The Komatsu UK Staff Pension Scheme

Statement of Investment Principles – June 2023

1. Introduction

The Trustee of The Komatsu UK Staff Pension Scheme ("the Scheme") has drawn up this Statement of Investment Principles ("the Statement") to comply with the requirements of the Pensions Act 1995 ("the Act") and associated legislation including the Occupational Pension Schemes (Investment) Regulations 2005 (as amended). The Statement is intended to affirm the investment principles that govern decisions about the Scheme's investments. The Trustee's investment responsibilities are governed by the Scheme's Trust Deed and Rules, of which this Statement takes full regard.

This Statement replaces the previous statement dated September 2022.

In preparing this Statement the Trustee has consulted a suitably qualified person by obtaining written advice from Mercer Limited ("Mercer"). In addition, consultation has been undertaken with Komatsu UK Limited ("the Sponsor") to ascertain whether there are any material issues of which the Trustee should be aware in agreeing the Scheme's investment arrangements and, in particular on the Trustee's objectives.

2. Process For Choosing Investments

The Trustee has appointed Mercer to act as discretionary manager to implement a Cashflow Driven Investment (CDI) strategy with the aim of delivering a long term, low risk, sustainable investment and funding strategy. The assets are invested predominately in income generating assets in such a way that the expected cashflows (or income) generated by the assets broadly match a proportion of the Scheme's expected liability cashflow profile, whilst still targeting a return in excess of gilts (noting that the intention is to match as high a proportion as possible, subject to the level of expected return required and associated risks).

In this capacity, and subject to agreed restrictions, the Scheme's assets are invested in multi-client collective investment schemes ("Mercer Funds") managed by a management company (Mercer Global Investments Management Limited ("MGIM")). MGIM has appointed Mercer Global Investments Europe Limited ("MGIE")) as investment manager of the Mercer Funds. In practice, MGIE delegates the discretionary investment management for the Mercer Funds to third party investment managers based in countries such as Ireland, UK and USA and those sub-investment managers will manage either a sub-fund or certain segments of a sub-fund. Mercer has expertise in identifying, selecting and combining highly rated fund managers who are best placed and resourced to manage the Scheme's assets on a day to day basis.

In considering the appropriate investments for the Scheme, the Trustee has obtained and considered the written advice of Mercer, whom the Trustee believes to be suitably qualified to provide such advice. 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).

3. Investment Policy and Risk

Overall investment policy falls into two parts. The strategic management of the assets is fundamentally the responsibility of the Trustee acting on advice from its investment consultant, and is driven by its investment objectives as set out below. The remaining elements of policy are part of the day to day management of the assets which is delegated to professional investment managers and described in the Statement of Investment Arrangements ("SIA"). The format of this Statement is designed to provide a logical statement rather than an ordered response to the Act. The Trustee believes, however, that it incorporates a response to all the requirements of the Act.

4. Investment Objectives

The Trustee understands that taking some investment risk, with the support of the Sponsor, is necessary to improve the Scheme's current and ongoing solvency funding positions. The Trustee recognises that non-hedge management investments will bring increased volatility to the funding level, but in the expectation of improvements in the Scheme's funding level through non-hedge management assets (and other growth asset) outperformance of the liabilities over the long term.

The Trustee's primary objective is to act in the best interest of its members and ensure that the obligations to the beneficiaries of the Scheme can be met. In meeting this objective the Trustee's further objectives are:

- To closely align the sensitivity of the Scheme's assets and liabilities to changes in interest rate and inflation expectations by hedging approximately 95% of the Scheme's assets.
- To achieve an asset return above the return from gilts over the long term, whilst recognising the need to balance risk control and return generation.
- To ensure consistency between the Scheme's investment strategy and the return assumptions used by the Scheme actuary.
- To pay due regard to the Sponsoring Company's interests in the size and incidence of employer contribution payments.
- To aim to match a large proportion of the projected member benefits by investing in income generating assets.

The objectives set out above and the risks and other factors referenced in this Statement are those that the Trustee determines to be financially material considerations. Non-financial considerations are discussed in section 9.

5. Risk Management and Measurement

There are various risks to which any pension scheme is exposed. The Trustee's policy on risk management 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 and the Sponsor's ability to support this mismatch risk.

- 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 volatility in the Scheme's funding position.
- The Trustee recognises that even if the Scheme's assets are invested in hedge management assets there may still be a small mismatch between the interest rate and inflation sensitivity of the Scheme's assets and the Scheme's liabilities. The Scheme's investment strategy targets a hedge ratio of c. 95% of the Scheme's assets but the Trustee recognises the risk that the actual ratio may drift slightly from that target from time to time. The Trustee also recognises that while the strategy is designed to approximately match expected cashflow requirements, changes in demographic assumptions, membership profile or other factors could lead to a mismatch between investment strategy and required cashflow.
- The Trustee invests in leveraged LDI funds to maintain the liability hedging without impacting on expected return but recognise that the use of leveraged LDI brings with it additional liquidity risks and requirements which can change over short periods of time with interest rate changes. The Trustee and Mercer reviews the hedge management portfolio as part of the regular reporting and strategy reviews, including consideration of the market stress buffer and governance.
- The Trustee recognises the risks that may arise from the lack of diversification of investments. Subject to managing the risk from a mismatch of assets and liabilities, Mercer aims to ensure the asset allocation policy in place results in an adequately diversified portfolio. Mercer provides the Trustee with regular monitoring reports regarding the level of diversification within the Trustee's portfolio.
- To help the Trustee ensure the continuing suitability of the current investments, Mercer provides the Trustee with regular reports regarding the performance of the underlying asset managers appointed within the relevant Mercer Funds to enable the monitoring of differences between the expected and experienced levels of risk and return.
- By investing in the Mercer Funds, the Trustee does not make investments in securities that are not traded on regulated markets. However, should the Scheme's assets be invested in such securities, in recognition of the associated risks (in particular liquidity and counterparty exposure) such investments would normally only be made with the purpose of reducing the Scheme's mismatch risk relative to its liabilities or to facilitate efficient portfolio management. In any event the Trustee would ensure that the assets of the Scheme are predominantly invested on regulated markets.
- The Trustee recognises the risks inherent in holding illiquid assets. The Trustee has carefully considered the Scheme's liquidity requirements and time horizon when setting the investment strategy and liquidity risk is managed by ensuring illiquid asset classes represent an appropriate proportion of the overall investment strategy.
- The Trustee recognises that environmental, social and corporate governance concerns, including climate change, have a financially material impact on return. Section 9 sets out how these risks are managed.

- Should there be a material change in the Scheme's circumstances, the Trustee will advise Mercer who will review whether and to what extent the investment arrangements should be altered; in particular, whether the current CDI strategy remains appropriate. In addition, the investment strategy will be reviewed approximately annually.

6. Investment Strategy

The Trustee, with advice from the Scheme's investment consultant and Scheme Actuary, initially reviewed the Scheme's investment strategy in 2019 which resulted in adopting a CDI strategy and will review it approximately annually thereafter. This review considered the Trustee's investment objectives, its ability and willingness to take risk (the "risk budget") and how this risk budget should be allocated and implemented.

At inception (1 April 2019) it was agreed that the discount rate would be gilts + 0.4% p.a. plus 20% of the change in credit spread. At the most recent review in May 2023 the discount rate was gilts + 0.3% p.a. as at 28 February 2023 (the analysis date for the 2023 review) plus 20% of the change in credit spread (according to a suitable index chosen by the Mercer) going forward.

With this in mind, the Trustee has agreed that the Scheme's broad asset allocation on implementation of the last investment strategy review in June 2023 should be as set out in the table below:

Portfolio	Target Asset Allocation On Implementation* (%)	Implementation Range (%)
Hedge Management	**40.3**	**+/-5.0%**
Non-Hedge Management	**59.7**	**+/-5.0%**

*Implementation date was 8 June 2023

The CDI strategy aims to closely align the sensitivity of the Scheme's assets and liabilities to changes in interest rate and inflation expectations. Following a hedging strategy review carried out in August 2022, it was agreed to update the hedge ratio to target c. 95% of Scheme's assets.

Details of the holdings within the Scheme's portfolios and the rebalancing policy relating to the portfolios can be found in the SIA.

Responsibility for monitoring the Scheme's asset allocation, and undertaking any rebalancing activity, is delegated to Mercer. Mercer reports quarterly to the Trustee on its rebalancing activities.

7. Realisation of Investments

The Trustee on behalf of the Scheme holds shares in the Mercer Funds. In its capacity as investment manager to the Mercer Funds, MGIE, and the underlying third party asset managers appointed by MGIE, within parameters stipulated in the relevant appointment documentation, have discretion in the timing of the realisation of investments and in considerations relating to the liquidity of those investments.

8. Cash flow and cash flow management

In the event of cashflows into, or out of, the Scheme, Mercer will invest or disinvest these as soon as reasonably practicable from the underlying funds at Mercer's discretion. Further detail on this process is set out in the SIA.

9. ESG, Stewardship, and Climate Change

The Trustee believes that environmental, social, and corporate governance (ESG) factors may have a material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration.

As noted above, the Trustee has appointed Mercer to act as discretionary investment manager in respect of the Scheme's assets and such assets are invested in a range of Mercer Funds managed by MGIE. Asset managers appointed to manage the Mercer Funds are expected to evaluate ESG factors where appropriate, including climate change considerations, and exercise voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code.

The United Nations' Sustainable Development Goals (SDGs) inform Mercer's long term investment beliefs and direct Mercer's and the Trustee's thinking when it comes to converting systemic risks into transformational investment opportunities as outlined in Mercer's Sustainability Policy.

The Trustee considers how ESG, climate change and stewardship is integrated within Mercer's, and MGIE's, investment processes and those of the underlying asset managers in the monitoring process. However, the Trustee acknowledges that given the nature of their investments (bond and bond like assets that do not have associated voting rights that would allow the Trustee and Mercer to directly impact an issuer's policies) and the limited data currently available, there is a limited scope for integration. Mercer, and MGIE, is expected to provide reporting to the Trustee on a regular basis, at least annually, on ESG integration progress, stewardship monitoring results, and climate-related metrics. The Trustee expects Mercer to enhance their monitoring, reporting and engagement and integration as the industry evolves and the level and quality of data available improves.

The Trustee recognises the conflict of interest which may arise in the context of responsible investment. Mercer and MGIE make investment decisions with the aim of improving long-term risk adjusted returns and assesses whether selected sub-investment managers have policies and procedures that manage conflicts in relation to stewardship. Sub-investment managers are required to report on any conflicts of interest and demonstrate that they have adhered to their conflicts of interest policies and reported any breaches.

Based on Mercer and MGIE's assessment and the sub-investment managers' reporting, all else equal, managers who display better ESG capabilities will be appointed by Mercer and MGIE. Following these appointments, on an ongoing basis the regular assessments and reporting form a key part of Mercer and MGIE's policy to engage on the Trustee's behalf with investment managers to improve ESG practices across the industry and further integrate ESG considerations into the investment decision making process.

The Trustee receives the following reporting on an annual basis:

- The Mercer Sustainability Policy, noting the following updates to Mercer's policy:
  - In March 2021 the policy was updated in relation to sustainability–related disclosures in the financial services sector ("SFDR") implementation.
  - In August 2022 the policy update reflected enhancements to the approach to climate change modelling and transition modelling, additional detail on how the policy is implemented, monitored and governed and, as part of the commitment to promote diversity, finalising MGIE's signatory status to the UK chapter of the 30% Club.
- Where available ESG ratings of all investment managers versus the asset class universe ESG ratings. In addition, ESG ratings are disclosed in the quarterly performance report which is reviewed by the Trustee. ESG ratings are assigned by Mercer (and its affiliates') global manager research team.
- Carbon footprint analysis versus the relevant indices for the Mercer funds where sufficient information is available. In addition, Mercer's Climate Change Management report highlights the approach to the Taskforce on Climate Related Financial Disclosures (TCFD) framework in more detail, including example analysis on strategy and targets and metrics.

Member views

Member views are not taken into account in the selection, retention and realisation of investments.

Investment Restrictions

Mercer has given its appointed investment managers restrictions in relation to particular products or activities for all equities and fixed income portfolios The Trustee has not set any investment restrictions on Mercer or the underlying investment managers in relation to particular products or activities, but may consider this in future.

10. Trustee's policies with respect to arrangements with, and evaluation of the performance and remuneration of, asset managers and portfolio turnover costs

When engaging Mercer as discretionary investment manager to implement the Trustee's investment strategy outlined in section 5, the Trustee is concerned that, as appropriate and to the extent applicable, Mercer is incentivised to align its strategy and decisions with the profile and duration of the liabilities of the Scheme, in particular, long-term liabilities.

As Mercer manages the Scheme's assets by way of investment in Mercer Funds, which are multi-client collective investment schemes, the Trustee accepts that it does not have the ability to determine the risk profile and return targets of specific Mercer Funds but the Trustee expects Mercer to manage the assets in a manner that is consistent with the Trustee's overall investment strategy as outlined in section 4. The Trustee has taken steps to satisfy itself that Mercer has the appropriate knowledge and experience to do so and keeps Mercer's performance under ongoing review.

Should Mercer fail to align its investment strategies and decisions with the Trustee's policies, it is open to the Trustee to disinvest some or all of the assets managed by Mercer, to seek to renegotiate commercial terms or to terminate Mercer's appointment.

To evaluate performance, the Trustee receives, and considers, investment performance reports produced on a quarterly basis, which present performance information and commentary in respect of the Scheme's funding level and the Mercer Funds in which the Scheme is invested. Such reports have information covering fund performance for the previous three months, one-year, three years and since inception. The Trustee reviews the absolute performance and relative performance against a portfolio's and underlying investment manager's benchmark (over the relevant time period) on a net of fees basis. The Trustee's focus is on the medium to long-term financial and non-financial performance of Mercer and the Mercer Funds.

Neither Mercer nor MGIE make investment decisions based on their assessment about the performance of an issuer of debt or equity. Instead, assessments of the medium to long-term financial and non-financial performance of an issuer are made by the underlying third party asset managers appointed by MGIE to manage assets within the Mercer Funds. Those managers are in a position to engage directly with such issuers in order to improve their performance in the medium to long term. The Trustee is, however, able to consider Mercer's and MGIE's assessment of how each underlying third party asset manager embeds ESG into their investment process and how the manager's responsible investment philosophy aligns with the Trustee's own responsible investment policy. This includes the asset managers' policies on voting and engagement.

Section 9 provides further details of the steps taken, and information available, to review the decisions made by managers, including voting history and the engagement activities of managers to identify decisions that appear out of line with a Mercer Fund's investment objectives or the objectives/policies of the Scheme.

The asset managers are incentivised as they will be aware that their continued appointment by MGIE will be based on their success in meeting MGIE's expectations. If MGIE is dissatisfied then it will, where appropriate, seek to replace the manager.

The Trustee is a long-term investor and is not looking to change its investment arrangements on an unduly frequent basis. However, the Trustee does keep those arrangements under review, including the continued engagement of Mercer using, among other things, the reporting described above.

The Trustee monitors, and evaluates, the fees it pays for asset management services on an ongoing basis taking into account the progress made in achieving its investment strategy objectives as outlined in section 4. Mercer's, and MGIE's, fees are based on a percentage of the value of the Scheme's assets under management which covers the design and annual review of the CDI strategy, and investment management of the assets. In addition, the underlying third party asset managers of the Mercer Funds also charge fees based on a percentage of the value of the assets under management. In some instances, some of the underlying managers may also be entitled to charge fees based on their performance.

MGIE reviews the fees payable to third party asset managers managing assets invested in the Mercer Funds on a regular basis with any negotiated fee savings passed directly to the Scheme. Mercer's, MGIE's, and the third party asset managers', fees are outlined in a quarterly investment strategy report prepared for the Trustee, excluding performance-related fees and other expenses involved in the Mercer Funds not directly related with the management fee.

Details of all costs and expenses are included in the Mercer Funds' Supplements, the Report & Accounts and within the Scheme's annualised, MiFID II compliant Personalised Cost & Charges statement. The Scheme's Personalised Cost & Charges statement also includes details of the transaction costs associated with investment in the Mercer Funds.

The Trustee does not have an explicit targeted portfolio turnover range, given the CDI mandate, but rebalancing ranges have been designed to avoid unnecessary transaction costs being incurred by unduly frequent rebalancing. Performance is reviewed net of portfolio turnover costs, with the review of portfolio turnover of the underlying investment managers undertaken by MGIE.

11. Additional Assets

Under the terms of the trust deed the Trustee is responsible for the investment of AVCs paid by members. The Trustee reviews the investment performance of the chosen providers on a regular basis and takes advice as to the providers' continued suitability.

12. Review of this Statement

The Trustee 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 Trustee 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.

The Trustee of The Komatsu UK Staff Pension Scheme

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Signature Date

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Signature Date