Novartis UK Pension Scheme

Statement of Investment Principles – May 2022 (replaces July 2020)

1. Introduction

Novartis UK Pension Trustees Limited, the Trustee of the Novartis UK Pension Scheme ("the Scheme") has drawn up this Statement of Investment Principles ("the Statement") to comply with the requirements of:

- The Pensions Act 1995, as amended by the Pensions Act 2004;
- The Occupational Pension Schemes (Investment) Regulations 2005, as amended from time to time;

and subsequent legislation.

The statement is intended to affirm the investment principles that govern decisions about the Scheme's investments. The investment responsibilities of the Trustee are governed by the Scheme's Trust Deed and Rules (a copy of which is available on request) and relevant legislation. The Trustee has ultimate power and responsibility for the Scheme's investment arrangements.

The strategic management of the assets is fundamentally the responsibility of the Trustee acting on expert advice and is driven by its investment objectives. However, the oversight of this strategy and the investment managers is delegated to a sub committee of the Trustee – the Investment Sub Committee. The remaining elements of policy are part of the day to day management of the assets which is delegated to professional investment managers.

As required by the legislation, the Trustee has consulted a suitably qualified person in having obtained written advice from its Investment Consultant, Mercer Limited. The Trustee, in preparing this Statement, has also consulted the principal employer, Novartis UK Limited ("the Company").

Where matters described in this Statement may affect the Scheme's funding policy, input has also been obtained from the Scheme Actuary.

The advice received and arrangements implemented are, in the Trustee's opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended) and relevant regulations.

2. Final Salary Investments

2.1 Process for Choosing Investments

The process for choosing investments is as follows:

(a) Identify appropriate investment objectives

(b) Consider the broad level of risk consistent with meeting the objectives set

(c) Construct a portfolio of investments that is expected to maximise the return (net of all costs) given the Trustee's risk tolerances

2.2 Investment Objectives

The primary objective of the Trustee is to ensure that members' benefits are payable as they fall due. From an investment perspective, this involves (given the agreed Schedule of Contributions) balancing a wish to generate investment returns to meet payments with a wish to limit the potential (downside) volatility of the returns (and the consequent impact on member benefit security). The view of what is and is not acceptable to the Trustee in investment terms ties in with funding and covenant considerations.

The Trustee recognise that the Scheme liabilities are long term (several decades) and hence the investment time horizon is potentially also very long term. They also recognise the potential for risk transfer opportunities e.g. through bulk annuities which could reduce the investment time horizon substantially for a proportion of the invested assets.

2.3 Financially Material Considerations, Risk Management and Risk Measurement

The Trustee has considered the following risks which it believes may be financially material to the Scheme over its anticipated lifetime. These considerations are taken into account in the selection, retention and realisation of investments and are recorded in a Risk Register. This Register records each key risk, its likelihood and the potential scale of impact, together with the control mechanisms in place to mitigate the identified risks.

The Trustee's policy on the management of the key investment-related risks is as follows:

- The primary risk upon which the Trustee focuses is that arising through a mismatch between the Scheme's assets and its liabilities. The Trustee's willingness to take investment risk is dependent on the continuing financial strength and support of the Company. Therefore, a key risk is the failure of the Company to be able or willing to support the Scheme. As a result, the Trustee monitors the Scheme's funding position through regular funding updates and ongoing triennial actuarial valuations, with appropriate action to prevent value deterioration of the funding position.

- The key strategic investment risks inherent in the current investment strategy are as follows:

    - Interest rate risk: the risk that the assets do not move in line with the value placed on the Scheme's liabilities in response to changes in interest rates. The Trustee seeks to manage and monitor this risk via a Liability Driven Investment ("LDI") portfolio, which, in conjunction with investments in buy & maintain corporate bonds, aims to partially match the interest rate sensitivity of the Scheme's estimated liabilities.

    - Inflation risk: similar to interest rate risk but concerning inflation. The Trustee also seeks to manage and monitor this risk via a LDI portfolio, which aims to partially match the inflation sensitivity of the Scheme's estimated liabilities.

    - Credit risk: the risk that payments due to corporate bond investors may not be made. Credit risk is managed by investing the majority of the Scheme's bond assets in UK government bonds, where the risk is considered minimal, and in buy & maintain corporate bond funds which invests in primarily investment grade rated bonds and imposes limits on exposure to individual issuers. Credit risk arising on cash held within financial institutions is managed by ensuring cash is held with a diversified range of institutions. Credit risk arising on derivatives is minimised by ensuring appropriate collateral arrangements.

    - Risks arising from Environmental, Social and Corporate Governance ("ESG") issues, including climate change and stewardship: the Trustee recognises these risks and believes they present threats as well as opportunities, alongside the other risks to which the Scheme is exposed. See Section 5 for dedicated comments on these risks and the Trustee's approach.

- As mentioned above, the strength of the Company's covenant is important and the Trustee is very aware of the risk posed if weak covenant coincides with a poor funding level.

- The Trustee recognises that whilst increasing risk increases potential returns over a long period, it also increases the risk of a shortfall in returns relative to that required to cover the Scheme's accruing liabilities as well as producing more short-term volatility in the Scheme's funding position.

- Recognising the above risks, the Trustee regularly reviews its stated objectives to ensure they continue to reflect the Scheme's liabilities, contribution levels and Trustee's attitude to risk. In turn, the Trustee regularly seeks investment advice to ensure that the Scheme's investment strategy reflects its objectives. This Statement is reviewed at least every three years to ensure that the stated investment objectives and strategic asset mix remain appropriate.

- The Trustee recognises the risks that may arise from the lack of diversification of investments and aims to ensure the asset allocation policy in place results in an adequately diversified portfolio. This principle of diversification extends across asset classes and within asset classes. Pooled fund vehicles will be used, where appropriate, to ensure appropriate diversification at stock level.

- The risk that the day to day management of the assets will not achieve the rate of investment return expected by the Trustee. The Trustee recognises that the use of active investment managers involves such a risk.

- There is currency risk inherent in investment in assets denominated in non-Sterling currencies. In order to limit unmanaged currency risk, the Trustee has adopted the policy of hedging non-Sterling currency exposure back to Sterling.

- The documents governing the investment manager appointments include a number of guidelines which, among other things, are designed to ensure that only suitable investments are held by the Scheme. The managers are prevented from investing in asset classes outside their mandate without the Trustee's prior consent. The managers are regulated by the Financial Conduct Authority.

- The safe custody of the Scheme's assets is delegated to professional custodians, selected and monitored by the Trustee (for segregated mandates) and the pooled fund providers (for pooled mandates).

- The Trustee recognises the importance of managing operational risks, such as counterparty risk. It works with its advisers and investment managers to understand the extent of such risks but delegates the day to day control of such risks to the managers, subject to guidelines agreed with the investment managers.

- Investment may be made in securities that are not traded on regulated markets. Recognising the risks (in particular liquidity and counterparty exposure), the Trustee will look to ensure that the assets of the Scheme are predominantly invested on regulated markets, or robustly collateralised if over-the-counter vehicles are used.

Arrangements are in place to monitor the Scheme's investments to help the Trustee check that nothing has occurred that would bring into question the continuing suitability of the current investments. To facilitate this, the Trustee meets periodically with the Scheme's managers and receives regular reports from all the investment managers and Mercer.

Should there be a material change in the Scheme's circumstances, the Trustee will review whether and to what extent the investment arrangements should be altered and will update this document accordingly.

In considering the selection, retention and realisation of investments the Trustee does not take account of non-financially material considerations, including member views.

2.4 Investment Strategy

The Trustee has determined, based on written expert advice from Mercer, a benchmark mix of asset types and ranges within which the investment managers may operate. This investment strategy is broadly split as follows:

LDI	*52.0%*
B&M corporate bonds	*35.0%*
Multi-asset credit	*5.0%*
HLV property (secure long lease properties)	*8.0%*
Total	**100.0%**

In addition, some investments may be held in other assets outside of the allocations set out above as a result of legacy arrangements.

The strategy includes significant exposure to assets which match movements in the Scheme's liability value, referred to as "liability driven investment" or LDI.

The Trustee anticipates reviewing its strategy as appropriate opportunities are presented to the Trustee, subject to appropriate levels of expected return, risk and liquidity.

In particular the stated strategy has significant exposure to assets which provide relatively secure ongoing cashflows which can help to match actual cashflow payments, and the Trustee understands the potential benefits of developing this further in line with a "cashflow driven investment" or CDI type investment strategy.

3. Day-to-Day Management of the Assets

The Trustee delegates the day to day management of the Scheme's assets to professional investment management firms who are regulated by the Financial Conduct Authority ("FCA"). The Trustee has taken steps to satisfy themselves that their managers have the appropriate knowledge and experience for managing the Scheme's investments and are carrying out the work competently. The Trustee has determined a benchmark mix of asset types and ranges within which each appointed investment manager may operate.

Section 6 sets out how the Trustee incentivises investment managers, where applicable, to operate in line with the objectives set out in Section 2.2.

4. Selection, retention and realisation of Assets

In general, the Scheme's investment managers have discretion in the timing of selection, retention and realisation of investments and in considerations relating to the liquidity of those investments. The Scheme's investments managers have responsibility for generating cash as and when required for benefit outgoings.

Any investments into or disinvestments will be used to support the investment strategy set out in Section 2.4.

5. ESG, Stewardship (including Engagement Activities) and Climate Change Considerations

The Trustee believes that good stewardship and ESG issues may have a material impact on investment risk and return outcomes and will therefore be considered as part of the Scheme's investment process. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that require explicit consideration. When setting investment strategy, ESG factors, including climate change, will be considered alongside a number of other factors that can influence investment strategy.

The Trustee will ensure that an appropriate governance budget is available for developing and implementing ESG and Climate Change related governance policies. The Trustee will adhere to the annual reporting requirements under the Task Force on Climate-Related Financial Disclosures ("TCFD") regulations.

The Trustee's intention is to align the Scheme's investments with the targets set under the Paris Agreement (which aims to limit climate change to well below 2°C, preferably to 1.5°C, compared to pre-industrial levels) in relation to greenhouse gas emissions and carbon neutrality, to the extent that this is consistent with overall risk and return considerations (including for example, avoiding, a material detriment to return expectations through the existence of "green premia" or a concentration of risk that could result from an excessively narrow investment universe). Further detail on the Trustee's beliefs and policies in relation to ESG factors and Climate Change is set out in the Trustee's Responsible Investment Policy document.

Subject to this Policy the Trustee has given the appointed investment managers full discretion when evaluating ESG factors, including climate change considerations, and in exercising voting rights and stewardship obligations attached to the Scheme's investments, in accordance with their own corporate governance policies and taking account of current best practice, including the UK Corporate Governance Code and the UK Stewardship Code. Where investment is in multi-investor pooled funds, the Trustee will consider the guidelines of the relevant pooled fund when deciding to appoint or retain the manager. The Trustee expect its managers to take these factors into account as appropriate to the mandate in the selection, retention and realisation of investments. This covers a range of matters including the issuers' performance, strategy, capital structure, management of actual or potential conflicts of interest, risks, environmental and social impact and corporate governance.

The Trustee will review periodically the responsible investment policies and practices of the appointed investment managers, with the assistance of their advisers. The Trustee will, where it is deemed appropriate, engage the managers in discussion on their responsible investment policies and may request the managers consider collective engagement further. It will however be made clear to the managers that any decisions taken by the managers should be in the best long term financial interest of the Scheme and its members.

The Trustee considers the ESG credentials of investment managers in the selection and ongoing monitoring of investment managers, making use of Mercer's ESG ratings and investment reports. Given a shortlist of highly rated strategies, the Trustee would consider those strategies with positive ESG tilts more favourably and under normal circumstances, the Trustee would not expect to appoint a strategy that is afforded the lowest rating by their advisor in relation to ESG.

The Trustee will consider the ESG policies and practices of prospective annuity providers to the extent possible. Furthermore, the Trustee will consider the ESG policies and practices of AVC providers noting that the impact of AVC performance is on individual members, but notes also that these contracts are a small proportion of total assets and hence will not have a significant impact on the Scheme's overall ESG.

6. Investment Manager Arrangements

Investment managers are appointed based on their perceived capabilities and, therefore, their perceived likelihood of achieving the expected return and risk characteristics for the asset class or specific investment strategy they are selected to manage over a suitable time horizon. This includes, appropriate levels of outperformance of relevant benchmarks where appropriate.

The Trustee seeks expert advice in relation to these appointments. This advice may consider factors such as the manager's idea generation, portfolio construction, implementation and business management, as well as the investment manager's approach to ESG voting and engagement activity, as they apply to the specific investment strategy being considered.

Where the Trustee makes segregated appointments, the Trustee specifies the investment objectives and guidelines in an investment management agreement ("IMA") and sets these so that they are in line with the Trustee's specific investment requirements. Where the Trustee invests in pooled investment vehicles they accept that they have no ability to specify the risk profile and return targets of the manager other than through the choice of specific vehicles. They will therefore select vehicles that best align with the Trustee's own policy in terms of investment objectives and guidelines as set out in Section 2.2. Once appointed, they will review the appointment, should there be any material changes in these terms.

The Trustee makes appointments with the view to them being long term (to the extent this is consistent with the Trustee's overall investment time horizon) and there is typically no set duration for the manager appointments.

For each appointment, retention is dependent upon the Trustee having ongoing confidence that the investment manager will achieve its investment objective. The Trustee makes this assessment taking into account various factors, which includes performance to date, as well as an assessment of future prospects.

Investment managers are therefore incentivised both to achieve the objectives set for them, which are consistent with the Trustee's policies and objectives, and to ensure that they remain capable of doing so on a rolling basis. This encourages investment managers to take a suitably long-term view when assessing the performance prospects of, and engaging with, the equity and debt issuers in which they invest or seek to invest.

6.1 Performance Assessment and Fees

The Trustee receives reporting on asset class and investment manager performance on a regular basis, via a combination of formal independent reports and presentations from the investment managers.

Investment returns (and volatility) are measured on both an absolute basis and relative to one or more suitable benchmarks and targets. Returns are considered net of fees and the Trustee will monitor the level of ongoing transaction costs. The Trustee's focus is on long-term performance but will consider a review if there are significant short-term performance concerns.

As well as assessing investment returns, the Trustee will consider a range of other factors, with the assistance of their Investment Consultant, when assessing investment managers, which may include:

- Personnel and business change
- Portfolio characteristics (including risk and compatibility with objectives) and turnover
- Voting and engagement activity
- Service standards
- The adviser's assessment of ongoing prospects based on their research ratings

The majority of investment managers are remunerated by way of a fee calculated as a percentage of assets under management. For liability hedging a fee is typically calculated based on a combination of physical and hedged exposures. In each case, the principal incentive is for the investment manager to retain their appointment (in full), by achieving their objectives, in order to continue to receive their fee in full. The Trustee carries out regular reviews of manager fee arrangements. Investment managers are not remunerated based on portfolio turnover.

6.2 Portfolio Turnover Costs

Turnover costs arise from a) "ongoing" transactions within an investment manager's portfolio and b) "cashflow" costs incurred when investing in, or realising assets from, a mandate. The Trustee will engage with a manager if portfolio turnover is higher than expected.

The Trustee will seek periodic reporting on turnover and ongoing costs for all appointed managers.

The Trustee seeks to minimise cashflow costs by receiving income from mandates where possible and consistent with overall policy. The Trustee monitors the costs of implementing strategic change via their Investment Consultant.

7. Professional Investment Advice

The Trustee has appointed Mercer to provide advice upon request on all aspects of investment facing the Scheme, ranging from strategic advice to the selection and monitoring of the investment managers. While Mercer are expected to respond to any issues raised by the Trustee, they will also endeavour to raise on a proactive basis any areas which they believe that the Trustee should address.

8. Compliance with this Statement

The Trustee will monitor compliance with this Statement annually.

9. Review of this Statement

The Trustee will review this Statement in response to any material changes to any aspects of the Scheme, its liabilities, finances and the attitude to risk of the Trustee and the Company which it judges to have a bearing on the stated Investment Policy.

This review will occur no less frequently than every three years to coincide with the Actuarial Valuation and without delay following any significant changes in membership or investment policy since the last review. Any such review will again be based on written, expert investment advice and will be undertaken in consultation with the Company.