Applied Materials (UK) Pension and Family Security Scheme

Statement of Investment Principles – September 2019

1. Introduction

The Trustees of the Applied Materials (UK) Pension and Family Security Scheme ("the Scheme") have drawn up this Statement of Investment Principles ("the Statement") to comply with the requirements of Section 35 of the Pensions Act 1995 ("the Act") and the Occupational Pension Schemes Regulations as amended from time to time. The Statement is intended to affirm the investment principles that govern decisions about the Scheme's investments. A separate document detailing the specifics of the Scheme's investment arrangements is available upon request.

In preparing this Statement the Trustees have consulted the Scheme sponsor to ascertain whether there are any material issues of which the Trustees should be aware in agreeing the Scheme's investment arrangements. The Trustees have obtained written advice from the Scheme's Investment Consultant, Mercer Limited.

The Scheme is divided into two main parts: (i) the **Defined Benefit Section** and (ii) the **Defined Contribution Section**.

2. Fund Governance

2.1 The Trustees

The Trustees take some decisions and delegate the balance. When determining which decisions to delegate, the Trustees have taken into account whether they have the appropriate training and are able to secure the necessary expert advice in order to take an informed decision. Furthermore, the Trustees' ability to effectively execute the decision is considered too.

2.2 The Investment Managers

The Investment Management Agreements specify:

- The investment objectives of the investment managers along with the benchmark;
- The time scale of performance measurement and assessment.

3. Process For Choosing Investments

The process for choosing investments is as follows:

- Identify appropriate investment objectives;
- Agree the level of risk consistent with meeting the objectives set;

- Construct a portfolio of investments that is expected to maximise the return (net of all costs) given the tolerable level of risk.

In considering the appropriate investments for the Scheme the Trustees have obtained and considered the written advice of the Investment Consultant, whom the Trustees believe to be suitably qualified to provide such advice. The advice received and arrangements implemented are, in the Trustees' opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended).

4. Investment Objectives

4.1 Defined Benefit Section

The Trustees' objective is to invest the Scheme's assets in the best interest of the members and beneficiaries, and in the case of a potential conflict of interest in the sole interest of the members and beneficiaries. Within this framework the Trustees seek to manage the Scheme's asset allocation in a manner that controls risk, costs and over time allows the Trustees to reduce reliance on covenant.

4.2 Defined Contribution Section

The Trustees recognise that members of the Defined Contribution section have differing investment needs and that these may change during the course of members' working lives. They also recognise that members have different attitudes towards risk. The Trustees believe that members should make their own investment decisions based on their individual circumstances. The Trustees' objective therefore is to make available a range of investment options which should assist members to:

- To maximise members' assets;
- To maintain the purchasing power of members' savings;
- To provide protection for accumulated assets in the years approaching retirement;
- To allow members to tailor their investment choices to meet their own needs.

To meet these objectives the Trustees have selected a range of actively and passively managed funds for members to select from, as well as a number of "Lifestyle" approaches which helps members plan for retirement. The range of options includes equities, bonds, diversified growth funds, pre-retirement funds and money market instruments.

If selecting their own investments, the balance between the different kinds of investments is the member's decision. This balance will determine the expected return on a member's assets and should be related to the member's own risk appetite and tolerance.

The Trustees regularly review the suitability of the options provided and from time to time will change or introduce additional investment portfolios as appropriate. Members are advised to seek independent financial advice if they are unsure as to the appropriate investment strategy for their needs.

The items set out in Section 4.2, 5.2, and 9 of this Statement are in relation to what the Trustees deem as ‘financially material considerations’ for the DC Section. Sections 6.2 and 6.3 apply specifically to the default strategy. The Trustees believe the appropriate time horizon for which to assess these considerations should be viewed at a member level. This will be dependent on the members’ age and when they expect to retire. It is for this reason that the default is a lifestyle strategy.

5. Risk Management and Measurement

There are various risks to which any pension scheme is exposed, which the Trustees believes may be financially material to the Scheme. Should there be a material change in the Scheme’s circumstances, the Trustees will review whether and to what extent the investment arrangements should be altered; in particular whether the current risk profile remains appropriate. Specific considerations to Environmental, Social and Governance (“ESG”) issues are addressed in Section 10.

The Trustees have considered the following risks:

5.1 Defined Benefit Section

- *Risk of erosion by inflation*. The Scheme’s liabilities are explicitly linked to price- and wage inflation. The Scheme’s long-term financial soundness will be determined by whether investment returns are at least in line with those assumed by the actuary in establishing the Scheme’s funding position.

- *Asset and liability mismatch risk*. The Trustees have put in place an investment strategy which has significant equity exposure and therefore generates a significant asset / liability mismatch risk. The Trustees accept the risk inherent in such a strategy as they are comfortable with the covenant of the sponsor of the Scheme.

- *Liquidity risk*. The Scheme must be able to meet its liabilities as and when they become due. Consequently, the Scheme holds the majority of investments in easily marketable and realisable assets to meet such benefit payments as and when they become due.

- *Market risk.* The value of securities, including equities, foreign exchange and interest bearing assets, can go down as well as up.

- *Risk from lack of diversification.* The Trustees are satisfied that the spread of assets by type and the investment managers’ policy on investing in individual securities within each type provides adequate diversification of investments.

- *Credit risk.* This reflects the possibility that the payments due under a bond (interest and principal) might not be made by the issuer.

- *Currency risk.* This arises through investment in non-Sterling assets, given that the Scheme’s liabilities are denominated in Sterling, because changes in exchange rates will impact the value of assets relative to liabilities. The Trustees have decided to hedge 50% of the currency exposure from its developed equity portfolio and to hedge all non-Sterling exposure from fixed income back to Sterling, in order to reduce volatility from currency effects.

- *Environmental, social and governance ("ESG") risk.* The risk that ESG factors, including climate change, have a financially material impact on the return on the Scheme's assets. The management of this risk is the responsibility of the investment managers. See Section 10 of this Statement for the Trustees' responsible investment and corporate governance statement.

The Trustees believe that the investment strategy outlined in section 6 is appropriate for meeting the risks outlined above.

5.2 Defined Contribution Section

- *Risk of capital loss in nominal terms.* In the short term there may be fluctuations in the capital value of the accounts that may impact detrimentally on an individual member's account and cause greater uncertainty of benefits to be received, particularly when close to retirement. The Trustees make available a range of funds across various asset classes, members are able to set their own investment allocations, in line with their own risk tolerance. The default is a lifestyle strategy which automatically and gradually switches a member's assets into lower risk investments as they approach retirement. A number of other lifestyle approaches are available for members to self-select, targeting different retirement destinations

- *Risk of erosion by inflation.* If investment returns lag behind inflation over the period of membership, the real (i.e. post inflation) value of the members' individual accounts will decrease. The Trustees make available a range of funds across various asset classes, with many expected to keep pace with inflation. The growth phase of the default strategy invests in equities.

- *Risk of returns from investment managers not meeting expectations.* This will lead to lower than expected returns to members. The Trustees recognise that the use of active investment management involves such a risk, and have also made some passive investment funds available. The Trustees monitor performance relative to expectations / objectives on a regular basis and take professional advice when appropriate.

- *Market risk.* The value of securities, including equities, foreign exchange and interest bearing assets, can go down as well as up. Members may not get back the amount invested. However, the Trustees realise that this risk is implicit in trying to generate returns above that earned by cash and accept this by investing in assets other than cash. The Trustees make available a range of funds across various asset classes, members are able to set their own investment allocations, in line with their risk tolerance. The default strategy is designed with the intention of diversifying market risk to reach a level of risk deemed appropriate given the objectives. This is set with the advice from the investment consultant.

- *Liquidity risk.* The Scheme must be able to meet its liabilities as and when they become due. Members invest in a range of pooled investment vehicles that facilitate the availability of assets to meet benefit outflows.

- *Risk of default strategy not being appropriate.* The Trustees manage this by reviewing the default at least triennially and monitoring member behaviour and the demographic profile. A number of other lifestyle approaches are available for members to self-select, targeting different retirement destinations

- *Environmental, social and governance ("ESG") risk.* The risk that ESG factors, including climate change, have a financially material impact on the return on the Scheme's assets. The management of this risk is the responsibility of the investment managers. See Section 10 of this Statement for the Trustees' responsible investment and corporate governance statement.

6. Investment Strategy

6.1 Investment strategy for the Defined Benefit Section

Given the investment objectives, the Trustees have implemented the investment strategy for the Defined Benefit Section as set out below and as detailed further in the separate "Summary of Investment Arrangements". The Trustees, based on advice from the Investment Consultant, believes that the investment risk arising from the investment strategy is consistent with the overall level of risk being targeted.

Asset Class	Target Benchmark Allocation (%)
UK Equities	9.0
Overseas (Developed Markets) Equities*	18.0
Emerging Markets Equities	3.0
All Stocks Gilts	5.0
UK Over 15 Years Index Linked Gilts	41.0
Corporate Bonds	10.0
Multi-Asset Credit	7.0
Secured Finance	7.0
Total	**100.0**

*50% currency hedged back to Sterling

6.2 Investment strategy for the default strategy of the Defined Contribution Section

Typically, a proportion of members will actively choose the default option because they feel it is most appropriate for them. However, the vast majority of DC members do not make an active investment decision and are invested in the default option.

The aims of the default option, and how they are achieved, are detailed below:

- The default investment strategy's growth phase structure, which invests in global equities, is expected to provide growth like returns with some protection against inflation erosion.

- As a member's pot grows, investment risk will have a greater impact on member outcomes. Therefore, the Trustees believe that the default strategy that seeks to reduce investment risk as the member approaches retirement is appropriate.

  - *In view of the above, the Trustees consider the level of risk within the default option in the context of the variability of returns relative to annuity prices and cash rates.*

  - *These risks are managed via automated lifestyle switches over the ten-year period prior to a member reaching the selected retirement date. Investments are switched firstly into a mix of UK Government bonds and investment grade corporate bonds (to broadly match short term changes in the price of fixed annuities). Four years prior to the retirement date, an allocation to a cash fund is introduced for capital preservation purposes and to seek to broadly match tax free cash benefits.*

- Based on their understanding of the Scheme's membership, an investment strategy that targets annuity purchase and a tax-free cash lump sum (up to 25% of a members' pot) at retirement is likely to meet a typical member's requirements for income in retirement. This does not mean that members have to take their benefits in this format at retirement – it merely determines the default investment strategy that will be in place pre-retirement. Members who intend to take their retirement benefits through other formats have the option of switching to an alternative lifestyle strategy prior to retirement or even choosing their own investment strategy.

  - *At the member's selected retirement date, to reduce the mismatch risk between asset values and the expected costs of purchasing an annuity, 75% of the member's assets will be invested in investment grade corporate bonds and UK Government bonds and 25% in a money market fund.*

6.3 Investment policies for the default strategy of the Defined Contribution Section

The Trustees have the following policies in relation to the default lifestyle strategy:

- The default lifestyle strategy manages investment and other risks through a diversified strategic asset allocation consisting of traditional and alternative assets. Risk is not considered in isolation, but in conjunction with expected investment returns and outcomes for members. Any investment in derivative instruments contributes to risk reduction, or efficient portfolio management.

- In designing the default lifestyle strategy, and the asset classes included, the Trustees have explicitly considered the trade-off between risk and expected returns.

- If members wish to, they can opt to choose their own investment strategy (or an alternative lifestyle strategy) on joining but also at any other future date.

- Assets in the default lifestyle strategy are invested in the best interests of members and beneficiaries, taking into account the profile of members.

- Assets in the default lifestyle strategy are invested in a manner which aims to ensure the security, quality, liquidity and profitability of a member's portfolio as a whole.

- Assets are invested mainly on regulated markets (those that are not must be kept to prudent levels). We note that some funds may have higher exposure to securities which are not on regulated markets. These are indirect investments, via pooled funds. The Trustees have delegated the management of these securities to investment managers to ensure the level is kept to prudent levels.

Taking into account the demographics of the Scheme's membership and the Trustees' views of how the membership will behave at retirement, the Trustees believe that the current default strategy is appropriate and will continue to review this over time, at least triennially, or after significant changes to the Scheme's demographic, if sooner.

Details of the funds available in the Defined Contribution Section are detailed in the "Summary of Investment Arrangements".

7. Day–to-Day Management of the Assets

The Trustees delegate the day-to-day management of the assets to their investment managers. The Trustees have taken steps to satisfy themselves that the managers have the appropriate knowledge and experience for managing the Scheme's investments and that they are carrying out their work competently.

The Trustees have determined, based on expert advice, a benchmark mix of asset types and ranges within which each appointed investment manager may operate.

The Trustees regularly review the continuing suitability of the Scheme's investments, including the appointed managers and the balance between active and passive management, which may be adjusted from time to time. However any such adjustments would be done with the aim of ensuring the overall level of risk is consistent with that being targeted.

Details of the appointed managers can be found in a separate document produced by the Trustees entitled "Summary of Investment Arrangements", which is available to members upon request.

8. Additional Assets

Under the terms of the trust deed the Trustees are responsible for the investment of additional voluntary contributions (AVCs) paid by members. The Trustees review the investment performance of the chosen providers on a regular basis and takes advice as to the providers' continued suitability.

9. Selection, Retention and Realisation of Investments

The investment managers have discretion in the timing of the selection, retention and realisation of investments and in considerations relating to the liquidity of those investments within parameters stipulated in the relevant appointment documentation and pooled fund prospectuses.

Assets in the DC Section, including the default lifestyle strategy , are invested in a long-term insurance contract. The assets underlying the insurance contract are invested in daily traded pooled funds which hold highly liquid assets, and therefore should be realisable at short notice based on either Trustees' or member demand. The pooled funds are commingled investment vehicles which are managed by various underlying fund managers. The selection, retention and realisation of assets within the pooled funds are delegated to the respective underlying fund managers in line with the mandates of the funds.

10. Responsible Investment and Corporate Governance

As all of the Scheme's assets are managed in pooled arrangements, the Trustees accept that the assets are subject to the managers' policies on socially responsible and ethical investment (that is the extent to which, if at all, environmental, social and governance considerations are taken into account in the management of the underlying pooled fund assets).

However, the Trustees believe that good stewardship and environmental, social and governance (ESG) issues may have a financially material impact on investment returns. The Trustees also recognise that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration. The Trustees have given the investment manager(s) full discretion when evaluating ESG issues, including climate change considerations, and in exercising right and stewardship obligations attached to the Scheme's investments.

Similarly, the Scheme's voting rights are exercised by its investment manager(s) in accordance with their own corporate governance policies, as is and taking account of current best practice including the UK Corporate Governance Code and the UK Stewardship Code.

Equity managers who are regulated by appropriate UK (or other relevant) authorities are expected to report on their adherence to the UK Stewardship Code on an annual basis.

Non-financial considerations, including member views are not explicitly taken into account in the selection, retention and realisation of investments.

The Trustees have not set any investment restrictions on the appointed investment manager in relation to particular products or activities.

11. Compliance with this Statement

The Trustees monitor compliance with this Statement annually and obtain written confirmation from the investment managers that they have given effect to the investment principles in this Statement so far as reasonably practicable and that in exercising any discretion the investment managers have done so in accordance with Section 4 of The Occupational Pension Schemes (Investment) Regulations 2005.

12. Review of this Statement

The Trustees will review this Statement at least once every three years and without delay after any significant change in investment policy. Any change to this Statement will only be made after having obtained and considered the written advice of someone who the Trustees reasonably believes to be qualified by their ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of pension scheme investments.

Gillian Martin	25 September 2019
For and on behalf of the Trustees	**Date**
Robert Grimwood	25 September 2019
For and on behalf of the Trustees	**Date**

The Trustees of the Applied Materials (UK) Pension and Family Security Scheme