the Trustees believe to be suitably qualified and experienced to provide such advice. The Trustees believe that the investment adviser meets the requirements of the Section 35(5) of the Pensions Act 1995. 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 Trustees have consulted with the relevant employer and the parent company Alfa Laval Holding AB in producing this SIP.

The Trustees will review this SIP from time to time and where they are required to make an investment decision, the Trustees always receive advice from their investment adviser and will amend it as appropriate. These reviews will take place as soon as practicable after any significant change in investment policy and at least once every three years.

- **Appendix 1** sets out details of the Scheme's investment governance structure, including the key responsibilities of the Trustees, investment advisers and investment managers. It also contains a description of the basis of remuneration of the investment adviser and the investment managers.
- **Appendix 2** sets out the Trustees' policy towards risk appetite, capacity, measurement and management.

The current investment manager arrangements of the Scheme, based on the principles set out in this SIP, are detailed in the Investment Policy Implementation Document ("IPID"), which is a separate document. The Trustees are responsible for updating the IPID as necessary.

2. Investment objectives

The primary objective is to ensure that the Scheme should be able to meet benefit payments as they fall due. In addition to this primary objective, the Trustees have additional objectives. These are as follows:

- that the expected return on the Scheme's assets is maximised whilst managing and maintaining investment risk at an appropriate level. What the Trustees determine to be an appropriate level of risk is set out in Appendix 2. The Trustees have an objective of achieving full funding on a technical provisions basis. As part of their triennial actuarial valuation, the Trustees have undertaken a review of their employer covenant and believe that the covenant is able to support the:
    - Technical provisions deficit according to the latest actuarial funding report; and
    - risks within the Scheme's investments, as discussed with their investment consultants, including relevant Value at Risk (VAR) statistics.

3. Investment strategy

The Trustees, with the advice obtained from their previous advisers and in consultation with the employer, reviewed the investment strategy in 2023 considering the objectives described in Section 2 above.

The result of the review was that the Trustees agreed that the investment strategy of the Scheme should be based on the allocation below.

Asset class	Strategic allocation
Buy & maintain corporate bonds	30%
Short duration buy & maintain corporate bonds	10%
LDI, gilts and money market cash	60%
Total	100%

Liquidity, cash flow and rebalancing

The majority of the Scheme's assets are held in a combination of pooled funds which are fully and readily realisable. New money will typically be invested (or disinvestments required for cash flow made) on a process basis to bring the asset allocation back to benchmark strategy as far as possible.

There is no formal rebalancing policy. The Trustees are mindful of the need to periodically consider rebalancing the assets of the Scheme in line with the Scheme strategic benchmark asset allocation.

The Trustees will monitor the Scheme's actual asset allocation on a regular basis and will decide on a course of action that may involve redirecting cash flows, a switch of assets or taking no action, taking into account advice from the investment adviser. The investment adviser issues quarterly reports to assist the Trustees to monitor their investments.

The Trustees maintain a cashflow policy relating to the Trustees' Bank Account.

Strategic Liability Hedge

The assets currently hedge a portion of the liabilities against changes in both interest rates and inflation through investments in fixed interest gilts, index-linked gilts, corporate bonds and leveraged Liability Driven Investments ("LDI"). The degree of liability hedging may be reviewed from time to time taking into account the Trustees' integrated risk management and market conditions.

4. Considerations in setting the investment arrangements

When deciding how to invest the Scheme's assets, the Trustees consider several risks, including, but not limited to, those set out in Appendix 2. Some of these risks are more quantifiable than others, but the Trustees have tried to allow for the relative importance and magnitude of each risk.

The Trustees considered a wide range of asset classes for investment, taking account of the expected returns and key individual risks associated with those asset classes as well as how these risks can be mitigated where appropriate.

At the time of the most recent strategy review, the Trustees expected to generate a return over the long-term of c.0.5% per annum (net of expenses) above a portfolio of long-dated UK Government bonds (which are considered to change in value in a similar way to the Scheme's liability values). This return is a 'best estimate' of future returns that has been arrived at given the Scheme's asset allocation.

In setting the strategy the Trustees considered:

- the Scheme's investment objectives, including the target return required to meet the Trustees' investment objectives;
- the Scheme's cash flow requirements in order to meet benefit payments in the near to medium term;
- the best interests of all members and beneficiaries;
- the circumstances of the Scheme, including the profile of the benefit cash flows (and the ability to meet these in the near to medium term), the funding level, and the strength of the employer covenant;
- the risks, rewards and suitability of a number of possible asset classes and investment strategies and whether the return expected for taking any given investment risk is considered sufficient given the risk being taken;
- the need for appropriate diversification between different asset classes to ensure that both the Scheme's overall level of investment risk and the balance of individual asset risks are appropriate;

- any other considerations which the Trustees consider financially material over the time horizon that the Trustees consider is needed for the funding of future benefits by the investments of the Scheme; and
- the Trustees' investment beliefs about how investment markets work, and which factors are most likely to impact investment outcomes.

5. Investment beliefs

The Trustees have agreed a set of Investment Beliefs that are used as a framework when making decisions and agreeing investment strategy. The Trustees' key investment beliefs are:

- Clear and well-defined objectives are essential to achieve future success;
- Asset allocation is the primary driver of long-term returns;
- Risk-taking is necessary to achieve return, but not all risks are rewarded;
- Funding and investment strategy related decisions should be considered together;
- Long-term investing provides opportunities for enhancing returns;
- Equities are expected to generate superior long-term returns;
- Alternative asset class investments provide diversification;
- Costs have a significant impact on long-term performance and therefore obtaining value for money for the investments is important ;
- Monitoring and rebalancing the asset allocation is important;
- Investment markets are not always efficient and there may be opportunities for good active managers to add value; and
- Environmental, Social and Governance ("ESG") factors are likely to be one area of market inefficiency and so managers may be able to improve risk-adjusted returns by taking account of ESG factors.

6. Implementation of the investment arrangements

Before investing in any manner, the Trustees obtain and consider proper written advice from their investment adviser on the question of whether the investment is satisfactory, having regard to the need for suitable and appropriately diversified investments.

Details of the investment managers are set out in the separate IPID.

The Trustees have signed agreements with the investment managers setting out in detail the terms on which the portfolios are to be managed. The investment managers' primary role is the day-to-day investment management of the Scheme's investments.

The Trustees, and investment managers to whom discretion has been delegated, exercise their powers to giving effect to the principles in this Statement of Investment Principles, so far as is reasonably practicable.

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

The Trustees' view is that the fees paid to the investment managers, and the possibility of their mandate 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 Trustees' responsibility to ensure that the managers' 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 Trustees expect 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 Trustees evaluate investment manager performance by considering performance over both shorter and longer-term periods as available except in closed-ended funds where the duration of the investment is determined by the fund's terms. Generally, the Trustees would be unlikely to terminate a mandate on short-term performance grounds alone, and, therefore, the duration of a manager's appointment would usually depend on strategic considerations and the outlook for future performance.

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

The Trustees recognise 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 Trustees expect their investment consultant to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Scheme's investment mandates.

7. Realisation of investments

The investment managers have discretion over the timing of realisation of investments of the Scheme within the portfolios that they manage, and in considerations relating to the liquidity of investments.

When appropriate, the Trustees, on the administrators' recommendation, decide on the amount of cash required for benefit payments and other outgoings and inform the investment managers of any liquidity requirements. The Trustees' preference is for investments that are readily realisable but recognise that achieving a well-diversified portfolio may mean holding some investments that are less liquid (eg infrastructure). In general, the Trustees' policy is to use cash flows to rebalance the Scheme's assets towards the strategic asset allocation, and also receive income from some of the portfolios where appropriate.

8. Financially material considerations and non-financial matters

The Trustees have adopted a policy which considers how ESG and ethical factors should be taken into account in the selection, retention and realisation of investments, given the time horizon of the Scheme and its members.

The Trustees expect their investment managers to take account of financially material considerations (including climate change and other ESG considerations). The Trustees seek to appoint managers that have appropriate skills and processes to do this, and from time to time review how their managers are taking account of these issues in practice. The Trustees have limited direct influence over managers' investment practices where assets are held in pooled funds, but they encourage their managers to improve their practices where appropriate.

The Trustees' primary objective is to maximise the investment return of the assets and to protect the funding level. The Trustees recognise that non-financial factors (ie matters relating to ethical or other views of members and beneficiaries, rather than considerations of financial risk and return) will vary between individual Scheme members and, in some cases, may conflict with the primary objective of the Trustees. As such, the Trustees believe that non-financial factors should not necessarily be the primary focus when making investment decisions such as the selection, retention and realisation of investments. However, the Trustees believe that, in many cases, issues considered to be non-financial will, over time, be sufficiently addressed by incorporating financially material ESG considerations into the managers' investment processes due to the efficient nature of investment markets.

9. Voting and engagement

The Trustees recognise their responsibilities as owners of capital, and believe 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 and is in the best interest of its members.

The Trustees have delegated to their investment managers 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 Trustees do not monitor or engage directly with issuers or other holders of debt or equity. They expect the investment managers to exercise ownership rights and undertake monitoring and engagement in line with the managers' general policies on stewardship, as provided to the Trustees from time to time, considering the long-term financial interests of the beneficiaries.

The Trustees seek to appoint managers that have strong stewardship policies and processes, reflecting where relevant the recommendations of the UK Stewardship Code issued by the Financial Reporting Council, and from time to time the Trustees review how these are implemented in practice.

The Trustees carry out a detailed review of their managers' voting/stewardship activities and outcomes to determine how well they align with the Scheme's stewardship themes and priorities (see below). The Trustees also express their preferences regarding ESG and stewardship approaches with prospective managers, to check alignment.

The Trustees monitor managers' activities in relation to ESG factors, voting and engagement on a regular basis. The Trustees seek to understand how they are implementing their stewardship policies in practice to check that their stewardship is effective and aligned with the Trustees' expectations.

The Trustees have selected some priority ESG themes to provide a focus for monitoring investment managers' voting and engagement activities. The Trustees review the themes regularly and update them if appropriate. The Trustees communicate these stewardship priorities to the managers each year and also confirm the Trustees' more general expectations in relation to ESG factors, voting and engagement. If the Trustees monitoring identifies areas of concern, they will engage with the relevant manager to encourage improvements.

Appendix 1: Investment governance, responsibilities, decision-making and fees

The Trustees have decided on the following division of responsibilities and decision-making for the Scheme. This division is based upon the Trustees' understanding of the various legal requirements placed upon them, and their view that the division of responsibility allows for efficient operation and governance of the Scheme overall. The Trustees' investment powers are set out within the Scheme's governing documentation.

1. Trustees

In broad terms, the Trustees are responsible in respect of investment matters for:

- developing a mutual understanding of investment and risk issues with the employer;
- setting the investment strategy, in consultation with the employer;
- formulating a policy in relation to financially material considerations, such as those relating to ESG considerations (including, but not limited to, climate change);
- formulating a policy on taking account of non-financial matters in the selection, retention and realisation of investments;
- setting the policy for rebalancing between asset classes;
- setting a policy on the exercise of rights (including voting rights) and undertaking engagement activities in respect of the investments;
- putting effective governance arrangements in place and documenting these arrangements in a suitable form;
- appointing, monitoring, reviewing and dismissing investment managers, investment advisers, actuary and other service providers;
- monitoring the exercise of the investment powers that they have delegated to the investment managers and monitoring compliance with Section 36 of the Act;
- communicating with members as appropriate on investment matters, such as the Trustees' assessment of its effectiveness as a decision-making body, the policies regarding responsible ownership and how such responsibilities have been discharged;
- reviewing the investment policy as part of any review of the investment strategy;
- reviewing the content of this SIP from time to time and modifying it if deemed appropriate; and
- consulting with the employer(s) when reviewing the SIP.

2. Investment managers

In broad terms, the investment managers will be responsible for:

- managing the portfolios of assets according to their stated objectives, and within the guidelines and restrictions set out in their respective investment manager agreements and/or other relevant governing documentation;
- taking account of financially material considerations (including climate change and other ESG considerations) as appropriate when managing the portfolios of assets;
- exercising rights (including voting rights) attaching to investments and undertaking engagement activities in respect of investments;
- providing regular information concerning the management and performance of their respective portfolios, including information on voting and engagement undertaken; and
- having regard to the provisions of Section 36 of the Act insofar as it is necessary to do so.

The custodians of the portfolios (whether there is a direct relationship between the custodian and the Trustees or not) are responsible for safe keeping of the assets and facilitating all transactions within the portfolios.

3. Investment adviser

In broad terms, the investment adviser will be responsible, in respect of investment matters, as requested by the Trustees, for:

- advising on how material changes within the Scheme's benefits, membership, and funding position may affect the manner in which the assets should be invested and the asset allocation policy;
- advising on the selection, and review, of the investment managers, incorporating its assessment of the nature and effectiveness of the managers' approaches to financially material considerations (including climate change and other ESG considerations); and
- participating with the Trustees in reviews of this SIP and the IPID.

4. Fee structures

The Investment Managers are paid a management fee on the basis of assets under management which are reflected in the unit prices (where relevant). The investment adviser is paid on a project basis which may be a fixed fee or based on time cost, as negotiated by the Trustees in the interests of obtaining the best value for the Scheme.

5. Performance assessment

The Trustees are satisfied, taking into account the external expertise available, that there are sufficient resources to support their investment responsibilities. The Trustees believe that they have sufficient expertise and appropriate training to carry out their role effectively.

It is the Trustees' policy to assess the performance of the Scheme's investments, investment providers and professional advisers from time to time. The Trustees will also periodically assess the effectiveness of their decision-making and investment governance processes and will decide how this may then be reported to members.

6. Working with the Scheme's employer

When reviewing matters regarding the Scheme's investment arrangements, such as the SIP, the Trustees seek to give due consideration to the employer's perspective. While the requirement to consult does not mean that the Trustees need to reach agreement with the employer, the Trustees believe that better outcomes will generally be achieved if the Trustees and employers work together collaboratively.

Appendix 2: Policy towards risk

1. Risk appetite and risk capacity

Risk appetite is a measure of how much risk the Trustees' are willing to bear within the Scheme in order to meet their investment objectives. Taking more risk is expected to mean that those objectives can be achieved more quickly, but it also means that there is a greater likelihood that the objectives are missed, in the absence of remedial action. Risk capacity is a measure of the extent to which the Trustees can tolerate deviation from their long term objectives before attainment of those objectives is seriously impaired. The Trustees' aim is to strike the right balance between risk appetite and risk capacity.

When assessing the risk appetite and risk capacity, the Trustees considered a range of qualitative and quantitative factors, including:

- the strength of the employer's covenant and how this may change in the near/medium future;
- the agreed journey plan and employer contributions;
- the Scheme's long-term and shorter-term funding targets;
- the Scheme's liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged;
- the Scheme's cash flow and target return requirements; and
- the level of expected return and expected level of risk (as measured by Value at Risk ("VaR")), now and as the strategy evolves.

2. Approach to managing and monitoring investment risks

The Trustees consider that there are several different types of investment risk that are important to manage and monitor. These include, but are not limited to:

2.1. Risk of inadequate returns

A key objective of the Trustees is that, over the long-term, the Scheme should generate its target return so that it has adequate assets to meet its liabilities as they fall due. The Trustees therefore invest the assets of the Scheme to produce a sufficient long-term return in excess of the liabilities. There is also a risk that the performance of the Scheme's assets and liabilities diverges in certain financial and economic conditions in the short term. This risk has been considered in setting the investment strategy and is monitored by the Trustees on a regular basis.

2.2. Risk from lack of diversification

This is the risk that failure of a particular investment, or the general poor performance of a given investment type, could materially adversely affect the Scheme's assets. The Trustees believe that the Scheme's assets are adequately diversified between different asset classes and within each asset class. This was a key consideration when determining the Scheme's investment arrangements and is monitored by the Trustees on a regular basis.

2.3. Investment manager risk

This is the risk that an investment manager fails to meet its investment objectives. Prior to appointing an investment manager, the Trustees receive written advice from a suitably qualified individual and will typically undertake an investment manager selection exercise. The Trustees monitor the investment managers on a regular basis to ensure they remain appropriate for their selected mandates.

2.4. Collateral adequacy risk

The Scheme invests in leveraged LDI arrangements to provide protection (hedging) against adverse changes in interest rates and inflation expectations. The LDI manager may from time to time call for additional cash to be paid to the LDI portfolio in order to support a given level of leverage. Collateral adequacy risk is the risk that the Trustee when requested to do so will not be able to post additional cash to the LDI fund within the required timeframe.

A potential consequence of this risk is that the Scheme's interest rate and inflation hedging could be reduced and that the Scheme's funding level could suffer subsequently as a result should markets move against the Scheme. In order to manage this risk, the Trustees ensure that the Scheme has a sufficient allocation to cash and other highly liquid assets which can be readily realised, so that cash can be posted to the LDI manager at short notice.

2.5. Counterparty risk

This is the risk that one party to a contract (such as a derivative instrument) causes a financial loss to the other party by failing to discharge a contractual obligation. This risk applies in particular for those contracts that are traded directly between parties, rather than traded on a central exchange.

The leveraged LDI funds make use of derivative and gilt repo contracts. These help the Trustees to match a portion of the movements in the value of the Scheme's liabilities. Counterparty risk is managed within the LDI funds through careful initial selection and ongoing monitoring of trading counterparties, counterparty diversification and a robust process of daily collateralisation of each contract, to ensure that counterparty risk is limited, as far as possible, to one day's market movements.

2.6. Illiquidity/marketability risk

This is the risk that the Scheme is unable to realise assets to meet benefit cash flows as they fall due, or that the Scheme will become a forced seller of assets in order to meet benefit payments. The Trustees are aware of the Scheme's cash flow requirements and believe that this risk is managed by maintaining an appropriate degree of liquidity across the Scheme's investments and by investing in income generating assets, where appropriate.

2.7. Environmental, Social and Governance (ESG) risks

ESG factors are sources of risk to the Scheme's investments which could be financially material, over both the short and longer term. These potentially include risks relating to factors such as climate change, unsustainable business practices, and unsound corporate governance. The Trustees seek to appoint investment managers who will manage these risks appropriately on their behalf and from time to time review how these risks are being managed in practice.

2.8. Credit risk

This is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The Scheme is subject to credit risk because it invests in bonds via pooled funds. The Trustees manage their exposure to credit risk by only investing in pooled funds that have a diversified exposure to different credit issuers.

2.9. 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 can help diversify the strategy and is appropriate. Furthermore, the Trustees manage the amount of currency risk by investing in pooled funds that hedge currency exposure.

2.10. Interest rate and inflation 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 assets hedges part of the corresponding risks associated with the Scheme's liabilities.

The Trustees consider interest rate and inflation risks to be generally unrewarded investment risks.

To offer some protection against this risk, the Trustees invest in funds which include a mixture of bonds as well as leveraged LDI arrangements. This helps to hedge part of the Scheme's exposure to interest rate risk and inflation risk and, therefore, the Trustees believe it is appropriate to hold these types of assets. The level of this hedging will be reviewed on a regular basis.

2.11. Climate-related risks

Climate change is a source of risk, which could be financially material over both the short and longer term. This risk relates to the transition to a low carbon economy, and the physical risks associated with climate change (eg extreme weather). The Trustees seek to appoint investment managers who will manage this risk appropriately, and from time to time review how this risk is being managed in practice.

2.12. Valuation risk

Some of the Scheme's assets (such as listed equities and government gilts) can be valued regularly based upon observable market prices. For other assets (such as infrastructure), prices may only be estimated relatively infrequently using one or more of a range of approximate methods – eg using mathematical models or comparing against recent sales prices of equivalent transactions.

At times of market stress, there is a risk for all assets that the valuations provided by investment managers do not reflect the actual sale proceeds which could be achieved if the assets were liquidated at short notice. This risk is particularly relevant for assets such as infrastructure.

The Trustees consider exposure to valuation risk in the context of the Scheme's overall investment strategy and believe that the level of exposure to this risk is appropriate.

2.13. Other non-investment risks

The Trustees recognise that there are other, non-investment, risks faced by the Scheme, and takes these into consideration as far as practical in setting the Scheme's investment arrangements as part of their assessment of the other aspects of the Scheme's risk management processes.

Examples include:

- longevity risk (the risk that members live, on average, longer than expected); and
- sponsor covenant risk (the risk that, for whatever reason, the sponsoring employer is unable to support the Scheme as anticipated).

Together, the investment and non-investment risks give rise generally to funding risk. This is the risk that the Scheme's funding position falls below what is considered an appropriate level. The Trustees regularly review progress towards the Scheme's funding target, both in the longer-term as well as against short-term milestones, comparing the actual versus the expected funding level.

By understanding, considering and monitoring the key risks that contribute to funding risk, the Trustees believe that they have appropriately addressed and are positioned to manage this general risk.