Virgin Money
Unit Trust Managers Ltd
PO Box 9522
Chelmsford
CM99 2AB

virginmoney.com

VIR number

Hello

We're improving our Bond and Gilt Fund

Here's what you need to know

You might remember we wrote to you earlier this year explaining why the performance of your fund hadn't been great in the 12 months up to March 2022. We said we were planning changes to improve potential returns. We're pleased to confirm the changes we'll be making, whilst keeping the nature and risk level of the fund the same.

What's changing?

1. **Investing in a wider set of bonds** – we'll change the fund's benchmark to include corporate bonds rated 'BBB', rather than just 'AAA-A' bonds as it is now. This new benchmark has generated higher returns without more risk in the past, so we believe it's a better performance target for the fund going forward.
2. **More flexibility** – your fund is currently an 'index-tracker', holding all the bonds within the benchmark. We're introducing some flexibility to diverge from that benchmark, including using Environmental, Social and Governance (ESG) criteria when considering which bonds to invest in. We're doing this to help generate better returns over the medium to long term.
3. **New performance target** – because of this new flexibility, we'll change the Investment Objective from *"track the performance of the benchmark, before charges"* to *"match or beat the benchmark, after charges"*.
4. **Name change** – the fund will no longer invest equally in corporate bonds and gilts, so for simplicity it will be called the "Virgin Money Bond Fund". You may still see the occasional reference to the old name after the change as we update our systems.

Take a look at the enclosed leaflet for more details.

There's nothing you need to do – we'll make these changes on or around 1 December 2022.

Continued overleaf...

Are there any risks associated with these changes?

As with any change in investment strategy, there's no guarantee it'll generate better returns and it could lead to lower returns compared to leaving the fund unchanged. These points are worth noting:

- We'll invest partly in corporate bonds with less strong credit ratings than the current 'AAA to A' ratings. While these pay higher rates of income, there's a higher risk they won't be able to keep up interest payments. If market conditions worsen, such as in a prolonged recession, the fund could fall in value by more than it would have if we'd kept the current strategy.
- Introducing flexibility to invest differently from the benchmark could improve returns, but the opposite is also true. If the bonds we select don't perform as well as the bonds left out, returns will be lower.

Does this mean the fund will be riskier than now?

Although some of the individual bonds we'll hold could be considered higher risk/higher return, the overall ups and downs (volatility) of the fund shouldn't be more than they are now. We're also taking the following steps to manage risk:

- The starting point for selecting which bonds to hold is the benchmark, which is 100% in investment grade bonds. We'll then actively select which bonds we remove or add. The term 'investment grade' covers bonds with credit ratings of AAA, AA, A and BBB. In the past, these bonds have a good history of being able to make payments.
- Limiting investment in bonds with lower than BBB rating to a maximum of 10%.
- Ensuring investment is spread across lots of different bonds/companies. So, if one company can't keep up payments, it should only have a limited impact on the fund.
- Limiting how differently the fund can invest from the benchmark, meaning the potential for outperformance (and underperformance) is tightly controlled. See the Investment Policy in the accompanying leaflet for details.

The cost of making these changes

There will be some transaction costs in making the changes, as we'll be selling 60–70% of the bonds the fund owns to buy new ones. We don't expect the cost to be more than 0.2% of the fund's value. For example, if you had £10,000 in the fund the transaction cost would be £20 or less. This will happen behind the scenes and will reduce the unit price slightly (and therefore the value of your investment) when it happens.

Over the medium to long term, we believe the additional potential returns will more than make up for the cost of making these changes.

What if I don't like these changes?

We think these changes improve the fund's performance potential and will be well received by customers. However, we're giving you plenty of notice in case you decide they're not for you.

If you're not happy with the changes, you can switch to any of our other funds at no cost. You can also transfer your money to another provider. We won't charge you anything to leave but we'll be sorry to see you go.

What if I have some questions?

We can't give you advice, but we can answer lots of other questions. Just give us a call on **03456 10 20 30***. We'll do everything we can to help. Remember, for an up-to-date valuation at any time, simply sign in to Online Service or call our automated valuation line on **0800 917 97 91**.

The team at Virgin Money

*We're here from 8am to 9pm Monday to Friday, and 9am to 6pm on Saturdays. Calls may be monitored and recorded. Calls to 03 numbers cost the same as calls to 01 and 02 numbers and they are included in inclusive minutes and discount schemes in the same way.

VM37146 v0.5 09/22

We're improving our Bond and Gilt Fund

virginmoney.com

In this leaflet you'll find out about the key changes to the fund. Please read it carefully.

Key changes to the Virgin Money Bond and Gilt Fund

The table below shows the current annual charge, the Investment Objective and Policy, and what these will change to.

	Current	New (from on or around 1 December 2022)
Name	**Virgin Money Bond and Gilt Fund**	**Virgin Money Bond Fund**
Annual charge	**0.60% per year**	**0.60% per year** (not changing)
Investment Objective	The investment objective of the Fund is to provide a total return (predominantly income but also any capital growth) from bonds and gilts. The Fund aims to achieve this by tracking the performance of a composite index, comprising 50% the FTSE 5-15 Year Gilt Index and 50% the Bank of America Merrill Lynch 5-15 Year AAA-A Non-Gilt Index, measured annually, less charges.	The Fund aims to provide a total return (income and capital growth) over the longer term (5 years or more) by investing mainly in sterling denominated bonds. The Fund aims to match or beat the performance of its benchmark (50% the FTSE 5-15 Year Gilt Index and 50% the ICE Bank of America Merrill Lynch 5-15 Year Non-Gilt Index), after charges, measured over periods of three years or more.

	Current	New (from on or around 1 December 2022)
Investment Policy	The Fund invests 50% of its assets in bonds issued by the UK Government (known as "gilts") and 50% in other bonds. These other bonds comprise: • corporate bonds • bonds issued by government agencies; and • bonds issued by supranational organisations, such as the European Investment Bank. All bonds are denominated in sterling. The Fund pursues a low-risk strategy by investing in medium term (5 to 15 years) gilts, whilst its other bonds are highly rated (AAA-A) by leading credit agencies. This means a lower risk of non-payment compared to lower rated bonds. An Investment Advisor manages the Fund and seeks to match closely the composition of the composite index by only investing in the bonds and gilts that make up the two indices referenced in the investment objective. This means that the Fund is "passively" managed, as it only invests in line with these indices. Tracking error is the volatility of the differences in returns between the Fund and the index it tracks. This is measured by the standard deviation (variability) of these returns. The Fund seeks to keep the tracking error within 0.20% in any 12-month period, measured on a total return basis, gross of fees.	The Fund will invest in: • corporate bonds • bonds issued by governments and government agencies • bonds issued by supranational organisations, such as the European Investment Bank. At least 80% of the Fund's assets will be denominated in sterling or hedged back to sterling. Investment will mainly be directly in individual bonds, but the Fund can also invest up to 20% in other investment funds, which themselves invest in bonds. Whilst the benchmark (see Objective) provides a starting point, the Investment Adviser has discretion over which bonds to invest in. The Fund can also invest in bonds which aren't part of the benchmark, including non-investment grade bonds (as rated by the leading credit rating agencies). Non-investment grade bonds, often called 'high-yield' bonds, won't exceed 10% of the value of the Fund.

New (from on or around 1 December 2022)

The amount a Fund's returns differ from its benchmark is known as tracking error. It's calculated as the standard deviation of the difference in annual returns. This is low (0% to 0.5%) for index-tracking funds and higher (4%+) for active stock-picking funds. The Fund is expected to have relatively low tracking error of 1-3%, meaning returns will differ from the benchmark, but not by a large amount.

One way in which the Fund will differ from the benchmark is due to some exclusions and Environmental, Social and Governance (ESG) considerations.

- The Fund won't invest in bonds issued by companies that make more than 5% of their earnings from the manufacture or sale of tobacco products, extraction or processing of thermal coal or unconventional fossil fuels (such as oil sands), and the manufacture of controversial weapons. It also excludes bonds issued by companies that violate the UN Global Compact principles on human rights, labour, the environment and anti-corruption.
- Using third party data and in-house research, the Fund will compare companies against others in their industry and/or with similar credit rating/maturity profiles on a range of ESG measures. Based on this analysis, the Fund will either not invest in companies within the benchmark or increase/decrease the amount it does invest. In this way, we expect the Fund to have a better ESG rating and lower carbon footprint than the benchmark itself. This will be reported in the value statement when reviewing the non-financial performance of the Fund.
- The Fund will engage with companies to encourage better ESG practices and as part of the transition to a low carbon economy. You can read about our 'investor engagement policy' on **virginmoney.com**

The Fund seeks to be fully invested at all times but may hold cash (up to 5%) for cash flow and transactional purposes as deemed appropriate to manage costs.

The Fund may use derivatives to reduce trading costs and generally for the efficient management of the Fund, for example managing money coming in and out of the Fund. The Fund will not use derivatives for speculative purposes or to increase the risk profile of the Fund.

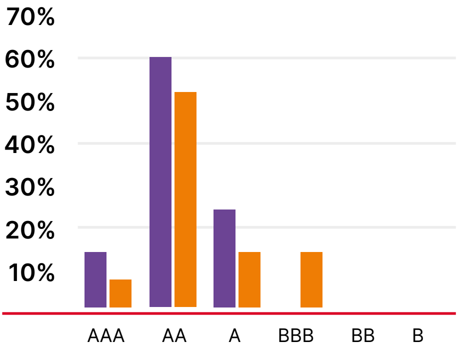
How the Fund invests

The bar charts below show how the fund is expected to change in terms of credit rating and maturity. There are some key points in the bullets, but if you want to know more about these terms, then we've included information under the charts which we hope you'll find helpful. You can also read about how our investment approach is influenced by ESG (Environmental, Social and Governance) considerations.

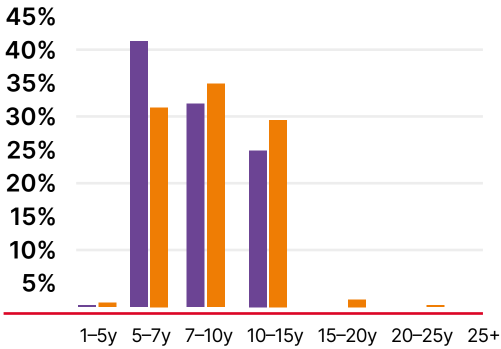
- **Credit rating** – The fund will start to invest in BBB bonds and up to 10% in 'high-yield' bonds (bonds rated BB and lower). These new bonds have more credit risk compared to AAA-A rated bonds, but the risk of non-payment of interest remains low, and by spreading investment over many companies, we don't expect the risk profile of the fund to change.

- **Maturity** – The fund will remain invested mainly in bonds with 5 to 15 year maturities, but it'll have the option to invest in shorter and longer bonds. Maintaining the core exposure to 5 to 15 year bonds is important for risk control, as longer maturity bonds carry more risk (see the explanation of Maturity in the box on page 8).

Credit Rating



Maturity



Key:

Current

Expected

Some additional reading, if you like this kind of thing!

Credit Rating

Each bond is given a credit rating by the leading independent credit rating agencies such as Standard & Poors and Fitch. These ratings are an assessment of the ability of the company or government that issues the bond to make the regular interest payments and return the value of the loan at maturity. Large, well established companies with high and predictable cash flows will have a higher credit rating (AAA being the highest) than companies that are perhaps new to market, or in industries where there's more uncertainty about the future.

Bonds rated AAA to BBB are known as 'investment grade'. The likelihood of non-payment from them is low. Bonds rated BB, B, CCC or lower are known as 'speculative' or 'high-yield' bonds. The likelihood of non-payment from them is higher.

The charts opposite show that your fund will remain invested in investment grade bonds where the risk of non-payment is low. The chart on the left shows that the amount invested in BBB will increase from zero to about 25% of the fund, at the expense of AAA-A bonds.

Why would anyone buy bonds which are not A rated if the risk of non-payment is higher? The simple answer is the price you have to pay for the bonds. The higher a bond is rated, the more expensive it is. The more you have to pay, the less income you receive for each £1 invested. So there's a trade-off between higher income received and higher risk of future problems receiving that income.

We believe that by spreading the fund across a wider range of credit ratings and across lots of companies, the returns of the fund can be increased without materially increasing the risk. Also, by including Environmental, Social and Governance (ESG) considerations in selecting the bonds, we can reduce some of the risks facing individual companies – such as in the transition to a low carbon economy, i.e. by not lending money to coal mining companies where the long term viability of the company is in doubt. If 1 or 2 bonds out of more than 100 has problems making payments, it's unlikely to have much impact on the fund.

Maturity

Each bond has a set date when the loan's value must be repaid to investors. This is in the name of the bond, for example "Sky Limited 4.0% 26/11/2029", is a bond issued by Sky which pays 4.0% interest each year and will return the face value (also known as the 'par' value) of the bond in November 2029.

With longer maturity bonds, you have to wait longer until the loan is repaid. The further away this is, the greater the uncertainty and the higher the risk. Longer maturity bonds also react more to changes in inflation and interest rate expectations. Because the longer you're locked into the fixed rate payments the bond makes, changes in the attractiveness of its income stream can push the price of the bond up or down more than a bond which only has a few payments to go.

The chart on page 6 shows the maturity profile of our fund won't change much. The fund will continue to invest mainly in bonds with 5 to 15 years until maturity, which aligns with the benchmark we've set. What does change is that there is more flexibility for the Investment Adviser (abrdn) to invest in shorter or longer maturity bonds based on their views of the market. We believe this will lead to better returns over the longer term.

Environmental, Social and Governance (ESG)

ESG is the term used for a set of non-financial things to consider when deciding whether to invest in a company.

ESG considerations are important as they represent risks and opportunities in how that company provides its products and services. There is a growing expectation that companies need to consider their impact on society and the planet.

What is meant by ESG?

Environmental – *the impact of that company on the planet*
So, things such as carbon emissions, natural resource usage, pollution and waste management, biodiversity.

Social – *the impact of that company on people*
So, things such as human and labour rights, diversity and inclusion, inequality, customer relations.

Governance – *how well that company is run*
So, things such as corporate governance, risk management, tax transparency, anti-corruption.

What this means for our fund

We will use ESG considerations to help us decide which bonds to hold and how long to hold them for. This is how it affects our investment approach:

We will invest more in companies that are managing risks well and are positioning themselves well for the future, in the section of the economy they support.

We won’t invest in companies that support activities which we think don’t have a place in the future. For example thermal coal.

We won’t invest in companies (or we’ll invest less), if we think they’re not managing their risks in relation to what they do.

Past performance comparison

Although past performance isn't a reliable indicator of future returns, it can be helpful to understand the performance of the current fund against the existing benchmark and the new benchmark.

The table below looks at the past 10 calendar years, and also 2022 to the end of August. The total return for the 10 years to end August 2022 would have been 0.4% per year for the Virgin Money Bond & Gilt Fund, 1.6% per year for the current benchmark and 1.9% per year for the new benchmark. Both the new and old benchmark assume no cost of investing. Some points to note opposite:

	2012	2013	2014	2015
Bond and Gilt Fund	6.7%	-4.7%	11.4%	-0.9%
Current benchmark	8.8%	-3.3%	13.1%	1.1%
New benchmark	10.5%	-2.2%	12.8%	1.1%

Source: Lipper for Investment Management, net income reinvested. 2022 year to date return is to end August.

Past performance is not a reliable guide to the future. Remember, the value of your investments can go down as well as up and you may get back less than you invest.

- We expect the new benchmark to provide a higher performance hurdle than the current benchmark over the longer term.

- The fund will seek to match or beat the new benchmark after charges, rather than track the old benchmark before charges.

- The below returns do not consider the potential for outperformance the fund will now have. For example, with the ability to invest differently from the benchmark, the fund can increase / decrease exposure to rising interest rates based on the views of the Investment Adviser. This could have protected the fund from some of the losses seen recently, although there will always be interest rate risk within the fund due to the relatively tight tracking error tolerance as per the Investment Policy above.

2016	2017	2018	2019	2020	2021	2022
7.8%	1.6%	-0.5%	5.0%	5.8%	-4.9%	-14.0%
8.7%	3.0%	0.4%	6.0%	6.4%	-4.3%	-13.6%
8.9%	3.5%	0.1%	7.0%	6.8%	-3.9%	-14.3%

Any questions?

Just call a member of our team on **03456 10 20 30*** and they'll do all they can to help.

You can reach them Monday to Friday 8am to 9pm, and 9am to 6pm Saturdays.

Calls may be monitored and recorded. Calls to 03 numbers cost the same as calls to 01 and 02 numbers and they are included in inclusive minutes and discount schemes in the same way.

VM37156 09/2022