Cummins UK Pension Plan

Statement of **Investment Principles**

APPENDIX – DB Section

October 2020

Contents

Introduction

This document is created for and maintained by the investment sub-committee (ISC).

The Trustee is responsible for the management of the Plan's investments and, in recognition of the specialist, technical nature of investment management, has established the ISC. The ISC has formal terms of reference, approved by the Trustee, to provide greater focus and the appropriate level of expertise to assist with and advise on investment matters for the Plan.

The majority of the ISC's members are Trustee directors. At any given time, the Plan is represented on the ISC by at least three Trustee directors, along with other suitably experienced individuals.

The DB Section's objectives and long-term policy

The Plan's benchmark asset allocation:

	Strategic asset allocation %	Actual asset allocation % 31 Dec 2019
Return-seeking assets	**43.5**	**45.2**
Passive equities	**10.0**	**10.3**
Global equities (market cap weighted)	5.0	5.2
Global equities (economically weighted)	5.0	5.1
Private markets	**13.0**	**12.9**
Secure income assets	**5.0**	**4.8**
Alternatives	**15.5**	**17.1**
Diversifying strategies	8.0	7.3
Sovereign credit	3.0	2.7
Multi-asset alternative credit	4.5	4.6
AAA CLOs	-	2.6
Liability-matching assets	**55.5***	**53.4**
SSgA LDI pooled funds	-	-
Pensioner buy-in	-	-
Cash	**1.0**	**1.5**
Total	**100.0**	**100.0****

*This is the total proportion of the liability-matching allocation. Allocations to the pensioner buy-in cannot be defined, as these change over time. The buy-in price was £254 million at the date of the transition and is revalued each year. The allocation of the LDI pooled funds (as a percentage of the Plan's assets) changes depending on the valuation of the buy-in.

**Total doesn't sum to 100% due to rounding.

The actual asset allocation compared with the benchmark asset allocation is assessed on a quarterly basis with adjustments made as required, as recommended by the Plan's advisers.

In July/August 2012, the Trustee purchased a deferred-premium pensioner buy-in insurance policy to address the interest rate, inflation and mortality risk associated with these liabilities. This involved selling some government bonds, with the remaining bonds being restructured. The buy-in provider, Legal & General Assurance Society, will take on pensioner liabilities after the 10-year deferment period. After 10 years, it is expected that the Plan will be protected against inflation and interest-rate risk for these liabilities.

In July 2013, the Trustee agreed to implement a Liability Driven Investment (LDI) approach, which aims to hedge the inflation and interest-rate risk of the Plan using derivatives.

The Trustee has made a long-term commitment to allocate 15.5% of the Plan's assets to alternative asset classes, which includes an allocation to diversifying strategies, multi-strategy alternative credit and sovereign credit as described above. In October 2018, the Trustee agreed to wind down the AAA CLO allocation over the course of three years with a view to using the proceeds to partially fund the 5% allocation to Secure Income Assets. In addition, the Trustee has made a long-term commitment to allocate 13% of the Plan's assets to private markets.

The Plan has a strategic allocation to cash to manage the Plan's liquidity needs.

The Trustee considers this asset allocation to:

- include suitable investments
- be appropriately diversified
- provide a reasonable expectation of meeting the objectives.

The Trustee will review this policy regularly to ensure that it remains appropriate for the purposes of meeting the objectives.

Asset class assumptions

In September 2018, the Trustee, in conjunction with the investment consultant, reviewed the strategic asset allocation of the Plan. The risk-and-return assumptions as at 31 December 2017 used in the analysis are shown below:

	Arithmetic average year 1 return %	Year 1 standard deviation %	Arithmetic average long-term return % p.a.	Long-term standard deviation % p.a.	10-year median real return % p.a.	Standard deviation 10-year return % p.a.
Equity investments						
Global equities (hedged)	2.4	17.0	5.3	17.2	2.4	5.4
Global equities ex UK (hedged)	2.4	17.2	5.3	17.3	2.4	5.4
Global equities ex UK (unhedged)	4.2	19.0	5.6	19.4	3.2	5.7
Global small cap (hedged)	2.8	20.9	5.7	21.4	2.2	6.8
Global low volatility equities (hedged)	1.5	11.6	4.4	11.8	2.3	3.7
Global non-market-cap equities (hedged)	2.8	16.7	5.7	16.8	3.0	5.3
Emerging market equities (unhedged)	6.0	27.0	7.0	26.9	3.4	7.5
Pac Basin equities (unhedged)	4.9	24.3	5.9	24.0	2.9	6.8
UK equities	1.7	17.6	5.0	17.5	1.9	5.5
Global REIT (hedged)	1.4	15.5	4.3	15.6	1.6	4.8
UK property	0.8	10.0	3.5	10.1	1.6	3.4
Private equity fund of funds (hedged)	2.0	24.2	5.4	24.3	0.8	7.4
Private market alpha	5.5	22.1	8.9	21.7	4.9	6.8
Core infrastructure	2.3	17.0	5.4	17.1	2.4	5.4
Listed core infrastructure	1.7	15.0	4.8	15.2	2.1	4.8
Fund of hedge funds (hedged)	0.0	7.4	3.0	7.4	1.2	2.3
Commodities	-0.5	14.5	2.7	14.7	0.1	4.5
Reinsurance	-0.9	7.7	3.0	7.7	1.5	4.0
FX carry	-0.5	9.9	2.8	10.1	0.6	3.2
Multi-assets carry	-0.2	7.9	3.0	8.1	1.0	2.6
Multi-assets volatility premium	-0.3	7.9	3.0	8.1	1.0	2.5
Multi-assets value	0.2	8.8	3.5	9.0	1.4	2.8
Merger arbitrage	0.0	8.9	3.3	9.1	1.2	2.9
Momentum strategy	0.5	9.7	3.7	10.0	1.6	3.2
Secure income assets	0.7	6.6	3.7	7.2	1.3	2.0

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	Arithmetic average year 1 return %	Year 1 standard deviation %	Arithmetic average long-term return % p.a.	Long-term standard deviation % p.a.	10-year median real return % p.a.	Standard deviation 10-year return % p.a.
Active strategies						
Long-short equity	2.2	12.6	5.1	12.5	2.9	3.9
Macro/GTAA	0.3	9.9	3.5	9.9	1.3	3.2
Bonds and cash						
All stock corporates	-1.8	7.1	2.4	9.4	-0.2	1.6
Long-dated corporates	-1.5	11.3	2.7	12.8	-0.6	2.4
All stock fixed interest gilts	-2.4	6.1	1.3	7.6	-0.9	1.5
Long-dated fixed-interest gilts	-1.7	10.6	1.5	10.3	-0.7	2.3
Ultra-long-dated fixed-interest gilts	-1.2	19.2	2.1	16.7	-1.4	3.7
Long-dated index-linked gilts	-1.3	8.5	1.0	8.7	-1.6	1.5
Ultra-long-dated index-linked gilts	-1.0	17.1	1.9	17.6	-2.2	3.4
Overseas bonds (hedged)	-2.1	4.4	1.8	5.2	-0.6	1.2
Overseas bonds (unhedged)	-0.2	9.1	2.1	9.7	0.0	2.0
US TIPS (hedged)	-1.9	5.5	1.2	5.7	-0.9	1.1
Cash	-2.2	1.6	1.0	1.8	-0.7	0.7
High-yield bonds (hedged)	-1.0	10.4	3.5	11.5	-0.1	2.2
Emerging market debt aggregate	0.6	10.5	3.3	11.6	0.9	2.7
Leveraged loans (hedged)	-1.0	7.3	3.0	7.5	0.3	1.3
Asset-backed securities (ABS) (hedged)	-1.3	6.0	2.5	6.2	0.0	1.2
AAA-rated CLOs	-1.4	2.7	1.5	2.9	-0.2	0.9
Emerging market cash fund (unhedged)	-0.5	5.9	2.8	6.0	0.9	1.9
Global sovereign credit	0.3	9.2	2.8	9.7	0.8	2.3
Diversity fund	0.6	6.9	3.7	7.0	1.8	2.2
Global credit (hedged)	-2.0	5.3	2.4	6.7	-0.4	1.3
Global credit (unhedged)	0.0	9.5	2.7	10.5	0.5	2.0
Inflation (RPI)	3.7	1.9	2.7	2.5	3.0	1.2
Inflation (CPI)	2.6	1.5	1.7	2.0	1.9	1.1
Long swap relative to ILG	-0.4	5.6	-0.3	7.2	-0.6	0.6

Assumptions were also made for the correlation between the different asset classes.

The Trustee's expectations for future investment returns are consistent with the central assumptions shown, but the Trustee recognises that fluctuations from year to year can be very large.

The Plan's investment managers

The Trustee considers advice and recommendations from the investment consultant about suitable investment manager arrangements. The manager line-up and allocation may change from time to time.

Asset class	Manager	Benchmark index	Proportion of total Plan benchmark
Return-seeking allocation			**43.5%**
Passive equities*			**10.0%**
Global equities (Global adaptive capped ESG fund)	State Street Global Advisors	MCSI AC world adaptive capped ESG universal index	5.0%
Global equities (economically weighted)	State Street Global Advisors	FTSE RAFI AW – 3000	5.0%
Alternatives			**15.5%**
AAA CLO	Alcentra	FTSE sterling corporates AAA index	-
Diversifying strategies			8.0%
Emerging market currency	State Street Global Advisors	3-month LIBOR USD +3%	-
Market-neutral equity	Systematica	3-month LIBOR USD +3%	-
Merger arbitrage	ARP Investments	3-month LIBOR USD +3%	-
Alternative risk premia	Fulcrum	3-month LIBOR USD +3%	-
Reinsurance	Credit Suisse Asset Management	3-month UK treasury bills	-
Multi-strategy alternative credit	Brigade Credit Offshore Fund II Ltd	50% BofA Merrill Lynch high yield master II constrained index and 50% Credit Suisse leveraged loan index	4.5%
Sovereign credit	Franklin Templeton Investors	JP Morgan global government bond index (hedged)	3.0%
Secure income assets	Towers Watson Investment Management	FTSE actuaries over 15-year index-linked gilts	**5.0%**

*As agreed by the Trustees, the allocation to passive equities will be split 50/50 between equally weighted and economically weighted indices. In practice, this split may vary due to de-risking switches, cash disinvestments and other portfolio liquidity requirements.

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Asset class	Manager	Benchmark index	Proportion of total Plan benchmark
Private markets			**13.0%**
Private equity			10.0%
	Goldman Sachs Asset Management	70% FTSE all-share/30% FTSE world (ex UK)	-
	Morgan Stanley Investment Management	FTSE all-world	-
	American Securities VI	FTSE all-world	-
	American Securities VII	FTSE all-world	-
	Advent	FTSE all-world	-
	Axiom Asia	FTSE all-world Asia Pacific	-
	Sun Capital	FTSE all-world	-
	Energy Capital Partners	FTSE all-world	-
	Francisco Partners	FTSE all-world	-
	SC Management (Recap IV)	Absolute return	-
	Altas Partners I	Absolute return	-
	Altas Partners II	Absolute return	-
	CDH VGC Fund I	Absolute return	-
	CDH VGC Fund II	Absolute return	-
	Mobeus Equity Partners	Absolute return	-
	Cabot Square Capital	Absolute return	-
	Waud Capital Partners	Absolute return	-
Property	CBREGI	Absolute return	-
Private markets			3.0%
Property	LGIM Heitman Global Prime Property	FTSE EPRA/NAREIT global developed real estate index +0.5%	-
Agriculture	TIAA CREF (Global Agriculture II)	Absolute return	-
Infrastructure	Ancala Partners	Absolute return	-
Illiquid credit	Hayfin	Credit Suisse Western European leveraged loan index	-
Liability-matching allocation**			**55.5%**
Liability Driven Investment***	State Street Global Advisors	n/a	-
Pensioner buy-in	Legal & General Assurance Services – insurance/annuity	Deferred premium (10 years)	-
Cash		7-day LIBID	**1.0%**
Total			**100.0%**

**The buy-in price was £254 million. This translates to approximately 32% of the Plan's assets as at 21 July 2012. This will fluctuate over time and therefore the LDI portfolio will be rebalanced as required.

***The bespoke fund of one LDI portfolio managed by State Street was implemented on 10 April 2017. This portfolio includes an allocation to a cash fund to manage liquidity.

Investment performance objectives

The table below lists the DB Section's investment managers and their individual performance objectives.

Manager	Performance objective
Advent International	To generate an absolute return in excess of publicly quoted equity markets.
Alcentra	To exceed the FTSE sterling corporates AAA index.
Altas Partners I	To generate an absolute return in excess of publicly quoted equity markets.
Altas Partners II	To generate an absolute return in excess of publicly quoted equity markets.
American Securities	To generate an absolute return in excess of publicly quoted equity markets.
Ancala	To generate an absolute return in excess of publicly quoted equity markets.
ARP	To achieve 3-month LIBOR USD +5-6%.
Axiom	To generate an absolute return in excess of publicly quoted equity markets.
Brigade	To generate 2% p.a. (gross) performance ahead of the benchmark over a full market cycle.
Cabot Square Capital	To generate an absolute return in excess of publicly quoted equity markets.
CBREGI	To achieve a total return of between 8% and 10% p.a. net of all fees and expenses by obtaining diversified exposure to pan-European real estate (excluding the UK) through the investment funds and/or property related assets.
CDH VGC Fund I	To generate an absolute return in excess of publicly quoted equity markets.
CDH VGC Fund II	To generate an absolute return in excess of publicly quoted equity markets.
Credit Suisse	To exceed the 3-month UK treasury bills benchmark by 3% p.a. (net of fees).
Energy Capital Partners (ECP)	To generate an absolute return in excess of publicly quoted equity markets.
Francisco Partners	To generate an absolute return in excess of publicly quoted equity markets.
Franklin Templeton Investors	To maximise total return, with a combination of interest income, capital appreciation and currency gains.
Fulcrum	To achieve 3-month LIBOR USD +6%.
Goldman Sachs	To generate an absolute return in excess of publicly quoted equity markets.
Hayfin	To generate a meaningful premium over public loan markets.
Heitman Global Prime Property	To exceed the FTSE EPRA/NAREIT global developed real estate index +0.5%.
Legal & General passive funds	To track the total return of the relevant benchmark indices.
Various managers – Cash	To exceed the 7-day LIBID benchmark over a rolling three-year period.
Mobeus Equity Partners	To generate an absolute return in excess of publicly quoted equity markets.
Morgan Stanley	To generate an absolute return in excess of publicly quoted equity markets.

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Manager	Performance objective
SC Management	15% net returns through opportunistic real estate investments in Asia Pacific.
State Street Global Advisors (Emerging markets currency fund)	To achieve 3-month LIBOR USD +3%.
State Street Global Advisors (Global adaptive capped ESG fund)	To track the total return of the MSCI AC world adaptive capped ESG universal index.
State Street Global Advisors (LDI portfolio)	To provide a leveraged return in line with each fund's individual benchmark (either a specified gilt, index-linked gilt, interest-rate swap or real-rate swap).
State Street Global Advisors (RAFI equity)	To track the total return of the FTSE FAFI all-world 3000 index.
Sun Capital	To generate an absolute return in excess of publicly quoted equity markets.
Systematica	To achieve 3-month LIBOR USD +3%.
TIAA CREF	6.5% to 10.5% net after tax returns through a globally diversified farmland investment strategy.
Towers Watson Investment Management Secure Income Fund	To yield the FTSE actuaries over 15-year index-linked gilts +2-3% over five-year periods.
Waud Capital Partners	To generate an absolute return in excess of publicly quoted equity markets.

Other arrangements

Northern Trust provides custody and performance services to the Plan.

The DB Section's funding objectives

The actuarial valuation of the Plan as at 1 January 2018 revealed a funding surplus (the value of the assets less the technical provisions) of £73.6 million.

As the Plan had a surplus on the technical provisions basis, there was no need for a recovery plan. The Company will pay contributions in respect of future benefit accrual, PPF levies and meet the cost of life assurance premiums but excluding contributions in respect of SMART pensions payable on behalf of members.