Akzo Nobel (CPS) Pension Scheme
Statement of funding principles

Status

This statement has been prepared by the Trustee of the Akzo Nobel (CPS) Pension Scheme ("the Scheme") to satisfy the requirements of Section 223 of the Pensions Act 2004, taking into account the advice of the Scheme Actuary. It has been revised and reissued following the valuation of the Scheme as at 31 March 2020.

The Trustee has discussed and agreed this statement with the Principal Employer, Akzo Nobel UK Ltd ("the Company"). This document is dated ____September 2021, and applies from that date.

Statutory funding objective

The statutory funding objective is that the Scheme should have sufficient and appropriate assets to cover its technical provisions, and this statement sets out the Trustee's policy for securing that this objective is met.

Subsidiary funding objective

In addition to the statutory funding objective, the Trustee has a subsidiary funding objective, which is to be able to provide benefits in accordance with the Scheme Rules with a very high level of security on a self-sufficiency basis with minimal reliance on further support from the Company. For this purpose the Trustee will calculate the value of the liabilities allowing only for investment returns from risk-free assets such as gilts and will include suitable loadings to cover risks and expenses.

The Trustee will have regard to the Scheme's anticipated progress towards meeting this subsidiary objective when considering funding and investment matters.

The Trustee acknowledges that progress towards this subsidiary funding objective is likely to be achieved predominantly through investment returns but considers that circumstances may arise in which it would be appropriate to discuss with the Company payment of additional contributions in order to make further progress. In particular, if payment is made to the Scheme from the CR Escrow Assets described in clause 11 of the Deed of Undertaking between the Trustee the Company and the Northern Trust Company dated 1 February 2019 (the "**Deed of Undertaking**") or in conjunction with the Change of Control provisions of the guarantee between the Trustee and Akzo Nobel N.V. dated 18 March 2016, as amended and restated by deeds dated 28 September 2018 and ____ September 2021(the "**Guarantee**"), such payments will accelerate progress towards this subsidiary funding objective.

Technical provisions

The approach below takes account of the existence of a parent company guarantee from Akzo Nobel N.V., the escrow accounts described in the Deed of Undertaking and the Framework Agreement between the Trustee, the Company and Akzo Nobel N.V. dated ____ September 2021. Both the investment strategy and the approach itself would be subject to review, the latter in the light of the prudence requirements of the Pensions Act 2004, if the quality of Akzo Nobel N.V.'s covenant was judged to have deteriorated, or if payments were made into the Scheme from the CR Escrow described in the Deed of Undertaking or in conjunction with the Change of Control provisions of the Guarantee.

Method

The Trustee and the Company have agreed that the technical provisions for the Scheme at any given date are to be calculated as the capital value of the prospective benefits arising from service completed before that date, including allowance for prospective salary increases for those members in active service at that date. This method of calculating technical provisions is commonly known as the projected unit credit method. However, for the purposes of assessing the technical provisions, the value of the liabilities in respect of an active member shall not be less than the corresponding value assuming that the member left active service at the valuation date. The technical provisions will also take into account the premiums and receipts due under the ReAssure longevity swap.

The assessed cost of future service accrual has been calculated using the projected unit method and a four-year control period. However, to the extent that the liabilities in respect of active members as described above are expected to reduce over the control period specifically as a result of the Company's policy on pensionable salary increases, the expected reduction shall be used to abate the required Employers' future service contribution rates.

Financial assumptions – discount rate

The Trustee and the Company have agreed that, for the purposes of determining the technical provisions:

- The investment strategy is assumed to evolve as the Scheme matures. A term dependent discount rate approach will be adopted, which reflects a prudent estimate of the investment return expected to be achieved on the Scheme's assets, allowing for the asset allocation to gradually de-risk. This prudent return will be expressed as a margin relative to a gilt yield curve, with the margin reducing over time to a long-term margin.

- The initial margin will be reduced uniformly to the long-term margin over 8 years starting in 2022 (the '2020 De-risking Path'). The long-term investment margin for the purposes of the 2020 valuation is assumed to be gilts+0.25% pa.

- In determining the initial margin,

    i. the Trustee will firstly consider what a realistic allowance might be for future investment returns on the different asset classes in which the Scheme

        - is currently invested or

        - would have been expected to be invested in by reference to the 2020 De-risking Path (prior to any reduction in ii. below for prudence).

    ii. The Trustee will then base the funding assumptions on lower returns to build in a margin for prudence. The Trustee will measure the margin of prudence being taken by considering, at each actuarial valuation, the likely spread of investment return outcomes in the future, using asset modelling techniques to allow for the likely returns and volatility of returns on each type of asset.

- For the 2020 valuation, the initial discount rate has been set so that the investment return above gilts, on the Scheme's March 2020 investment strategy (but taking into account the subsequent investment in buy and maintain credit which took place in April 2020), is expected to be equal to or exceed the assumed initial margin in 65% of future scenarios over a 15 year period, modelled using a suitable stochastic asset model by the Scheme Actuary.

- The Investment Condition side letter referred to in paragraph 7 of the Guarantee provided by Akzo Nobel N.V., as agreed in conjunction with this 2020 valuation and to be executed on or around the date of this statement, maps out the permitted de-risking steps in accordance with the technical provisions discount rate (the 2020 De-risking Path). The Trustee and the Company have agreed that their joint intention is that the Investment Condition letter will be revised as part of the valuation due as at 31 March 2023.Investment returns will include an allowance for investment expenses.

Other financial assumptions

The Trustee and the Company have agreed that:

- The remaining financial assumptions, in particular the assumption for future price inflation, will take into account information available in respect of equity and bond markets at the effective date of the actuarial valuation. In setting the rate of future price inflation, consideration will also be given to the average rate of inflation calculated from gilt and swap yield curves and the Scheme’s projected cashflows and other sources of relevant information such as the Bank of England’s inflation targets and forecasts and the inflation assumptions within the stochastic asset model used to derive the discount rates.

- In the absence of an established investment market for Consumer Prices Index (CPI) related investments the assumption for CPI will also have regard to views on the expected differential between the Retail Prices Index (RPI) and CPI inflation.

Demographic assumptions

The Trustee and the Company have agreed that, with one exception, the demographic assumptions will be determined on a best estimate basis, based upon:

- An analysis of the Scheme's experience over a suitable period.
- The Actuary's advice about general trends in the UK population.
- The Trustee’s and the Company’s views about how these may change in future.

The exception is the allowance to be made for life expectancy. The base mortality tables used will include a margin for prudence. The allowance for future improvements in life expectancy will be assessed taking into account the latest available information. Overall, the allowance made for mortality will be prudent.

Where the Scheme Actuary recommends it is appropriate, the Trustee may apply different demographic assumptions to different groups.

Additional reserve in respect of Macpherson members

In addition to the amount calculated in accordance with the above method and assumptions, an extra reserve will be added to the technical provisions. This reserve will be equal to the estimated value of the uplift applicable on a notional winding up of the Scheme at any calculation date to former members of the Macpherson Retirement Benefits Plan, calculated on the Scheme’s solvency basis at that time.

The purpose of this reserve is to ensure that the level of cover of all other Scheme members’ benefits is not adversely impacted by the existence of this uplift on a winding up if the assets available are sufficient to satisfy the Scheme’s PPF protected liabilities but insufficient to secure all liabilities in full. It is accepted that the extent to which the reserve will exceed the amount required to achieve that purpose depends upon the Scheme’s funding level on a solvency basis at the time of winding up. The reserve will be calculated on the Scheme’s solvency basis to reflect the fact that it relates to a benefit entirely contingent upon winding up, regardless of what method and assumptions are considered prudent for the calculation of the rest of the Scheme’s technical provisions.

Discretionary Benefits

There are a number of areas where the benefits payable are subject to some exercise of discretion on the part of the Trustee and/or the Company, the principal details of which are set out below:

- Pensions in the course of payment and deferred pensions may be increased at the discretion of the Trustee above the guaranteed rate, subject to the consent of the Company. The Actuary has made no advance allowance for such increases in his calculations.
- In the event that any individual augmentations to benefits within the Scheme are granted, it is expected that an appropriate special employer (or employee) contribution equal to the associated increase in the Scheme’s technical provisions will be paid at the time that the augmentation is awarded.

- There are a number of further discretions that enable Members to convert benefits from one form into another, typically at the discretion of the Trustee. The most commonly exercised of these discretions is that Members may commute pension for a lump sum. The Trustee and the Company have agreed that an allowance for members to commute pension will be made in the calculation of the technical provisions. The Trustee and the Company have agreed that no allowance will be made for other more minor discretions that do not have a material impact on the determination of the technical provisions.

GMP equalisation

A revised reserve of £50 million has been included to reflect the expected increase in technical provisions when members' benefits are equalised as required on account of the inequalities arising from Guaranteed Minimum Pensions ("GMP"), and any change in benefits following GMP rectification. The appropriate level of the reserve will be considered at future valuations, depending on progress made in implementing GMP equalisation.

Benefit uncertainties

There are a number of other areas where the benefits are not certain at the valuation date.

No allowance has been included in the technical provisions for any increase in the Scheme’s liabilities due to any other benefit uncertainties, but the Trustee and Company will consider how any increase in liabilities will be met when the impact is known, which may be in advance of the next valuation.

Non-investment expenses

For the purposes of the 2020 actuarial valuation of the Scheme, administrative and other non-investment expenses, including the annual Pension Protection Fund levy, are to be paid by the Company. All expenses paid towards the cost of independent financial advice provided to members will be met from the assets of the Scheme.

Actuarial investigation as at 31 March 2020

In line with the general principles outlined above, the assumptions adopted for the purposes of determining the technical provisions for the actuarial valuation as at 31 March 2020 are described below.

Financial assumptions as at 31 March 2020

	% per annum
Term dependent discount rate*:	gilt curve + 1.1% pa to 31 March 2022, reducing uniformly to gilts + 0.25% pa by 31 March 2030
Price inflation* (RPI):	RPI curve
Price inflation (CPI):	RPI less 1.0% pa up to 2030 and RPI with no adjustment thereafter
Salary increases for the purposes of determining past service liabilities:	In line with deferred revaluation
Salary increases in line with the pensionable salary cap:	1.5
Pension increases:	
CPI, maximum 5%, minimum 0%	RPI or CPI as appropriate, subject to the relevant cap and floor in each year applied to the forward rates (CPI only has been used for pension where there is the 70% RPI underpin)
CPI, maximum 5%, minimum 0%, underpinned by 70% RPI	
CPI, maximum 3%, minimum 0%	
CPI, maximum 2.5%, minimum 0%	
RPI, maximum 5%, minimum 0%	
RPI, maximum 5%, minimum 3%	
RPI, maximum 3%, minimum 0%	

RPI, maximum 2.5%, minimum 0%
70% of RPI, minimum 0%

*for the purposes of the valuation as at 31 March 2020 the gilts curve adopted is the Willis Towers Watson zero coupon nominal gilt curve, and the RPI curve is the Willis Towers Watson gilt breakeven inflation curve

Demographic assumptions as at 31 March 2020

Details of the demographic assumptions are shown in Appendix 1 to this statement.

Regular Employer contributions

The Trustee and the Company have agreed that the Employer contributions required to meet the cost of the ongoing accrual of members' benefits will be calculated using the same method and assumptions as for the technical provisions, with a four year control period and reduced by the amount of the normal members' contributions. However, to the extent that the liabilities in respect of active members as described above are expected to reduce over the control period specifically as a result of the Principal Employer's policy on pensionable salary increases, the expected reduction shall be used to abate the required Employers' future service contribution rates.

Eliminating a shortfall

The Trustee and the Company have agreed that any funding shortfalls identified at an actuarial valuation should be eliminated by the payment of additional annual contributions over the recovery period. The length of the recovery period will be agreed by the Trustee and the Company. In determining the actual recovery period at any particular valuation the Trustee's principles are to take into account the following factors:

- The size of the funding shortfall.
- The risk that the value of the Scheme's assets may deteriorate further against the technical provisions and/or the solvency liabilities of the Scheme.
- The free assets and projected cashflow position of the participating employers.
- The funding guarantee from, and financial strength of, Akzo Nobel N.V.
- Any contingent security (e.g. escrow account) offered by the Company.
- The desirability of eliminating the shortfall over the shortest possible period consistent with the growth objectives of the employers and of Akzo Nobel N.V.

The assumptions employed for determining the payments to be made to eliminate the shortfall are to be the same as for determining the technical provisions, with one possible exception. This is that a higher rate of investment return on the Scheme assets may be assumed in certain circumstances, this rate not to exceed a best estimate assumption as determined by the Actuary. Additional assumptions may also be made, as required, for example for the investment return on a contingent security such as an escrow account. Such assumptions are to be determined on a prudent basis as agreed by the Trustee and the Company, having considered the advice of the Actuary.

Frequency of actuarial investigations

In the normal course of events the Trustee will request subsequent valuations three years after the preceding one. The Actuary will provide an estimate of the up-to-date financial position of the Scheme, relative to both the statutory funding objective and the solvency liabilities, as at each 31 March for which a full valuation is not requested.

The Trustee may call for a formal funding valuation at any date if it is of the opinion that events have made it unsafe to rely on the results of the previous valuation for funding purposes. In reaching such a view, the Trustee will consider the advice of the Actuary and will consult with the Company. On a Change of Control (as defined in the Guarantee) in relation to which paragraph 15 of the Guarantee applies, in circumstances in which both: (a) a guarantee has not been provided in accordance with the provisions of paragraphs 15(i) or (ii) of the Guarantee; and (b) £150m has not been paid to the Scheme in accordance with the provisions of paragraph 15 of the Guarantee, the effective date of a valuation validly called within 6 months after the effective date of the Change of Control may be up to twelve months before the date the valuation is called.

Paying funding surpluses to the employer

The Rules do not include provisions for the Trustee to make payments to the Company out of Scheme funds unless there exists a surplus following a winding-up the Scheme.

Cash Equivalent Transfer Value calculations

Cash equivalent transfer values calculated by reference to assumptions determined by the Trustee based on actuarial advice are available to members who have left Scheme service. The Trustee currently makes these payments in full, without reduction.

Dates of review of this statement

This statement will be reviewed, and if necessary revised, by the Trustee and the Company either:

- within 15 months after the effective date of each actuarial valuation; or
- within a reasonable period after any occasion on which the Pensions Regulator has used its powers to modify future accrual of the Scheme, directed as to the manner in which technical provisions are to be calculated or the period over which failure to meet the statutory funding objective is to be remedied, or imposed a schedule of contributions.

The Trustee and the Company may also elect to review, and if necessary revise, the statement at other times.

Signed on behalf of the Company

Signature:	Signature:
Print name:	Print name:
Position:	Position:
Date:	Date:

Signed on behalf of Akzo Nobel (CPS) Trustee Limited

Signature:

Print name:

Date:

Appendix 1 – Demographic assumptions as at 31 March 2020

In service decrements

	In service - specimen rates per 1000 members			
Age	Withdrawal		Ill-health retirement	
	Male	Female	Male	Female
25	81	81	0.2	0.3
30	66	66	0.3	0.7
35	51	51	0.7	1.1
40	37	37	1.3	1.6
45	27	27	2.3	2.6
50	17	17	4.3	5.2
55	7	7	9.4	11.0
60	-	-	19.7	24.5

	In service - specimen rates per 1000 members CPS Section members			
Age	Early Retirement (Pre 93 Joiners)		Early Retirement (Post 93 Joiners)	
	Male	Female	Male	Female
50-59	50	50	50	50
60	500	700	50	50
61	200	200	50	50
62	200	200	50	50
63	200	200	50	50
64	200	200	50	50
65	-	-	-	-

Members of other sections, apart from CPS, will be assumed to retire at the earliest age at which their benefits can be paid unreduced without employer or Trustee consent.

Pre-retirement mortality (active members and deferred pensioners)

As for post-retirement mortality.

Early retirement for deferred pensioners

Deferred pensioners’ benefits are valued assuming that they retire at the earliest age at which they can receive an unreduced pension without employer or Trustee consent.

Post-retirement mortality

The base tables used for the rates of post-retirement mortality have been assumed to be in accordance with the following published tables as described overleaf.

94% of S3PMA_M for men
92% of S3PFA_M for female members
92% of S3DFA for female dependants

The above tables include allowance for mortality improvements from 2013 to 2020 in line with the core projection model CMI_2019 with a long-term trend of 1.5% per annum, the core 7.0 value of the (period) smoothing parameter (S_{κ}) and an initial addition to mortality improvements (A) of 0.25% pa.

For the 2020 valuation a 3% prudence margin was adopted for the base mortality tables and is included in the tables above.

Future improvements in mortality

The core projection model CMI_2019 with a long-term trend of 1.5% per annum, the core 7.0 value of the (period) smoothing parameter (S_{κ}) and an initial addition to mortality improvements (A) of 0.25% pa.

Spouses' and dependants' pensions

The proportion of members assumed to be married or with a qualifying dependant is 87.5% for males and 57.5% for females at normal retirement age. An allowance for children's benefits is included for non-pensioner members of 0.5% of the liability.

Age difference between members and dependants

The assumed age difference (husband-wife) is 3 years at normal retirement age for males and 2 years for females.

Allowance for option of members to commute pension for cash at retirement

Members have the option to exchange pension at retirement for a lump sum. An allowance has been made for members to commute 20% of their pension at retirement, using factors 10% above the factors in force at 31 March 2020.

GMP equalisation

The technical provisions include a reserve of £50 million in relation to the estimated costs of equalising member benefits in accordance with the Lloyds judgments and GMP rectification..