Smith & Nephew UK Pension Fund

Statement of Investment Principles

1. Scope of Statement

This Statement has been prepared in accordance with section 35 of the Pensions Act 1995 (as amended by the Pensions Act 2004 and the Occupational Pension Schemes (Investment) Regulations 2005). This Statement documents the principles and policies by which the Trustee manages the assets in the Smith & Nephew UK Pension Fund ('the Fund').

The effective date of this Statement is June 2023. The Trustee will review this Statement and the Fund's investment strategy no later than three years after the effective date of this statement and without delay after any significant change in investment policy.

2. Consultations Made

The Trustee has consulted with the Principal Employer, which has acted on behalf of all participating employers, prior to writing this Statement and will take the employer's comments into account when it believes it is appropriate to do so.

The Trustee is responsible for the investment strategy of the Fund. It has obtained written advice on the investment strategy appropriate for the Fund and on the preparation of this Statement. This advice was provided by Lane Clark & Peacock LLP ("LCP"), the Investment Consultant whom the Trustee believes to be suitably qualified and experienced to provide such advice. LCP is regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

The majority of the Fund's assets are invested in Buy-In Policies with Rothesay, securing all known defined benefit liabilities. Rothesay is a UK insurance company authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The day to day management of the Fund's surplus assets has been delegated to Columbia Threadneedle Investments which is authorised and regulated by the Financial Conduct Authority.

3. Nature of the Fund

The Fund is governed by its Trust Deed and Rules which specifies the Trustee's investment powers. The investment powers do not conflict with this Statement. The Fund is closed to new members. As of 31 December 2016, the Fund was also closed to accrual.

4. Liabilities

The value of the Fund's ongoing liabilities is sensitive to various demographic and financial factors. The financial factors which are relevant to the Fund's investment policy are:

- the rate of return on assets
- price inflation for pensioners
- long-term interest rates

The value of the Fund's liabilities for the purpose of scheme funding are sensitive to the expected return on assets, price inflation and yields on index-linked and conventional gilts.

The latest actuarial valuation had an effective date of 30 September 2020, with the next valuation due by no later than 30 September 2023 which will be carried out in accordance with prevailing legislation.

5. Objectives

The Trustee's primary objective is to ensure, as far as possible, that sufficient assets are available to pay out members' benefits as and when they arise taking account of contributions received.

Having purchased Buy-in Policies to cover the Fund's known defined benefit liabilities, the Trustee's secondary objective is to maintain the residual assets in order to preserve the surplus value and help meet ongoing expenses not covered by the Plan's Buy-in Policies.

6. Choosing Investments

Before investing in any manner, the Trustee obtains and considers proper written advice from its Investment Consultant on the question of whether the investment is satisfactory, having regard to the need for suitable and appropriately diversified investments.

The types of investments held and the balance between them are chosen to be appropriate given the liability profile of the Fund, its cashflow requirements, the funding level of the Fund and the Trustee's objectives.

With the exception of the Buy-in Policies (detailed in Section 10), which the Trustee has purchased from Rothesay, the Trustee has delegated its powers of investment to its fund manager, Columbia Threadneedle Investments, in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole.

The Trustee has limited influence over Rothesay's and Columbia Threadneedle Investments' investment practices, but it encourages them to improve their practices where appropriate.

The Trustee's 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 fund. 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 Trustee's responsibility to ensure that the managers' investment approaches are consistent with its 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 Trustee expects 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. It assesses this when selecting and monitoring managers.

The Trustee evaluates 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, the duration of a manager's appointment will depend on strategic considerations and the outlook for future performance. Generally, the Trustee would be unlikely to terminate a mandate on short-term performance grounds alone.

The Trustee's policy is to evaluate each of its investment managers by reference to the manager's individual performance as well as the role it plays in helping the Fund 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 Trustee recognises 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 Trustee expects its Investment Consultant to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Fund's investment mandates.

The surplus assets of the Fund (ie other than the Buy-in Policies) are invested predominantly on regulated markets (with investments not on regulated markets being kept to a prudent level) and properly diversified to avoid excessive reliance on any particular asset, issuer or group of undertakings so as to avoid accumulations of risk in the portfolio as a whole.

Investment in derivatives is only made in so far as they contribute to the reduction of investment risks or facilitate efficient portfolio management and are managed such as to avoid excessive risk exposure to a single counterparty or other derivative operations.

7. Investment Risk Measurement and Management

The Trustee regards 'risk' as the likelihood that it fails to achieve the objectives set out above and has taken several measures which are set out in this Statement to minimise this risk so far as is possible.

In particular, in arriving at its investment strategy and the production of this Statement, the Trustee has considered the following risks:

- Actions by the investment managers – These are monitored regularly by the Trustee, with advice from the Investment Consultant.
- The continuing suitability of the appointed managers is reviewed annually or more frequently if this is appropriate. The investment managers' actions are controlled by individual agreements.
- The need to pay benefits in the short-term – Cash flow risk arises when there is a need to realise investments in order to meet the benefit outgo, and so close attention is paid to the liquidity of assets.
- The failure of some of the investments – In order to reduce the risk that the failure of any one investment has an excessive impact on the overall performance of the assets, a range of different securities are held.
- The risk that the buy-in provider, Rothesay, fails to honour its obligations under the Buy-in Policies. This could occur if, for example, Rothesay became insolvent. The Trustee recognises that this risk cannot be eliminated altogether, however, the Financial Services Compensation Scheme is expected to provide significant additional protection under these circumstances.

8. Employer Risk

The Trustee and Smith & Nephew plc have considered the risks associated with the funding of members' benefits. On 23 January 2006, a Guarantee was signed by the then Trustees of the Fund and by Smith & Nephew plc. Under this document Smith & Nephew plc guaranteed the obligations of Smith & Nephew UK Limited (the Principal Employer) and the Fund's other continuing participating employers, to make payments to the Fund. Later, a replacement Guarantee in a format satisfactory to the Pension Protection Fund (and not materially less favourable than the existing Guarantee) was signed by the Trustee and Smith & Nephew plc and forwarded to the Pension Protection Fund prior to 31 March 2006. This Guarantee was updated in March 2010 to reflect the change to a corporate trustee but remains in the same form as the old Guarantee and in accordance with Pension Protection Fund requirements.

The Trustee and the Principal Employer are also aware of the requirement to report 'Notifiable Events' to the Pensions Regulator. These are events that might have the potential to reduce the security of the funding of members' benefits. In the event of such a notification the Trustee would consider the continued appropriateness of the Fund's existing investment strategy.

9. Asset Allocation Strategy

The Trustee regards the choice of asset allocation policy as the decision which has most influence on the likelihood that it will achieve its investment objectives. The Trustee retains responsibility for this decision, which is made on the advice of its Investment Consultant and the Fund Actuary, and in consultation with the Principal Employer.

The Trustees has secured all known defined benefit liabilities of the Fund through Buy-in Policies with Rothesay.

The surplus assets are invested in a combination of the Columbia Threadneedle Investments' pooled gilt and cash funds.

The Columbia Threadneedle Investments gilt fund allocations are intended to broadly hedge against the estimated interest rate and inflation exposures of the residual premiums to be paid to Rothesay.

The Trustee does not have a fixed strategic benchmark in place and expects the allocation to change over time as required to meet the Plan's objectives.

10. The Buy-in Policies

The Trustee purchased bulk annuity contracts with Rothesay in January 2013, May 2017 and June 2023 (together the "Buy-in Policies") to cover all of the Fund's known defined benefit liabilities. Each policy covers a subset of the Fund's liabilities.

The Trustee took investment advice from LCP in relation to the purchase of the Buy-in Policies. The Trustee also commissioned an independent report into Rothesay's finances and investment strategy from Oliver Wyman before purchasing the first policy in 2013, and a second report from FTI Consulting before purchasing the final policy in 2023. The Trustee was comfortable with the conclusions of these reports.

The payments received by the Trustee under each Buy-in Policy have been designed to match as closely as possible a portion of the Fund's liabilities. The return on the Buy-in Policies is therefore the income that they generate to meet the benefit payments covered by the contracts.

11. Expected Returns on Assets

Over the long-term the Trustee's expectations are:

- for the Buy-in Policies, the return is expected to be the income required to meet the benefit payments covered by the contract;
- for the gilt holdings, to achieve a rate of return closely correlated to the residual premiums to be paid to Rothesay; and
- for the cash holding, to achieve a rate of return closely in line with the Sterling Overnight Index Average.

Returns achieved by the fund managers are assessed against performance benchmarks set by the Trustee in consultation with its advisers and fund managers.

12. Rebalancing

From time to time the Trustee will consider, after taking appropriate advice, whether to rebalance the asset allocation following movements due to investment returns.

13. Employer-related Investments

The Fund will not invest directly in securities (including shares) issued by Smith & Nephew plc or hold directly any other employer-related investment. However, this does not exclude any pooled vehicle that the Fund invests in from investing in Smith & Nephew plc as part of a well-diversified investment strategy.

The Trustee monitors the holdings of such pooled funds to ensure that the Fund's aggregate exposure to such securities is prudent and in accordance with prevailing legislation.

14. Investment of Additional Voluntary Contributions

The Trustee selects the choice of investment vehicles used by members for additional voluntary contributions (AVCs).

Some members obtain further benefits by paying AVCs to the Fund. The liabilities in respect of these AVC arrangements are equal to the value of the investments selected by the members. The Trustee reviews regularly the choice of investments available to members to ensure that they remain appropriate to member needs. The investment vehicles are currently provided by Utmost Life and Pensions, Clerical Medical, Prudential and Scottish Widows.

15. Custody

The investments are held on behalf of the Fund by custodian companies, selected by the investment managers, who are responsible for settlement of transactions executed by the investment managers. The custodians are independent of the Trustee, the Fund and Smith & Nephew.

16. Review and Control

The Trustee will monitor the strategy and its implementation as follows:

16.1 Monitoring investments

The Investment Consultant monitors the investment arrangements on behalf of the Trustee, and reports on performance on a quarterly basis.

16.2 Realisation of Investments/Liquidity

The Trustee recognises that there is a risk in holding assets that cannot be easily realised should the need arise.

The Trustee expects to be able to meet benefit payments as they fall due using income from the Buy-in Policies. The Trustee is comfortable that any additional cash flow requirements could be met from the Fund's remaining assets which are mostly realisable at short notice.

17. Service Provider Monitoring

The Trustee reviews from time to time the services provided by the Investment Consultant and other service providers as necessary to ensure that the services provided remain appropriate for the Fund.

18. Voting and engagement

The Trustee recognises its responsibilities as owners of capital, and believes 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. The Trustee has delegated to its 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 Trustee does not monitor or engage directly with issuers or other holders of debt or equity. It expects 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 Trustee from time to time, as the Trustee expects this to be in the long-term financial interests of the beneficiaries. The Trustee seeks 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 Trustee reviews how these are implemented in practice.

The Trustee monitors managers' activities in relation to ESG factors, voting and engagement on a regular basis, with a formal annual review. The Trustee seeks to understand how they are implementing their stewardship policies in practice to check that their stewardship is effective and aligned with their expectations.

The Trustee has selected some priority ESG themes to provide a focus for their monitoring of investment managers' voting and engagement activities, being business ethics, climate change and human rights. The Trustee reviews the themes regularly and updates them if appropriate. The Trustee communicates these stewardship priorities to the Fund's investment managers and also confirms their more general expectations in relation to ESG factors, voting and engagement.

If the Trustee's monitoring identifies areas of concern, the Trustee will engage with the relevant manager to encourage improvements.

19. Financially material considerations and non-financial matters

The Trustee has considered how environmental, social, governance ("ESG") and ethical factors should be taken into account in the selection, retention and realisation of investments, given the time horizon of the Fund and its members.

The Trustee expects its investment managers to take account of financially material considerations (including climate change and other ESG considerations). The Trustee seeks to appoint managers that have appropriate skills and processes to do this, and from time to time reviews how its managers are taking account of these issues in practice.

The Trustee also considers credible investment options that give increased weight to ESG considerations when appointing new managers and will periodically consider whether new options have become available for existing allocations.

The Trustee has limited influence over managers' investment practices as assets are held in pooled funds, but it encourages its managers to improve their practices where appropriate and the Trustee may seek to disinvest if it views that ESG considerations are not given sufficient priority.

The Trustee does not take into account any non-financial matters (ie matters relating to the ethical and other views of members and beneficiaries, rather than considerations of financial risk and return) in the selection, retention and realisation of investments.

Signed by Bob Newcomb on 26 June 2023. Signatures redacted.