Statement of Investment Principles

This is the Statement of Investment Principles (the "Statement") made by the Trustee Directors of the Scottish Hydro-Electric Pension Scheme ("the Scheme") in accordance with the Pensions Act 1995 (as amended). It is subject to periodic review by the Trustee Directors at least every three years and without delay after any significant change in investment policy.

In preparing this Statement, the Trustee Directors have consulted with the Sponsoring Employer, SSE Plc ("the Company") and has taken written advice from the Investment Practice of Hymans Robertson LLP.

Further details on how the investment policy of the Scheme is implemented are set out in the "Investment Implementation Document" which is maintained by the Trustee Directors. This document can be made available by the Trustee Directors upon request.

Scheme objective

The Scheme's funding objective is set out in detail in the Statement of Funding Principles based on the 31 March 2018 valuation. The main objectives are as follows.

Primary funding objective

The Trustee Directors are required under section 222 of the Pensions Act 2004 to adopt a "*Statutory Funding Objective*". The *Statutory Funding Objective* is that the Scheme must have "sufficient and appropriate" assets to cover the expected cost of providing members' *past service benefits*[1].

Sufficiency

The Trustee Directors have a secondary *funding objective* of building up surplus assets over and above the expected cost of providing members' *past service benefits*, generated by actual experience, particularly investment returns, being more favourable than the assumptions used for the *Statutory Funding Objective*. The aim will be over time to use some, or all of this surplus, to reduce the proportion of assets that offer greater expected returns, with a corresponding greater level of risk, and to adopt an investment strategy that is more closely matched to the nature of the *past service benefits*.

Appropriateness

The policy for securing the appropriateness of the assets is set out in this Statement of Investment Principles.

Investment strategy

The Trustee Directors have translated their objectives into a suitable strategic asset allocation benchmark for the Scheme. All day to day investment decisions have been delegated to a number of authorised investment managers. The strategic benchmark has been translated into benchmarks for the individual managers which are consistent with the Scheme's overall strategy. The Scheme benchmark is consistent with the Trustee Directors' views on the appropriate balance between seeking an enhanced long-term return on investments and accepting greater short-term volatility and risk.

The investment strategy takes due account of the maturity profile of the Scheme (in terms of the relative proportions of liabilities in respect of pensioners and non-pensioner members), together with the level of disclosed surplus or deficit on a gilts basis.

[1] The phrase used in the legislation to refer to the expected cost of members' past service is "technical provisions".

It is intended that the investment strategy will be reviewed at least every three years following actuarial valuations of the Scheme and will normally be reviewed annually. Written advice is received as required from professional advisors.

To achieve their objectives the Trustee Directors have agreed the following:

Choosing investments

The Trustee Directors have appointed a number of investment managers who are authorised under the Financial Services and Markets Act 2000 to undertake investment business. The Trustee Directors have delegated all day to day investment decisions to these authorised investment managers. The Trustee Directors, after seeking appropriate investment advice, have given the managers guidelines as to the asset allocation, including control ranges for each asset class and or geographic region. Subject to their respective benchmarks and guidelines, the managers are given full discretion over the choice of stocks and are expected to maintain a diversified portfolio.

The Trustee Directors review the nature of Scheme investments on a regular basis, with particular reference to suitability and diversification. The Trustee Directors seek and consider written advice from a suitably qualified person in undertaking such a review. If at any time investment in a security or product not previously known to the Trustee Directors is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.

Kinds of investment to be held

The Scheme may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds, cash, property and pooled funds. Where invested in pooled funds, the Trustee Directors are satisfied that the funds selected are consistent with the objectives of the Scheme, particularly in relation to diversification, risk, expected return and liquidity. The Scheme may also make use of derivatives and contracts for difference (or in pooled funds investing in these products) for the purpose of efficient portfolio management as well as annuity contracts. The Trustee Directors consider all of these classes of investment to be suitable in the circumstances of the Scheme.

Investment Strategy

The investment managers are instructed to deliver a specific performance target, which overall will align to deliver the broader Scheme investment strategy. The Trustee Directors ensure that all manager engagements have clearly defined benchmarks, objectives and management parameters.

Where appropriate, and where commercial considerations permit, the terms of the mandate and the basis on which the manager is engaged will be defined specifically for the Scheme. Where such tailoring is not directly achievable or appropriate, the Trustee Directors will invest in pooled funds where the objectives of the fund and the policies of the investment manager will be evaluated by the Trustee Directors to ensure that they are appropriate for the needs of the Scheme. The Trustee Directors are satisfied that the pooled funds selected are consistent with the objectives of the Scheme, particularly in relation to diversification, risk, expected return and liquidity.

Investment Management Remuneration

Remuneration for each mandate is determined at its inception based on commercial considerations and typically set on an ad valorem basis (i.e. fees paid as a percentage of assets under management). Where appropriate to the nature of the mandate, the term of the mandate and the role the mandate plays within the investment strategy, the Trustee Directors may agree to a fee structure where the manager is incentivised to deliver outperformance relative to an agreed benchmark, typically in conjunction with a lower ad valorem fee. The Trustee Directors periodically review the fees paid to all of their managers against industry standards.

Investment Time Horizon
The Trustee Directors recognise the long-term nature of the Scheme's liability profile and appoint their managers to invest in a way that generates long-term sustainable returns. The Trustee Directors will carry out necessary due diligence on the underlying investment decision making process, to ensure the manager makes investment decisions over an appropriate time horizon aligned with the Scheme's objectives.

The duration of each mandate is determined by the Trustee Directors at its inception. For open-ended investments, the Trustee Directors generally engage with managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Trustee Directors expect the minimum duration of the appointment will be three years, this being the period over which performance of the mandate can be appropriately evaluated, although all mandates are subject to ongoing review against various financial and non-financial metrics in addition to their continued appropriateness within the investment strategy. For closed-ended investments, the Trustee Directors expect the term of the appointment to be the lifetime of the investment.

Balance between different kinds of investments
The Scheme's investment managers will hold a mix of investments which reflect their views relative to their respective benchmarks. Within each major market, each manager will maintain a diversified portfolio of stocks through direct investment or pooled vehicles.

Expected return on investments
The investment strategy aims to achieve a return on Scheme assets which, taken in conjunction with any contributions, is sufficient over time to match growth in the Scheme's pension liabilities.

Realisation of investments
The majority of the Scheme's investments may be realised quickly if required. Property, private equity and unquoted fixed income investments may however be difficult to realise quickly in certain circumstances. The bulk annuity insurance contracts that the Trustee Directors have entered into cannot be realised.

Risk
The Scheme is exposed to a number of risks which pose a threat to meeting its objectives. The principal risks affecting the Scheme are:

Funding risks:

- Financial mismatch – The risk that Scheme assets fail to grow in line with the developing cost of meeting Scheme liabilities, including increases in benefit payments relating to unexpected increases in inflation.
- Changing demographics – The risk that longevity improves, and other demographic factors change increasing the cost of Scheme benefits.
- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting Scheme liabilities. Climate change is a particular systemic risk that has the potential to cause economic, financial and demographic impacts.

The Trustee Directors measure and manage funding risks in a number of ways:

- They have set a strategic asset allocation benchmark for the Scheme. They assess risk relative to that benchmark by monitoring the Scheme's asset allocation and investment returns relative to the benchmark. They also assess risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

- The Trustee Directors keep under review mortality and other demographic assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation.
- The Trustee Directors have entered into bulk annuity insurance contracts in respect of a proportion of pensioner liabilities to help manage and reduce these risks. In return for the payment of premiums, the Trustee Directors hold annuity policies with an insurer. Under each policy, the insurer makes monthly payments to the Scheme and carry the risk of longevity for a subset of the pensioners, as well as the investment risks for this proportion of the Scheme's assets.
- All pensioners continue to be members of the Scheme and the Trustee Directors continue to have ultimate responsibility for the payment of benefits to their members.
- The Trustee Directors seek to mitigate systemic risk through a diversified portfolio, but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset risks

- Concentration - The risk that significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Scheme cannot meet its immediate liabilities because it has insufficient liquid assets.
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.
- Currency risk – The risk that the currency of the Scheme's assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Environmental, Social and Governance (ESG) risks – the extent to which ESG issues are not reflected in asset prices and/or not considered in investment decision making leading to underperformance relative to expectations.
- Climate risk – The extent to which climate change causes a material deterioration in asset values as a consequence of factors including but not limited to policy change, physical impacts and the expected transition to a low-carbon economy.

The Trustee Directors measure and manage asset risks in a number of ways.

- They ensure that there is sufficient diversification across a range of asset classes and within each asset class to reduce potential concentration risks.
- The majority of assets are liquid and readily realisable in the short term.
- They have appointed several investment managers to minimise the impact of a particular manager underperforming. In addition, each mandate has a defined objective, benchmark and guidelines and constraints which ensure that the risk within it are limited.
- The majority of the Scheme's mandate are sterling denominated or the manager is expected to hedge currency exposures back to sterling.
- The approach to the consideration of ESG risks including climate risk is set out in further detail below.

Other provider risk

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Trustee Directors take professional advice and consider the appointment of specialist transition managers.
- Custody risk - The risk of losing economic rights to Scheme assets, when held in custody or when being traded.
- Counterparty risk - The possibility of default of a counterparty in meeting its obligations.

The Trustee Directors monitor and manage risks in these areas through a process of regular scrutiny of its providers and audit of the operations they conduct for the Scheme or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds).

Manager engagement

Performance Evaluation

The Trustee Directors do not expect managers to take excess short-term risk and carry out regular monitoring of the Scheme's investments and managers. This monitoring includes a review of investment performance of each manager relative to their respective benchmark or performance target on a short, medium and long-term basis. The monitoring of the Scheme's investments and managers also includes a review of strategic and funding risks.

The Trustee Directors also seek information from their investment managers on meeting objectives of the mandates and exercising stewardship responsibilities including engagement with issuers (as set out in greater detail in the section on Stewardship), and the management of risks. Material deviation from performance or risk targets is likely to result in the mandate being formally reviewed.

The Trustee Directors draw input from their investment advisors to provide input and analysis to support any such review of and engagement with its investment managers. Where necessary, the Trustee Directors will highlight any areas of concern identified during such reviews to the manager as part of its engagement process and request that the manager takes appropriate action. This may include concerns over performance, risk management, stewardship practices, investment process and operational issues and, where such concerns are raised, the Trustee Directors will require the manager to demonstrate levels of improvement. Failure to achieve the desired improvements will result in the mandate being reduced or terminated.

Portfolio turnover

The Trustee Directors have an expectation on the level of turnover within each mandate which is determined at the inception of the mandate, based on the Trustee Directors' knowledge of the manager, investment process and the nature of the portfolio. Whilst the Trustee Directors expect performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustee Directors expect managers to report on at least an annual basis on the underlying assets held within the portfolio and details of transactions over the period. The Trustee Directors will challenge the manager if there is a sudden change in the portfolio turnover or if the level of turnover seems excessive.

The Trustee Directors will request turnover costs incurred by the asset manager over the Scheme's reporting year.

Consideration of financially material factors in investment arrangements

The Trustee Directors recognise that the consideration of financially material factors over the appropriate time horizon of the investments, including ESG factors, is relevant at different stages of the investment process. The Trustee Directors further recognise that the financial materiality of any factor, including ESG factors, is context specific and that whilst some factors may be relevant to certain stocks/assets, they may not be relevant to others. The Trustee Directors will consider such factors in the development and implementation of their investment arrangements, for the purposes of determining the selection, retention and realisation of investments, where there is sufficient data or evidence to allow them to systematically do so. Where there is not sufficient data or evidence, they will require that their investment managers take such considerations into account within their decision making.

Strategic considerations

The strategic benchmark has been determined using appropriate long term economic and financial assumptions from which expected risk/return profiles for different asset classes have been derived. These assumptions apply at a broad market level and are considered to implicitly reflect all financially material factors.

The Trustee Directors have discussed climate change risk with their investment advisor and actuary but given the inherent uncertainty, they have not made explicit allowance for the risks of climate change in setting their strategic benchmark.

Structural considerations

Given the discretion afforded to the active Investment Managers, the Trustee Directors expect that their Investment Managers will take account of all financially material factors including the potential impact of ESG factors in the implementation of their mandate.

Within active mandates, the Trustee Directors have delegated responsibility for the consideration of stock specific issues to their individual Investment Managers. The Trustee Directors have discussed the extent to which ESG issues and climate change risk, where relevant to the investment mandate, are integrated into the investment processes of their Investment Managers and are satisfied that the Investment Managers are following an approach which takes account of all financially material factors.

Selecting new investment managers

In selecting new investment managers for the Scheme, where relevant to the investment mandate, the Trustee Directors explicitly consider potential managers' approach to responsible investment and the extent to which managers integrate ESG issues in the investment process as a factor in their decision making.

Consideration of non-financially material factors in investment arrangements

The Trustee Directors have not considered any non-financially material factors in the development and implementation of their investment strategy. The Trustee Directors have not imposed any restrictions or exclusions to the investment arrangements based on non-financially material factors.

Stewardship

The Trustee Directors recognise that stewardship encompasses the exercise of voting rights, engagement by and with Investment Managers and the monitoring of compliance with agreed policies.

Voting and engagement

The Trustee Directors have adopted a policy of delegating voting decisions to their Investment Managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. The Investment Managers are expected to exercise the voting rights attached to individual investments in accordance with their own house policies and taking account of current best practice including the UK Stewardship Code. On an annual basis, the Trustee Directors will request their Investment Managers provide details of any change in their policies. The Trustee Directors annually review the investment managers' adherence to the UK Stewardship Code, UNPRI and other relevant industry codes or standards where applicable. In the event that a manager does not adhere to a recognised set of principles for responsible investment, the Trustee Directors will take reasonable steps to ensure that they are comfortable with the policy that the manager has in place in respect of this.

The Trustee Directors do not engage directly but believe it is appropriate for their investment managers to engage with key stakeholders which may include corporate management, regulators and governance bodies, relating to their investments in order to consider the management of conflicts of interest and improve corporate behaviours, improve performance and mitigate financial risks. Where necessary, investment managers are expected to notify the Trustee Directors of any issue on which it may be beneficial for the Trustee Directors to undertake further engagement. The Trustee Directors will review engagement activity undertaken by their investment managers as part of its broader monitoring activity.

Responsibility for investment decisions has been delegated to the investment managers which includes consideration of the capital structure of investments and the appropriateness of any investment made. Where managers are responsible for investing in new issuance, the Trustee Directors expect the manager to engage with the issuer about the terms on which capital is issued and the potential impact on the rights of new and existing investors.

The Trustee Directors separately consider any conflicts of interest arising in the management of the Scheme and their investments and has ensured that each manager has an appropriate conflicts of interest policy in place.

Monitoring

The Trustee Directors review manager voting activity on a periodic basis in conjunction with their investment adviser. Where the Trustee Directors deem it appropriate, any issues of concern will be raised with their manager for further explanation.

The Trustee Directors meet with all their Investment Managers regularly. The Trustee Directors provide their managers with an agenda for discussion, including, where appropriate, ESG issues. Managers are challenged both directly by the Trustee Directors and by their investment advisers on the impact of any significant issues including, where appropriate, ESG issues that may affect the prospects for return from the portfolio.

Additional Voluntary Contributions (AVCs)

The Trustee Directors give members the opportunity to pay additional contributions to purchase additional service within the Scheme.

Signed For and on Behalf of the Trustee Directors of the Scottish Hydro-Electric Pension Scheme

Trustee	Date
Trustee	Date