SUMMARY FUNDING STATEMENT 2019

AN UPDATE FROM THE TRUSTEE

SCOTTISH HYDRO-ELECTRIC PENSION SCHEME

Your summary funding statement

Welcome to the 2019 summary funding statement for members of the Scottish Hydro-Electric Pension Scheme (the Scheme).

Every three years, the Scheme's actuary carries out a financial review of the Scheme, known as an actuarial valuation. In between each actuarial valuation, the actuary also carries out annual updates and the results are given to members in the form of a summary funding statement, like this one.

The Scheme's most recent actuarial valuation was completed as at 31 March 2018, and the next one is due at 31 March 2021. In this summary funding statement, we look at the Scheme's estimated financial position as at the 31 March 2019 annual update, comparing this with the results of the 2018 valuation.

What is an actuarial valuation?

A valuation is a detailed look at the Scheme's finances which measures the Scheme's ability to meet its commitment to pay members' benefits. It is carried out by the Scheme's actuary who makes assumptions about expected investment returns, inflation and salary growth, as well as how long members are expected to live. The actuary then estimates how much money the Scheme might need to pay members' promised benefits (the Scheme's liabilities) and compares this to the amount of money in the Scheme (its assets).

What is meant by funding level?

This is the headline figure produced by the actuarial valuation and is an indicator of the Scheme's financial health at that time. It is the percentage of the liabilities that can be covered by the assets. If the Scheme has exactly the same amount of assets and liabilities the funding level would be 100%.

What is the latest position?

As shown in the table below, the Trustee is pleased to report that the Scheme's funding position has strengthened further since the last review, with the surplus of £157 million reported as at 31 March 2018 growing to £220 million as at 31 March 2019. This is mainly due to better-than-expected investment returns and the payment of transfer values.

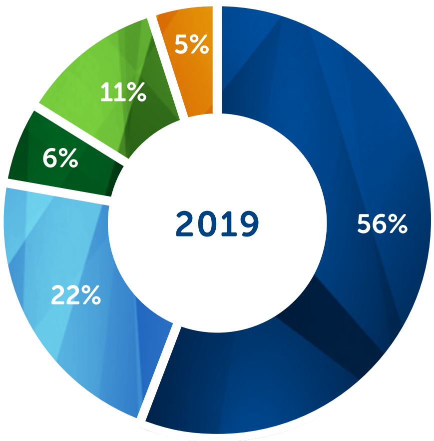
While funding levels will inevitably fluctuate over time, the ongoing de-risking of the Scheme should ensure that its funding position remains broadly stable in the medium to long term.

	March 2019 (valuation)	March 2018 (annual update)
Assets	£2,121m	£2,059m
Liabilities	£1,902m	£1,902m
Surplus	£220m	£157m
Funding level	112%	108%

Please note, these figures have been subject to rounding.

How are the Scheme's assets invested?

The Scheme's investments are held in a trust which is run by the Trustee and kept legally separate from the Company. The Trustee's policy is to invest in different types of investments, and the asset allocation as at 31 March 2019 is shown in the chart below.



Government bonds	56%
Corporate bonds	22%
Equities	6%
Annuity policy	11%
Other	5%
Total	**100%**

- **Corporate bonds:** issued by companies to raise money, these are essentially loans on which interest is paid during the life of the bond with the capital amount borrowed being repaid on maturity. Bonds provide a better match to the Scheme's pension payments than "growth assets" such as equities and property.
- **Government bonds:** similar to corporate bonds, these are issued by governments. UK government bonds are called gilts and are considered to be less risky than corporate bonds or equities.
- **Equities:** shares in a company.
- **Cash:** money held on deposit in a bank. A cash fund uses its buying power to secure a higher rate of interest than would normally be offered to private investors. A cash investment tends to be seen as a low risk but is also expected to yield lower returns than other investment types.

Managing the Scheme's investment risk

The Scheme needs to take some investment risk in order to deliver the benefits promised to members. In doing this, the Trustee – supported by its investment advisers – has agreed and actively monitors an investment strategy. As the Scheme is in surplus, the Trustee has been able to significantly reduce the amount of investment risk that it takes. This is consistent with the Trustee's objectives to manage risk in a controlled and measured way in order to reduce funding volatility and increase the security of members' benefits.

In December 2016, the Trustee purchased a bulk annuity policy with Pensions Insurance Corporation (PIC). This transaction, often referred to as a 'buy-in', helps to protect the Scheme as a whole against investment and other risks and, therefore, helps protect the security of your benefits. The buy-in does not give priority to any particular member's benefit and will not affect your benefit entitlement, with the policy simply paying an income into the Scheme each month equal in value to the members' pensions that are covered by the policy.

In June 2017, the Scheme entered into a longevity swap agreement. This transfers the risk of continuing to pay pensions for members living longer than expected to an insurance company, again helping to protect the security of benefits in the Scheme.

How does the Scheme operate?

Our Scheme is a defined benefit Scheme. The amount of pension you will receive at retirement will be based on how long you were paying into the Scheme and your final pensionable pay. Active members – and ordinarily the Company – pay contributions to the Scheme. The Scheme's investment managers invest these contributions into a fund, with the aim of increasing its value. The Trustee then uses the money in the fund to pay pensions for all members when they become due. This money is held in a common fund rather than in separate funds for each member.

The Scheme's position has improved steadily since the last formal valuation as at 31 March 2018. The main reasons for this are:

- better-than-expected investment returns
- a funding gain when members opt to transfer their benefits out of the Scheme.

In previous years, the Company has paid additional contributions to eliminate the Scheme's deficit. However, as the Scheme is now in surplus, these deficit reduction contributions are no longer required. The Company will however continue to pay regular contributions as required in order to meet the Scheme's ongoing commitments. These are documented in the Scheme's schedule of contributions, a copy of which is available on request.

Protecting your benefits

The Company remains committed to supporting the Scheme so that members' pensions are paid in full. This includes paying the ongoing contributions outlined earlier. However, if the Company was no longer able to support the Scheme, your benefits would be protected in a number of ways.

- **The Scheme could continue without the Company's support**
  No more benefits would build up and no new contributions would be made, but pensions could continue to be paid.

- **The Scheme could be wound up**
  When a Scheme is wound up, its assets are sold, and the money is used to buy policies from an insurance company which will pay members' pensions in the future. Securing members' benefits in this way is expensive as insurance companies require a one-off payment to pay pensions for life.
  On this basis, had the Scheme wound up on 31 March 2018, there would have been a shortfall of around £26 million. However, please note that this figure is purely theoretical since there are no plans to wind up the Scheme.

- **The Pension Protection Fund (PPF) could take over**
  The PPF aims to provide compensation to members of final salary schemes if their employer goes out of business and the pension scheme does not have enough money to pay the benefits promised.
  You can find out more about the PPF at **www.pensionprotectionfund.org.uk**

We are required to provide this information in the interests of openness and transparency. The Trustee has no reason to believe that the Company will find itself in a position where it can no longer support the Scheme.

Payments to the Company from the Scheme

There have been no payments to the Company from the Scheme in the last year other than for routine payments made in respect of the monthly pensioner payroll, recharge of Scheme invoices paid by the Company and pension administration employment costs.

Want to know more?

The following documents are available on request from the Pensions Department:

- **The statement of funding principles**, which sets out the Scheme's funding plan
- **The statement of investment principles**, states the Trustee's investment strategy
- **The schedule of contributions**, which shows how much money is being paid into the Scheme
- **The annual report and accounts**, which gives details of the Scheme's income and expenditure over the Scheme year
- **Governance statement**, which sets out the Scheme's compliance with the Pensions Regulator's required features in relation to money purchase AVC benefits
- **The actuarial valuation report**, as at 31 March 2018
- **Member booklet**, a copy of which you will have been given when you joined the Scheme, but you can request another
- **Annual benefit statement**, which you will automatically receive if you are still paying into the Scheme. If you have not received a statement, it could be that you have moved and forgotten to tell us. If so, please let us know your new address so we can update our records. You can request a statement from the Pensions Department if you have not received one in the last 12 months or you are no longer paying into the Scheme but have not retired.

Contact us

If you have any questions or would like any more information, please contact:

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J-070145