Statement of Investment Principles for the Michelin Pension and Life Assurance Plan

1. Introduction

This Statement of Investment Principles ("SIP") sets out the policy of Michelin Pensions Trust Limited (the “Trustee”) on various matters governing decisions about the investments of the Defined Benefit Section of the Michelin Pension and Life Assurance Plan (the “Plan”). This SIP replaces the previous SIP dated November 2018.

This SIP does not cover the Plan’s DC Section or AVC arrangements (or the managers and advisors related to the DC Section).

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, and the Pension Regulator’s guidance for defined benefit pension schemes (March 2017). The SIP also reflects the Trustee’s response to the Myners voluntary code of investment principles.

This SIP has been prepared after obtaining and considering written professional advice from LCP, the Plan’s DB investment adviser, whom the Trustee believes to be suitably qualified and experienced to provide such advice. The advice takes into account the suitability of investments including the need for diversification, given the circumstances of the Plan, and the principles contained in this SIP. The Trustee has consulted with the relevant employer in producing this SIP.

The Trustee will review this SIP from time to time and, with the help of its advisers, 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 Plan’s investment governance structure, including the key responsibilities of the Trustee, 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 Trustee’s policy towards risk appetite, capacity, measurement and management.

2. Investment objectives

The primary objective is to ensure that the Plan should be able to meet benefit payments as they fall due. In addition to this primary objective, the Trustee has a series of additional objectives. These are as follows:

- that the return on the Plan’s assets is maximised whilst managing and maintaining investment risk at an appropriate level. What the Trustee determines to be an appropriate level of risk is set out in Appendix 2.

- that the Plan should be fully funded on a technical provisions basis (i.e. the asset value should be at least that of its liabilities on this basis). The Trustee is aware that there are various measures of funding and has given due weight to those considered most relevant to the Plan.

- that the Plan has a long-term journey plan in place (which has been agreed with the Company) which is designed to help it achieve full funding by 31 March 2027 on the desired technical provisions basis. Progress against this long-term journey plan is assessed and reported on a regular basis with progress being measured against a set of short-term milestones.
3. Investment strategy

The Trustee, with the help of its adviser and in consultation with the employer, reviews the investment strategy on an ongoing basis, taking into account the objectives described in Section 2 above.

The strategic asset allocation is determined with reference to the Plan’s funding level. The assets are split between low risk assets, i.e. the “Matching portfolio”, and more volatile assets which are expected to deliver a higher return in the longer term, i.e. the “Return-seeking portfolio”. As the funding level of the Plan increases, triggers are in place to switch assets from the Return-seeking portfolio to the Matching portfolio.

The current strategic allocation of the Plan’s assets between the two portfolios is as follows:

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Strategic allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Matching portfolio</td>
<td>76%</td>
</tr>
<tr>
<td>Return-seeking portfolio</td>
<td>24%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Details of how each portfolio is currently invested and the funding level trigger mechanism are set out in the separate Investment Policy Implementation Document.

The Trustee will oversee the rebalancing of the Plan’s assets between the managers and monitor the split of assets from time to time. The Trustee generally invests net cash flow (i.e. contributions less benefits and expenses) or disinvests assets in such a way so as to rebalance towards the strategic allocation.

From time to time, the Trustee reviews how the Plan’s assets have performed. Dependant on performance, the Trustee will consider revising the Plan’s strategic allocation to the Matching and Return-seeking portfolios and the funding level triggers in place.

4. Considerations in setting the investment arrangements

When deciding how to invest the Plan’s assets, the Trustee considers a number of risks, including, but not limited to, those set out in Appendix 2. Some of these risks are more quantifiable than others, but the Trustee has tried to allow for the relative importance and magnitude of each risk.

The Trustee considers a wide range of asset classes for investment, and the expected returns and risks associated with those asset classes. As at 31 March 2019 the key financial assumptions made by the Trustee in determining the investment arrangements were:

- equity-type investments will, over the long term, outperform gilts by 5.0% pa;
- diversified growth will, over the long term, outperform gilts by 3.0% pa;
- absolute return bonds will, over the long term, outperform gilts by 1.2% pa;
- multi-asset credit will, over the long term, outperform gilts by 2.3% pa; and
- private credit will, over the long term, outperform gilts by 3.7% pa.

In setting the strategy the Trustee also took into account:

- the Plan’s investment objectives, including the target return required to meet the Trustee’s investment objectives;
- the Plan’s cash flow requirements in order to meet benefit payments in the near to medium term;
- the best interests of members and beneficiaries;
- the circumstances of the Plan, 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 Plan's overall level of investment risk and the balance of individual asset risks are appropriate; and

• the Trustee's investment beliefs about how investment markets work and which factors are most likely to impact investment outcomes.

Some of the Trustee's key investment beliefs, which influenced the setting of the investment arrangements, are set out below. Beliefs on environmental, social and governance factors were developed in a specific investment beliefs session held with the Investment Adviser;

• asset allocation is the primary driver of long-term returns;
• risk-taking is necessary to achieve return, but not all risks are rewarded;
• equity, credit and illiquidity are the primary rewarded risks;
• risks that do not have an expected reward should generally be avoided, hedged or diversified;
• investment markets are not always efficient and there may be opportunities for good active managers to add value;
• 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;
• long-term environmental, social and economic sustainability is one factor that the Trustee should consider when making investment decisions; and
• costs have a significant impact on long-term performance and therefore obtaining value for money from the investments is important.

5. Implementation of the investment arrangements

Before investing in any manner, the Trustee obtains and considers proper written advice from its 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, their objectives, investment guidelines, and custody arrangements are set out in the separate Investment Policy Implementation Document.

The Trustee has signed agreements with the investment managers setting out in detail the terms on which the portfolios are managed. The investment managers' primary role is the day-to-day investment management of the Plan's investments. The managers are authorised under the Financial Services and Markets Act 2000 (as amended) to carry out such activities.

Via Investment Management Agreements, the Trustee may enter into contracts with counterparties including investment banks, in order to execute derivative transactions (particularly as part of LDI, structured equity mandates, currency hedging and overseas interest rate hedging). The Trustee takes advice on the suitability of the contracts and sets restrictions on the use of derivatives where it thinks this is appropriate. Derivatives are only used for risk management, rather than tactical trading.

6. Realisation of investments

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

When appropriate, the Trustee, on the administrators' recommendation, decides on the amount of cash required for benefit payments and other outgoings and informs the investment managers of any liquidity requirements. The Trustee's 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 (e.g. property). In general, the Trustee's policy is to use cash flows to rebalance the Plan's assets towards the strategic asset allocation, and also receive income from some of the portfolios where appropriate.
7. Consideration of financially material 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 Plan and its members.

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

The Trustee has limited influence over managers’ investment practices where assets are held in pooled funds, but it encourages its managers to improve their practices where appropriate.

The Trustee does not take into account any non-financial matters (i.e. matters relating to the ethical and other views of members and beneficiaries, rather than considerations of financial risk and return).

8. Stewardship
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, 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 Trustees from time to time, taking into account 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.

SIP signed for and on behalf of the Trustee of the Michelin Pension and Life Assurance Plan:

Vincent Dormieux
Chairman to the Trustee
INVESTMENT GOVERNANCE, RESPONSIBILITIES, DECISION-MAKING AND FEES

The Trustee has decided on the following division of responsibilities and decision-making for the Plan. This division is based upon the Trustee’s understanding of the various legal requirements placed upon it, and its view that this division of responsibility allows for efficient operation and governance of the Plan overall. The Trustee’s investment powers are set out within the Plan’s governing documentation.

1. Trustee

In broad terms, the Trustee is responsible in respect of investment matters for:

- setting the investment strategy, in consultation with the employer;
- developing a mutual understanding of investment and risk issues with the employer;
- reviewing the investment policy as part of any review of the investment strategy;
- setting the policy for rebalancing between asset classes;
- formulating a policy in relation to financially material considerations, such as those relating to ESG considerations (including but not limited to climate change);
- setting a policy on the exercise of rights (including voting rights) and undertaking engagement activities in respect of the investments;
- appointing (and, when necessary, dismissing) investment managers, custodians, investment advisers, actuary and other advisers;
- 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 Trustee’s assessment of its effectiveness as a decision-making body, the policies regarding responsible ownership and how such responsibilities have been discharged;
- putting effective governance arrangements in place and documenting these arrangements in a suitable form;
- reviewing the content of this SIP from time to time and modifying it if deemed appropriate; and
- consulting with the employer 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 the Trustee with regular information concerning the management and performance of their respective portfolios; 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 Trustee 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 Trustee, for:

• advising on how material changes within the Plan’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. Such advice takes account of LCP’s assessment of the nature and effectiveness of managers’ approaches to financially material considerations (including climate change and other ESG considerations); and

• participating with the Trustee in reviews of this SIP.

4. Fee structures

The Trustee recognises that the provision of investment management and advisory services to the Plan results in a range of charges to be met, directly or indirectly, by deduction from the Plan’s assets.

The Trustee has agreed Terms of Business with the Plan’s investment advisers, under which work undertaken is charged for by an agreed fixed fee or on a “time-cost” basis.

The investment managers receive fees calculated by reference to the market value of assets under management and in some cases based on performance. The fee rates are believed to be consistent with the managers’ general terms for institutional clients and are considered by the Trustee to be reasonable when compared with those of other similar providers.

The Trustee has appointed one custodian in respect of all of the Plan’s investments. The custodian fees are calculated by reference to the market value of assets under custody, as well as on a per transaction basis. The fee rates are believed to be consistent with the custodian’s general terms for institutional clients and are considered by the Trustee to be reasonable when compared with those of other similar providers.

The fee structure used in each case has been selected with regard to existing custom and practice, and the Trustee’s view as to the most appropriate arrangements for the Plan. However, the Trustee will consider revising any given structure if and when it is considered appropriate to do so.

5. Performance assessment

The Trustee is satisfied, taking into account the external expertise available, that there are sufficient resources to support its investment responsibilities. The Trustee believes that it has sufficient expertise and appropriate training to carry out its role effectively.

It is the Trustee’s policy to assess the performance of the Plan’s investments, investment providers and professional advisers from time to time. The Trustee will also carry out periodically an assessment of its own effectiveness as a decision-making body and will decide how this may then be reported to members.

6. Working with the Plan’s employer

When reviewing matters regarding the Plan’s investment arrangements, such as the SIP, the Trustee seeks to give due consideration to the employer’s perspective. While the requirement to consult does not mean that the Trustee needs to reach agreement with the employer, the Trustee believes that better outcomes will generally be achieved if the Trustee and employer work together collaboratively.
1. Risk appetite and risk capacity

Risk appetite is a measure of how much risk the Trustee is willing to bear within the Plan in order to meet its 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 Trustee can tolerate deviation from its long term objectives before attainment of those objectives is seriously impaired. The Trustee’s aim is to strike the right balance between risk appetite and risk capacity.

When assessing the risk appetite and risk capacity, the Trustee 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 Plan’s long-term and shorter-term funding targets;
- the Plan’s liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged;
- the Plan’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.

Following implementation of the Plan’s current investment strategy, as at 31 March 2019, the Plan’s 1 year 95% Value at Risk was £219m. This means that there is a 1 in 20 chance that the Plan’s funding position on a technical provisions basis will worsen by £219m or more, compared to the expected position, over a one year period. When deciding on the current investment strategy, the Trustee believed this level of risk to be appropriate given the Trustee’s and employer’s risk appetite and capacity, given the Plan’s objectives.

2. Approach to managing and monitoring investment risks

The Trustee considers that there are a number of 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 Trustee is that, over the long-term, the Plan should generate its target return so that it has adequate assets to meet its liabilities as they fall due. The Trustee therefore invests the assets of the Plan to produce a sufficient long-term return in excess of the liabilities. There is also a risk that the performance of the Plan’s assets and liabilities diverges in certain financial and economic conditions in the short term. This risk has been taken into account in setting the investment strategy and is monitored by the Trustee 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 Plan’s assets. The Trustee believes that the Plan’s assets are adequately diversified between different asset classes and within each asset class. This was key consideration when determining the Plan’s investment arrangements and is monitored by the Trustee 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 Trustee receives written advice from a suitably qualified individual, and will typically undertaken an investment manager selection exercise. The Trustee monitors the investment managers on a regular basis to ensure they remain appropriate for their selected mandates.

2.4. Liquidity/marketability risk

This is the risk that the Plan is unable to realise assets to meet benefit payments as they fall due or that the Plan will become a forced seller of assets in order to meet benefit payments. The Trustee is aware of the Plan’s cash flow requirements and believes that this risk is managed by maintaining an appropriate degree of liquidity across the Plan’s investments and investing in income generating assets, where appropriate.
2.5. Environmental, social and governance (ESG) risks

Environmental, social and corporate governance (ESG) factors are sources of risk to the Plan’s investments, some of which could be financially significant, 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 Trustee seeks to appoint investment managers who will manage these risks appropriately on their behalf and from time to time reviews how these risks are being managed in practice.

2.6. Collateral adequacy risk

The Plan is invested in leveraged Liability Driven Investment (“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 Plan’s interest rate and inflation hedging could be reduced and that the Plan’s funding level could suffer subsequently as a result. In order to manage this risk, the Trustee ensures that the Plan 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.

2.7. 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 Plan is subject to credit risk because it invests in bonds. The Trustee manages its exposure to credit risk by holding a diversified exposure to different credit issuers.

2.8. Currency risk

The Plan is subject to currency risk because some of the Plan’s investments are held in overseas markets.

The Trustee considers the overseas currency exposure in the context of the overall investment strategy, and believes that the currency exposure that exists diversifies the strategy and is appropriate. Furthermore, the Trustee manages the amount of currency risk via a separate currency hedging arrangement with its custodian.

2.9. Interest rate and inflation risk

The Plan’s asset are subject to interest rate and inflation risk because some of the Plan’s assets are held in bonds or interest rate swaps, either as segregated investments or via pooled funds. However, the interest rate and inflation risks to which the Plan’s assets are exposed serves to hedge part of the corresponding risks associated with the Plan’s liabilities. The net effect will be to reduce the volatility of the funding level.

2.10. Other non-investment risks

The Trustee recognises that there are other, non-investment, risks faced by the Plan, and takes these into consideration as far as practical in setting the Plan’s investment arrangements as part of its assessment of the other aspects of the Plan’s Integrated Risk Management framework.

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 Plan as anticipated).

Together, the investment and non-investment risks give rise generally to funding risk. This is the risk that the Plan’s funding position falls below what is considered an appropriate level. The Trustee regularly reviews progress towards the Plan’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 Trustee believes that it has appropriately addressed and is positioned to manage this general risk.