Statement of Investment Principles (SIP) – Defined Benefit Section

This is the Statement of Investment and Governance Principles (“the Statement”) made by the QinetiQ Pension Scheme Trustee Limited (“the Trustee”), as trustee of the QinetiQ Pension Scheme (“the Scheme”) in accordance with the Pensions Act 1995, as amended. The Statement, which was approved by the Trustee on 9 September 2019, is subject to periodic review at least every three years and without delay after any significant change in investment policy.

This Statement covers only the Defined Benefit (“DB”) section of the Scheme. A separate document to the Statement, the Investment Policy Implementation Document (“IPID”) sets out further details relating to the Scheme’s policy on asset allocation and investment managers.

In preparing this Statement, the Trustee has consulted with the principal employer to the Scheme (QinetiQ Group plc) and has taken written advice from the Trustee’s appointed investment adviser, Hymans Robertson LLP. Hymans Robertson LLP has the knowledge and experience required under section 36(6) of the Pensions Act 1995.

Scheme objective

The primary objective of the Scheme is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependants, on a defined benefits basis. The Trustee’s over-riding funding principles for the Scheme are to set the employer contribution at a level which is sufficient:

- to recover any shortfall in assets relative to the value placed on accrued liabilities over the longer term; and
- to ensure that there are always sufficient assets of the Scheme (at their realisable value) to meet 100% of benefits as they fall due for payment to members.

The value of liabilities is calculated on the basis agreed by the Trustee and the Scheme Actuary. The funding position is monitored regularly by the Trustee and formally reviewed at each triennial actuarial valuation, or more frequently as required by the Pensions Act 2004.

Investment strategy

The Trustee has translated its objectives into a suitable strategic (asset allocation) benchmark for the Scheme. All day to day investment decisions have been delegated to several authorised investment managers. The strategic benchmark is consistent with the Trustee’s view on the appropriate balance between seeking an enhanced long-term return on investments and accepting greater short-term volatility and risk. The strategic benchmark is reflected in the benchmarks given to individual investment managers which, in aggregate, are consistent with the overall strategy.

The investment strategy takes due account of the maturity profile of the Scheme (in terms of the relative proportions of liabilities in respect of pensioners and non-pensioner members), together with the level of disclosed
surplus or deficit (relative to the funding bases used) and the Trustee’s view of the covenant of the sponsoring employer.

The Trustee monitors strategy relative to its agreed asset allocation benchmark and other agreed criteria on a regular basis. It is intended that investment strategy will be reviewed at least every three years following actuarial valuations of the Scheme, and will normally be reviewed annually. Written advice is received as required from professional advisers. The investment manager structure and investment objectives for each investment manager are shown in the IPID.

The Trustee has appointed a custodian to provide safekeeping for all the Scheme’s assets and perform the administrative duties attached where relevant, such as the collection of interest and dividends and dealing with corporate actions. The Scheme’s pooled funds have appointed their own custodian. Details of the current custodians are shown in the IPID.

**Choosing investments**

The Trustee has appointed a number of investment managers who are authorised under the Financial Services and Markets Act 2000 to undertake investment business. The Trustee, after seeking appropriate investment advice, has given the managers guidelines as to the asset allocation, including control ranges for each asset class and or geographic region. Subject to their respective benchmarks and guidelines, the managers are given full discretion over the choice of stocks and are expected to maintain a diversified portfolio.

The Trustee reviews the nature of Scheme investments on a regular basis, with particular reference to suitability and diversification. The Trustee seeks and considers written advice from a suitably qualified person in undertaking such a review. If, at any time, investment in a security or product not previously known to the Trustee is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.

The Trustee’s policy is to delegate all day-to-day decisions about the investments that fall within each mandate or fund to the relevant investment manager.

**Kinds of investment to be held**

The Scheme may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds, cash, property and pooled funds. Where invested in pooled funds, the Trustee is satisfied that the funds selected are consistent with the objectives of the Scheme, particularly in relation to diversification, risk, expected return and liquidity. The Scheme may also make use of derivatives and contracts for difference for the purpose of efficient portfolio management as well as annuity contracts. The Trustee considers all of these classes of investment to be suitable in the circumstances of the Scheme.

**Balance between different kinds of investments**

The Scheme’s investment managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market, each manager will maintain a diversified portfolio of stocks through direct investment or pooled vehicles.

**Risk**

The Scheme is exposed to a number of risks which pose a threat to the Scheme meeting its objectives. The principal risks affecting the Scheme are:


**Funding risks**

- **Financial mismatch** – The risk that Scheme assets fail to grow in line with the developing cost of meeting the liabilities.

- **Changing demographics** – The risk that longevity improves and other demographic factors change, increasing the cost of the Scheme benefits.

- **Systemic risk** - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial ‘contagion’, resulting in an increase in the cost of meeting the Scheme’s liabilities. Climate change is a particular systemic risk that has the potential to cause economic, financial and demographic impacts.

The Trustee measures and manages financial mismatch in two ways. As indicated above, the Trustee has set a strategic asset allocation benchmark for the Scheme. The Trustee assesses risk relative to that benchmark by monitoring the Scheme’s asset allocation and investment returns relative to the benchmark. The Trustee also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

The Trustee has entered into a bulk annuity insurance contract in respect of a proportion of pensioner liabilities to help manager and reduce these risks. In return for the payment of a premium, the Trustee holds an annuity policy with an insurer. Under the policy, the insurer makes monthly payments to the Scheme and carries the risk of longevity for a subset of the pensioners, as well as the investment risks for this proportion of the Scheme’s assets.

All pensioners continue to be members of the Scheme and the Trustee continues to have ultimate responsibility for the payment of benefits to their members.

The Trustee seeks to mitigate systemic risk through a diversified portfolio, but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

**Asset risks**

- **Concentration** - The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.

- **Illiquidity** - The risk that the Scheme cannot meet its immediate liabilities because it has insufficient liquid assets.

- **Currency risk** – The risk that the currency of the Scheme’s assets underperforms relative to Sterling (i.e. the currency of the liabilities).

- **Manager underperformance** - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

- **Covenant risk** – The possibility of failure of the Scheme’s sponsoring employer.

- **Environmental, Social and Governance (ESG) risks** – the extent to which ESG issues are not reflected in asset prices and/or not considered in investment decision making leading to underperformance relative to expectations.
Climate risk - The extent to which climate change causes a material deterioration in asset values as a consequence of factors including but not limited to policy change, physical impacts and the expected transition to a low-carbon economy.

The Trustee manages asset risks as follows. The Trustee provides a practical constraint on Scheme investments deviating greatly from the intended approach by investing in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrain risk within their expected parameters.

By investing across a range of assets, including quoted equities, bonds and bulk annuity policy, the Trustee recognises the need to access liquidity in the short term to pay benefits. In appointing several investment managers, the Trustee has considered the risk of underperformance by any single investment manager. The risk of underperformance is also mitigated by the inclusion of passive investment mandates within the investment portfolio.

The Trustee and its advisors consider covenant risk when setting the investment strategy and consult regularly with the sponsoring employer as to the suitability of the current investment strategy and any future changes that are proposed.

The Trustee’s approach to the consideration of ESG risks and climate risk is set out in further detail below.

Other provider risk

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Trustee takes professional advice and considers the appointment of specialist transition managers.

- Custody risk - The risk of losing economic rights to Scheme assets, when held in custody or when being traded.

- Credit default - The possibility of default of a counterparty in meeting its obligations.

The Trustee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Scheme, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). When carrying out significant transitions, the Trustee seeks professional advice. The Trustee operates, maintains and regularly reviews a risk log covering key investment, legal, regulatory and operational risks.

Expected return on investments

The investment strategy aims to achieve a return on Scheme assets, which taken in conjunction with contributions is sufficient over time to match growth in the Scheme’s pension liabilities.

Realisation of investments

The majority of the Scheme’s investments may be realised quickly if required. Property, private equity and unquoted fixed income may be difficult to realise quickly in certain circumstances. The bulk annuity insurance contract that the Trustee has entered cannot be realised.

Consideration of financially material factors in investment arrangements

The Trustee recognises that the consideration of financially material factors, including ESG factors, is relevant at different stages of the investment process.
Strategic considerations
The strategic benchmark has been determined using appropriate long-term economic and financial assumptions from which expected risk/return profiles for different asset classes have been derived are set out in a separate IPID. These assumptions apply at a broad market level and are considered to implicitly reflect all financially material factors.

The Trustee has discussed climate change risk with their investment advisor and actuary but given the inherent uncertainty, the Trustee has not made explicit allowance for the risks of climate change in setting the strategic benchmark.

Structural considerations
Given the discretion afforded to the active Investment Managers, the Trustee expects that their Investment Managers will take account of all financially material factors including the potential impact of ESG factors in the implementation of their mandate.

Within active mandates, the Trustee has delegated responsibility for the consideration of stock specific issues to their individual Investment Managers. The Trustee has discussed the extent to which ESG issues, where relevant to the investment mandate, are integrated into the investment processes of their Investment Managers and are satisfied that the Investment Managers are following an approach which takes account of all financially material factors.

In passive mandates, the Trustee recognises that the choice of benchmark dictates the assets held by the investment manager and that the manager has minimal freedom to take account of factors that may be deemed to be financially material. The Trustee accepts that the role of the passive manager is to deliver returns in line with the benchmark and believe this approach is in line with the basis on which their current strategy has been set. The Trustee will review the index benchmarks employed for the Scheme on at least a triennial basis.

Selecting new investment managers
In selecting new investment managers for the Scheme, where relevant to the investment mandate, the Trustee explicitly considers potential managers’ approach to responsible investment and the extent to which managers integrate ESG issues in the investment process as a factor in their decision making.

Consideration of non-financially material factors in investment arrangements
Given the objectives of the Scheme, the Trustee has not considered any non-financially material factors in the development and implementation of their investment strategy. The Trustee has not imposed any restrictions or exclusions to the investment arrangements based on non-financially material factors.

Stewardship
The Trustee recognises that stewardship encompasses the exercise of voting rights, engagement by and with investment managers and the monitoring of compliance with agreed policies.

Voting and engagement
The Trustee has adopted a policy of delegating voting decisions on stocks to their Investment Managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long-term shareholder value. The Investment Managers are expected to exercise the voting rights attached to individual investments in accordance with their own house policy and taking account of current best practice including the UK Stewardship Code.
Periodically, the Trustee will request their Investment Managers provide details of any changes in their policies. Where appropriate, the Trustee will engage with and may seek further information from their Investment Managers on how portfolios may be affected by a particular issue.

The Trustee does not engage directly but believes it is appropriate for its investment managers to engage with key stakeholders which may including corporate management, regulators and governance bodies, relating to their investments in order to improve corporate behaviours, improve performance and mitigate financial risks. The Trustee will review engagement activity undertaken by their investment managers as part of its broader monitoring activity.

**Monitoring**

The Trustee reviews manager voting activity on an periodic basis in conjunction with their investment adviser and uses this information as a basis for discussion with their investment managers. Where the Trustee deems it appropriate, any issues of concern will be raised with their manager for further explanation.

The Trustee aims to meet with all their Investment Managers on an annual basis. The Trustee provides their managers with an agenda for discussion, and where appropriate, ESG issues. Managers are challenged both directly by the Trustee and by their investment advisers on the impact of any significant issues including, where appropriate, ESG issues that may affect the prospects for return from the portfolio.

**Additional Voluntary Contributions (AVCs)**

The Trustee gives members the opportunity to invest in a range of vehicles, at the members’ discretion. The Trustee gives members the opportunity to pay additional contributions to purchase additional service within the Scheme. A range of funds is available for investment at members’ discretion.

**Conflicts of interest**

The Trustee maintains a register of interests of each of the Trustee Directors and their advisers and re-confirms/updates these at each Trustee meeting to ensure that any potential conflicts between Stakeholders are identified in a timely manner and dealt with appropriately.

**For and on behalf of the Trustee of the Scheme**

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<tr>
<th>Name</th>
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<tr>
<td>Huw Evans</td>
<td>![Signature]</td>
<td>25 September 2019</td>
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