

MSD Pension Scheme (“the Scheme”) Statement of Investment Principles (SIP)

Investment Objective

The Trustee aims to invest the assets of the Scheme to ensure that the benefits promised to members are provided. In setting the investment strategy, the Trustee first considered a low risk asset allocation that it could adopt in relation to the Scheme's liabilities. The asset allocation strategy it has selected is designed to achieve a higher return than the low risk strategy whilst taking into account the covenant of the Sponsoring Employer.

STRATEGY

The current **planned asset allocation strategy** chosen to meet the objective above is set out in the table below. The Trustee will monitor the actual asset allocation versus the target weight and the ranges set out in the table below.

Asset Class	Weighting %	Range %
Growth	30.0	25.0-35.0
Global Equities (market cap & multi-factor)	30.0	25.0-35.0
Matching	70.0	65.0-75.0
Total	100.0	-

The Trustee has adopted an investment strategy that involves passive management of a portfolio of global equities (using both market cap and multi-factor indices) and matching portfolio comprising a liability driven investment strategy and a bulk annuity.

The aim of the LDI portfolio is to provide protection against adverse movements in the Scheme's liability profile caused by interest rate and inflation movements. The LDI solution will look to hedge (protect) 95% of the Long Term Funding Target ("LTFT") liabilities.

The bulk annuity is an insurance contract on a proportion of the pensioner liabilities, and is secured with Just Group plc.

While the Trustee retains discretion and will take appropriate advice, during the normal course of business the Trustee expects to rebalance back to the target position if the ranges set out in the table above are breached.

This Statement of Investment Principles is produced to meet the requirements of the Pensions Acts 1995 & 2004, the Occupational Pension Schemes (Investment) Regulations 2005 and to reflect the Government's Voluntary Code of Conduct for Institutional Investment in the UK. The Trustees also comply with the requirements to maintain and take advice on the Statement and with the disclosure requirements.

The Trustee makes the assumption that equities will outperform gilts over the long term. However, the Trustee recognises the potential volatility in equity returns, particularly relative to the Scheme's liabilities, and the risk that the fund managers do not achieve the targets set. When choosing the Scheme's planned asset allocation strategy the Trustee considered written advice from its investment advisers and, in doing so, addressed the following:

- The need to consider a full range of asset class
- The risks and rewards of a range of alternative asset allocation strategies
- The suitability of each asset class
- The need for appropriate diversification

In addition, the Trustee also consulted with the Sponsoring Employer.

RISK

The Trustee recognises that the key risk to the Scheme is that it has insufficient assets to make provisions for 100% of its liabilities (“funding risk”). The Trustee has identified a number of risks which have the potential to cause a deterioration in the Scheme’s funding level and therefore contribute to funding risk. These are as follows:

- The failure by the fund managers to achieve the rate of investment return assumed by the Trustee (“manager risk”). This risk is considered by the Trustee and its advisers both upon the initial appointment of the fund managers and on an ongoing basis thereafter.
- The failure to spread investment risk (“risk of lack of diversification”). The Trustee and its advisers considered this risk when setting the Scheme’s investment strategy.
- The risk of a significant difference in the sensitivity of asset and liability values to changes in financial and demographic factors (“mismatching risk”). The Trustee and its advisers considered this mismatching risk when setting the investment strategy.
- The possibility of failure of the Scheme’s Sponsoring Employer (“covenant risk”). The Trustee and its advisers considered this risk when setting investment strategy and consulted with the Sponsoring Employer as to the suitability of the proposed strategy.
- The risk of a shortfall of liquid assets relative to the Scheme’s immediate liabilities (“cash flow risk”). The Trustee and its advisers will manage the Scheme’s cash flows taking into account the timing of future payments in order to minimise the probability that this occurs.
- The risk of fraud, poor advice or acts of negligence (“operational risk”). The Trustee has sought to minimise such risk by ensuring that all advisers and third party service providers are suitably qualified and experienced and that suitable liability and compensation clauses are included in all contracts for professional services received.

- The risk of a default by an annuity provider, in particular Just Group plc, with whom a bulk annuity is held. The Trustee and its advisors actively considered the strength of the insurer before entering into the policy whilst considering the wider regulatory framework within which they are required to operate. The Trustee and its advisors will continue to monitor Just Group plc and the annuity market environment from time to time.
- The risk that environmental, social and governance factors including climate change negatively impact the value of investments held if not understood and evaluated properly. The Trustee's approach to these risk is set out later in this statement.

The Trustee monitors the first two of the above risks in a quantitative manner on a quarterly basis. The Trustee receives quarterly reports showing:

- Performance versus the Scheme investment objective, as measured by an independent performance measurer
- Performance of individual fund managers versus their respective targets, as measured by an independent performance measurer
- Any significant issues with the fund managers that may impact their ability to meet the performance targets set by the Trustee

The mismatching risk outlined above is monitored quantitatively as part of each formal investment strategy review (normally triennially). This review considers the size of any possible deficit, the impact of this deficit on the contributions required and, most importantly, the ability of the ultimate sponsor, Merck, to meet the pension commitments. It assumes that Merck will fully support MSD, who is the Sponsoring Employer for the MSD Pension Scheme.

Due to the complex nature of the cashflow and operational risks, the Trustee considers these risks in a qualitative rather than quantitative manner.

IMPLEMENTATION & MONITORING

Aon has been selected as investment adviser to the Trustee. It operates under an agreement to provide a service which ensures the Trustee is fully briefed to take decisions itself and to monitor those it delegates. Aon is paid an agreed annual fee for regular work, such as quarterly reporting, with all other activities charged for on a time-cost basis. This structure has been chosen to ensure that cost-effective, independent advice is received.

The fund manager structure and investment objectives for each fund manager (“mandates”) are as follows:

<p><i>Legal & General – Passive Global Equities</i></p> <ul style="list-style-type: none">■ To perform in line with the FTSE World Index
<p><i>Legal & General – Multi-Factor Global Equities</i></p> <ul style="list-style-type: none">■ To perform in line with the SciBeta Developed High-Factor Intensity Multi-Beta Max. Deconcentration Index
<p><i>BlackRock Inc. – Liability Driven Investment (“LDI”)*</i></p> <ul style="list-style-type: none">■ To match the return of the benchmark and provide interest rate and inflation exposure in line with the target hedge ratio

The arrangements with the Scheme's fund managers represent investments with the managers that ultimately hold units in the relevant pooled funds. When choosing investments, the Trustee and the fund managers are required, as far as practically possible, to have regard to the criteria for investment set out in the Occupational Pension Schemes (Investment) Regulations 2005 (regulation 4).

The Trustee regularly monitors the Scheme’s investments to consider the extent to which the investment strategy and decisions of the asset managers are aligned with Trustee policies. This includes monitoring the extent to which asset managers:

- Make decisions based on assessments about medium- to long-term financial and non-financial performance of an issuer of debt or equity; and
- Engage with issuers of debt or equity in order to improve their performance in the medium- to long-term.

The Trustee is supported in this monitoring activity by their investment consultant.

The Trustee receives regular reports and verbal updates from the investment consultant on various items including the investment strategy, performance, and longer-term positioning of the portfolio. The Trustee focuses on longer-term performance when considering the ongoing suitability of the investment strategy in relation to the Scheme objectives, and assesses the asset managers over 3-year periods.

The Trustee also receives annual stewardship reports on the monitoring and engagement activities carried out by its asset managers, which supports the Trustee in

determining the extent to which the Scheme's engagement policy has been followed throughout the year.

The Trustee shares the policies (including, but not limited to the Responsible Investment and Stewardship policies), as set out in this SIP, with the Scheme's asset managers, and requests that the asset managers review and confirm whether their approach is in alignment with the Trustee's policies.

Before appointment of a new asset manager, the Trustee reviews the governing documentation associated with the investment and will consider the extent to which it aligns with the Trustee's policies. Where possible, the Trustee will seek to amend that documentation so that there is more alignment. Where it is not possible to make changes to the governing documentation, for example if the Scheme invests in a collective vehicle, then the Trustee will express its expectations to the asset managers by other means (such as through a side letter, in writing, verbally at Trustee meetings and/or via sharing the Trustee policies for review and comment by the manager).

The Trustee believes that having appropriate governing documentation, setting clear expectations to the asset managers by other means (where necessary), and regular monitoring of asset managers' performance and investment strategy, is in most cases sufficient to incentivise the asset managers to make decisions that align with Trustee policies and are based on assessments of medium- and long-term financial and non-financial performance.

Where asset managers are considered to make decisions that are not in line with the Trustee's policies, expectations, or the other considerations set out above, the Trustee will typically first engage with the manager but could ultimately replace the asset manager where this is deemed necessary.

There is typically no set duration for arrangements with asset managers, although the continued appointment all for asset managers will be reviewed periodically, and at least every three years.

The Trustee does not regularly monitor asset managers against non-financial criteria of the investments made on their behalf.

RESPONSIBLE INVESTMENT (INCLUDING ENVIRONMENTAL, SOCIAL AND GOVERNANCE "ESG" CONSIDERATIONS)

In setting the Scheme's investment strategy, the Trustee's primary concern is to act in the best financial interests of the Scheme and its beneficiaries, seeking return that is consistent with a prudent and appropriate level of risk. This includes the risk that environmental, social and governance factors including climate change negatively impact the value of investments held if not understood and evaluated properly. The Trustee considers this risk by taking advice from its investment adviser when setting the Scheme's asset allocation, when selecting managers and when monitoring their performance.

Stewardship – Voting and Engagement

The Trustee recognises the importance of its role as a steward of capital and the need to ensure the highest standards of governance and promotion of corporate responsibility in the underlying companies and assets in which the Scheme invests, as ultimately this creates long-term financial value for the Scheme and its beneficiaries. As part of their delegated responsibilities, the Trustee expect the Scheme's investment managers to:

- Take into account environmental, social and governance considerations in the selection, retention and realisation of investments; and
- Exercise the Trustee's voting rights in relation to Scheme assets.

Whilst the Trustee has delegated its voting activities to third party investment managers, the Trustee accepts it has ultimate responsibility for the Stewardship of the Scheme's assets. To fulfil this responsibility, the Trustee regularly reviews the suitability of the Scheme's appointed asset managers and takes advice from its investment consultant with regard to any changes. This advice includes consideration of broader stewardship matters and the exercise of voting rights by the appointed managers, including recent voting records. If an incumbent manager is found to be falling short of the standards the Trustee have set, the Trustee undertake to engage with the manager and seek a more sustainable position but may look to replace the manager.

The Trustee reviews the stewardship activities of their asset managers on an annual basis, covering both engagement and voting actions. The Trustee will review the alignment of the Trustee's policies to those of the Scheme's asset managers and ensure its managers, or other third parties, use their influence as major institutional investors to carry out the Trustee's rights and duties as a responsible shareholder and asset owner. This will include voting, along with – where relevant and appropriate – engaging with underlying investee companies and assets to promote good corporate governance, accountability, and positive change.

The Trustee will engage with its investment managers as necessary for more information, to ensure that robust active ownership behaviours, reflective of their active ownership policies, are being actioned. This will take the form of annual reporting which will be made available to scheme members.

Members' Views and Non-Financial Factors

In setting and implementing the investment strategy the Trustee acts for members as a whole. Given the primary fiduciary duty to secure member benefits as well as the significant practical and cost implications, the Trustee does not explicitly take into account the views of individual members and beneficiaries in relation to ethical considerations, social and environmental impact, or present and future quality of life matters (defined as "non-financial factors" in the relevant regulation).

COST TRANSPARENCY

The Trustee recognises the importance of monitoring the level of investment costs incurred in the management of their assets and the impact these can have on the value of the assets.

Cost Transparency

The Trustee is aware of the importance of monitoring its asset managers' total costs and the impact these costs can have on the overall value of the Scheme's assets. The Trustee recognises that in addition to annual management charges, there are a number of other costs incurred by its asset managers that can increase the overall cost.

The Trustee collects annual cost transparency reports covering all of its investments and ask that the investment managers provide this data in line with the appropriate Cost Transparency Initiative (“CTI”) template for each asset class. This allows the Trustee to understand exactly what it is paying its investment managers.

The Trustee will only appoint investment managers who offer full cost transparency via the CTI templates to manage assets of the Scheme. This will be reviewed before the appointment of any new managers and includes the existing managers held by the Scheme.

Portfolio Turnover

The Trustee accepts that transaction costs will be incurred to drive investment returns and that the level of these costs varies across asset classes and by manager style within an asset class. In both cases, a high level of transaction costs is acceptable as long as it is consistent with the asset class characteristics and manager’s style and historic trends. Where the Trustee’s monitoring identifies a lack of consistency the mandate will be reviewed.

Targeted portfolio turnover is defined as the expected frequency with which each underlying investment managers’ fund holdings change over a year. The Scheme’s investment consultant monitors this on behalf of the Trustee as part of the manager monitoring they provide to the Trustee and flags to the Trustee where there are concerns.

Evaluation of Performance and Remuneration

The Trustee undertakes analysis of the Scheme's costs and performance on at least a triennial basis by receiving benchmarking analysis comparing the Scheme's specific costs and performance of the underlying managers relative to those of the wider market. This is in line with the Trustee's policies on reviewing the kinds and balance of investments to be held.

The benchmarking analysis can be used to assess the value for money received from the Scheme's assets on a regular basis and challenge the Scheme's investment managers where appropriate. The Trustee will review the investment managers relative to their objectives to ensure that the net of fees performance has met its requirements.

The Trustee is open to managers implementing performance related fees if these are suitable for the Scheme and are aligned with the objectives of the Scheme.

GOVERNANCE

The Trustee is responsible for the investment of the Scheme's assets. The Trustee takes some decisions itself and delegates others. When deciding which decisions to take and which to delegate, the Trustee has taken into account whether it has the appropriate training and expert advice in order to take an informed decision. The Trustee has established the following decision making structure:

<p>Trustee</p> <ul style="list-style-type: none">■ Set structures and processes for carrying out its role■ Select and monitor planned asset allocation strategy■ Implementation of planned asset allocation■ Select direct investments (see below)■ Select and monitor investment advisers■ Select and monitor fund managers■ Make day-to-day decisions relevant to operation of Scheme's investment strategy■ From time to time delegate pieces of work to an Investment Sub-Committee who will subsequently report back to the Trustee
<p>Investment Adviser</p> <ul style="list-style-type: none">■ Advises on all aspects of the investment of the Scheme assets, including implementation■ Advises on this statement■ Provides required training
<p>Fund Managers</p> <ul style="list-style-type: none">■ Operate within the terms of this statement, as far as is practical■ Select individual investments with regard to their suitability and diversification■ Advise Trustee on suitability of the indices in its benchmark

The Pensions Act 1995 distinguishes between investments where the management is delegated to a fund manager with a written contract and those where a product is purchased directly, e.g. the purchase of an insurance policy or units in a pooled vehicle. The latter are known as direct investments. The Scheme currently has direct investments with L&G, BlackRock, and Just Group plc.

The Trustee policy is to review direct investments and to obtain written advice about them at regular intervals. These include vehicles available for members' AVCs. When deciding whether or not to make any new direct investments the Trustee will obtain written advice and consider whether future decisions about those investments should be delegated to the fund managers.

The written advice will consider the issues set out in the Occupational Pension Schemes (Investment) Regulations 2005 and the principles contained in this statement. The regulations require all investments to be considered by the Trustee (or, to the extent delegated, by the fund managers) against the following criteria:

- The best interests of the members and beneficiaries
- Security
- Quality
- Liquidity
- Profitability
- Nature and duration of liabilities
- Tradability on regulated markets
- Diversification
- Use of derivatives

The Trustee's investment adviser has the knowledge and experience required under the Pensions Act 1995.

The Trustee expects the investment managers to manage the assets under the terms of its policy and to give effect to the principles in this statement so far as is reasonably practical.

Fund managers are remunerated on a fee basis relating to the amount of assets managed.

In addition, fund managers pay commissions to third parties on many trades they undertake in the management of the assets and also incur other ad hoc costs.

Apart from the bulk annuity, all assets are held in pooled funds. Within each pooled fund, a custodian has been appointed. The custodian provides safekeeping for all the Scheme's assets and performs the administrative duties attached, such as the collection of interest and dividends and dealing with corporate actions.

The Trustee will review this SIP at least every three years and immediately following any significant change in investment policy. The Trustee will take investment advice and consult with the Sponsoring Employer over any changes to the SIP.

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