QinetiQ Pension Scheme – DC Section Statements of Investment Principles

January 2021

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Introduction

The law requires the Trustee to produce a formal "Statement of Investment Principles" for the Scheme's default arrangements and its other investment options. These Statements set out what the Trustee aims to achieve with the investment options and their investment policies which guide how members' money is invested.

This document is a collection of the Statements of Investment Principles for the DC Section of the QinetiQ Pension Scheme (the "Scheme."). These Statements must cover a number of technical points in order to comply with legislation as well as meet the expectations of the Pensions Regulator and needs of the Scheme's Auditors, which we have as far as possible shown separately in "for the record" boxes.

Statements of Investment Principles

The Statement of Investment Principles contained in this document includes the following:

1. Statement of the aims and objectives for the default arrangements*;
2. Statement of the aims and objectives for investment options outside the default arrangements*; and
3. Statement of investment beliefs, risks and policies**.

The Statement of Investment Principles for the Scheme ** comprises items 1, 2 and 3.

The Statement of Investment Principles for the Scheme's default arrangements *** comprises items 1 and 3.

For the record

* In accordance with Regulation 2A(1)(a) and 2A(1)(c) of the Occupational Pension Schemes (Investment) Regulations 2005

** In accordance with Regulation 2A(1)(b) of the Occupational Pension Schemes (Investment) Regulations 2005

*** As required by the Occupational Pension Schemes (Charges and Governance) Regulations 2015

The Trustee has taken proper written advice and consulted the Employer in the preparation of these Statements of investment Principles.

The Statement of Investment Principles will be reviewed at least every three years or more frequently as required by the Regulations.

For and on behalf of the Trustee of the Scheme

Name	Signed	Date
Huw Evans		15 January 2021

1 Statement of the aims and objectives for the default arrangements

Reasons for the default arrangements

The Trustee has decided that the Scheme should have a primary default investment arrangement because:

- While the Scheme is closed to new entrants, it is a qualifying scheme for auto-enrolment purposes for the existing membership and so must have a default option;
- It should be made easy for members of the Scheme to build their retirement benefits without the need to make any investment decisions; and
- A majority of the Scheme's members are expected to have broadly similar investment needs.

The Scheme will also have other investment arrangements that are classified as default arrangements. It may be necessary for the Trustee, acting in members best interests, to redirect contributions and/or assets to an investment option which differs from some members' original choices. When this occurs without obtaining members' explicit consent it creates a default arrangement. Circumstances when this may arise include when:

- The platform provider or fund manager suspends trading in a fund due to market conditions;
- The platform provider or fund manager decides to close a fund due to commercial or regulatory reasons; or
- The Scheme's investment adviser believes a more appropriate alternative exists within the self-select fund range and recommends that the Trustee redirects contributions to this more appropriate alternative.

Choosing the primary default arrangement

The Trustee believes that understanding the Scheme's membership is essential to designing and maintaining a primary default arrangement which meets the needs of the majority of members.

The Trustee has taken into account a number of aspects of the Scheme's membership including:

- The age and salary profile;
- The likely sizes of pension accounts at retirement;
- Previous sources of retirement income from the Employer; and
- Members' likely benefit choices at and into retirement.

Objectives for the primary default arrangement

The main objective of the primary default arrangement is to provide good member outcomes at retirement. The Trustee conducts an annual value for member assessment and believes the Scheme gives 'good' value for members.

The Trustee believes that it is in the best interests of the majority of members to offer a primary default arrangement which:

- Manages the main investment risks members face during their membership of the Scheme, including, but not limited to Environmental, Social and Governance (ESG) issues and climate change risk;
- Gives good member outcomes at retirement by maximising investment returns relative to inflation while taking an appropriate level of risk for the majority of members who do not make investment choices; and
- Reflects members' likely benefit choices at retirement.

The primary default arrangement

The primary default arrangement is:

A lifestyle strategy which is designed for members who are expected to use Flexible Access Income Drawdown during their retirement.

The lifestyle strategy gradually moves investments between different funds to manage the levels of expected investment risks and returns at each stage of membership of the Scheme.

Objectives for the other default arrangements

The objective of the other default arrangements will be either to:

- Preserve the value of member contributions and enable these contributions to be easily reinvested by the member into a different fund, with minimal transaction costs, should they choose too do so; or
- Replicate as far as possible the risk and return characteristics of a fund that has closed or is no longer rated positively by the Trustee's investment adviser.

Full details of the current primary default arrangement, as well as the other default arrangements, are provided in the document "Investment implementation for the default arrangements", within the Investment Policy Implementation Document (IPID).

2 Statement of the aims and objectives for investment options outside the default arrangement

Reasons for the investment options

In addition to the default arrangement, the Scheme offers members a choice of investment options because:

- While the primary default arrangement is intended to meet the needs of a majority of the Scheme's members, it may not meet the needs of a wider cross-section of members;
- Attitudes to investment risks and the need for investment returns will vary from member to member and will also vary for each member over time and, in particular, as they approach retirement;
- Members have differing investment needs and these needs change during their working lives; and
- Some members will want to be more closely involved in choosing where their contributions are invested.

Choosing the investment options

Membership analysis

The Trustee believes that understanding the Scheme's membership is important to maintaining an appropriate range of investment options and have taken into account a number of aspects including:

- The members' age and salary profile;
- The likely sizes of members' pension accounts at retirement;
- Previous sources of retirement income from the Employer;
- Members' likely range of benefit choices at retirement;
- The levels of investment risk and return members may be willing to take;
- The degree to which members are likely to take an interest in where their contributions are invested, and whether options provide enough mitigation of ESG and/or climate change risks; and
- The number of members who are likely to want a specialist range of funds that take into account non-financial factors e.g. ethical views, religious views etc.

Member behaviour

The Trustee has also considered the results of academic research and market surveys into how members choose where to invest their pension account which in summary shows:

- Too little choice is viewed negatively by members;
- Too much choice can prove confusing and deter members from taking action; and
- Some members will not regularly review their choices.

Costs of investment options

The investment and administration costs are borne by members and so a balance needs to be struck between choice and costs.

Objectives for the investment options

The Scheme offers members the following choices of investment options as an alternative to the default arrangements:

Alternative lifestyle option

The alternative lifestyle option has similar objectives to the primary default arrangement but is designed for members who are expected to take cash at retirement.

Self-select funds

The main objectives of the self-select fund range are to:

- Provide a choice of individual funds for members who want to be more closely involved in choosing where their pension accounts are invested;
- Complement the objectives of the primary default arrangement and the alternative lifestyle option;
- Provide a broader choice of levels of investment risk and return;
- Provide a broader choice of investment approaches including ethical based funds; and
- Help members more closely tailor how their pension accounts are invested to their personal needs and attitude to risk.

Nevertheless, the self-select fund range cannot be expected to cover all the investment needs of all members.

Full details of the current investment options are provided in the documents “Investment implementation for investment options outside the default arrangements” and “Investment implementation for the default arrangements”, both within the IPID.

3 Statement of investment beliefs, risks and policies

Introduction

This Statement sets out the general investment beliefs and policies which guides the Trustee's decision making.

> **For the record**
>
> This Statement of investment beliefs, risks and policies should be read in conjunction with the Statements of the aims and objectives for both the default arrangements and the investment options outside the default arrangements. Collectively, these respectively form the Statements of Investment Principles for the Scheme and the default arrangements.

Investment Risks

Principal risks

The Trustee believes that the three main investment risks most members will face are:

1) Inflation risk – investment returns over members' working lives may not keep pace with inflation and, as a result, do not produce adequate retirement benefits.

Further from retirement, this risk should be countered by investing in funds which are expected to produce returns well in excess of inflation over the longer term. Approaching retirement, the impact of this risk needs to be balanced against the other main risks members face.

2) Benefit conversion risk – investment conditions just prior to retirement may increase the cost of turning members' fund values into retirement benefits.

For members taking cash at retirement, funds investing in cash deposits and other short-term interest bearing investments provide a high degree of (but not complete) capital security. Funds investing in a mix of different assets are expected to be broadly suitable for members planning income drawdown during retirement. For members buying an annuity at retirement, the value of funds investing in longer-dated bonds (i.e. debt issued by companies) may be expected to broadly follow changes in annuity rates caused by long-term interest rates.

3) Volatility/Market risk – falls in fund values prior to retirement lead to a reduction in retirement benefits.

Funds investing in bonds or a mix of defensive assets and hedging techniques may be expected to be subject to lower levels of short-term fluctuations in values - although there may be occasions when this does not hold true.

Other investment risks

The Trustee believes that other potential investment risks members may face include:

Active management risk – a fund manager's selection of holdings may not lead to investment returns in line with the fund's objectives and investment markets generally.

Currency risk – changes in exchange rates will impact the values of investments outside the UK when they are being bought or sold.

Interest rate risk – the value of funds which invest in bonds will be affected by changes in interest rates.

Default risk – for bond funds (where money is lent in return for the payment of interest), the company or government borrowing money fails to pay the interest due or repay the loan.

ESG risk – 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.

Liquidity risk – funds which invest in assets which cannot be easily bought or sold (such as property) may at times not be able to accept new investments or disinvestments of existing holdings.

Counterparty risk – the financial institutions holding a fund's assets may get into financial difficulties leading to a reduction in a fund's value.

Managing investment risks

The lifestyle options manage the three main investment risks as members grow older by automatically switching from funds which are expected to give long-term growth relative to inflation into funds whose values should fluctuate less in the short-term relative to the benefits members are expected to take at retirement. The self-select fund range provides members with a choice of funds with differing risk and return characteristics.

The Trustee manages the other investment risks as part of the process for selecting and ongoing monitoring of the funds used by the Scheme. The funds used give a good spread of investments which will help manage risks associated with market conditions. The Trustee believes that the Scheme's investment options are appropriate for managing the risks typically faced by members.

Expected returns on investments

The Trustee believes that it is important to balance investment risks with the likely long-term returns from different types of assets used in funds (taking the funds' charges into account):

Asset class	Expected long-term investment returns relative to inflation	Expected shorter-term volatility in fund values
Equities (i.e. company shares)	Strong return relative to inflation	Most volatile in the short-term
Property (e.g. offices, shops and warehouses)	Positive, but lower than equities	Lower than equities
Corporate Bonds (i.e. loan stocks issued by companies)	Positive, but lower than equities and property	Lower than equities or property
Fixed Interest Government Bonds (e.g. UK Gilts)	Positive, but lower than equities, property or corporate bonds	Lower than equities, property or corporate bonds
Index-Linked Government Bonds (e.g. UK Index-Linked Gilts	In line with inflation	Lower than equities, property or corporate bonds
Cash (and other short-term interest bearing investments)	Return may not keep pace with inflation	Minimal with high degree (but not complete) of capital security

Long-dated Bonds (e.g. UK Gilts and Corporate Bonds with a duration of 15 years or more) – should give fund values which move broadly in line with the financial factors influencing annuity rates.

Multi-asset funds - invest in a varying mix of asset classes which should deliver positive returns relative to inflation over the longer-term, with shorter-term volatility lower than equities.

Derivatives (e.g. currency hedging) - typically to reduce shorter-term investment risks or to facilitate changing where funds are invested, should help achieve a fund's expected levels of risk and return.

Factor-based (i.e. funds investing in assets with certain characteristics and return drivers) – the strategy of these funds is intended to give a better return over the long-term than the broader market for the type of assets involved (e.g. equities).

Responsible Investment (i.e. funds selecting assets to mitigate ESG and/or climate change risks) – the broader strategy of these funds is expected to deliver a risk adjusted return no worse off over the long-term than the broader market for the type of assets involved and potentially a higher expected risk-adjusted return should current market trends continue.

Investment beliefs

The Trustee's investment decisions are made in the context of their investment beliefs that:

- Managing the main investment risks is the most important driver of good long-term member outcomes;
- Investment markets may not always behave in line with long-term expectations during the shorter-term;
- Taking investment risk is usually rewarded in the long term;
- Investment risks can be reduced by spreading investments both within and across asset classes;
- Actively managed funds, where the manager chooses where to invest, may not always deliver the expected investment returns in the shorter-term;
- Passively managed funds, whose returns are intended to track a market index, may produce investment returns more efficiently than actively managed funds in some markets; and
- As the Scheme invests for the long-term, environmental, social and governance factors will have a bearing on the funds' expected levels of risk and return.

Types of funds used

The Scheme uses funds provided through an investment platform. This investment platform in turn invests into funds provided by a selection of fund managers where investments are pooled with other investors. This enables the Scheme to invest in a range of funds giving a good spread of investments in a cost-effective manner. It does mean that the Trustee has delegated day to day investment decisions to the fund managers.

Manager incentives

When selecting funds, the Trustee will ask their investment advisor to consider the investment managers' remuneration strategies and appropriateness of each fund's investment guidelines to ensure that there is no inducement or scope to take an undue level of risk and that the investment managers will act in line with the interests of the Scheme's members.

In accordance with the 2015 Regulations, the Trustee conducts an annual Value for Members assessment and will take action should the provider be found to be giving poor value. In addition, in accordance with guidance from the Pensions Regulator, the Trustee will periodically review the Scheme's choice of provider to ensure their charges and services remain competitive. The Trustee believes that these steps are the most effective way of incentivising the provider to deliver Value for Members, of which investment management charges and investment performance are key considerations.

The Trustee also undertakes a review at least every three years, in which the appropriateness of the investment options at which time the suitability of the Scheme's investment management arrangements are also considered.

The Trustee monitors the investment managers against a series of metrics on a quarterly basis over a long-term time horizon of three years including:

- Performance of their funds' respective benchmarks or performance targets;
- Relative tracking error where appropriate;
- The exercise of stewardship responsibilities (including engagement with companies); and
- The management of risks.

Comparison of performance against a more specialist ESG-related benchmark is also completed on a periodic basis.

The investment managers are expected to provide explanations for any significant divergence from a fund's objectives. A material deviation from performance and risk targets or approach to portfolio management is likely to result in the fund being formally reviewed.

Portfolio turnover

The Trustee does not expect investment managers to take excessive short-term risk and will monitor the investment manager's performance against the benchmarks and objectives on a short, medium- and long-term basis.

For passively managed funds the turnover of holdings is driven by changes in the index a fund seeks to track, and hence is largely outside the control of the investment manager. When selecting actively managed funds, the Trustee will consider, with the help of their investment advisor, the expected level of turnover commensurate with a fund's investment objectives, the investment manager's investment processes and the nature of the fund's assets.

Whilst the Trustee expects performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustee will ask the investment managers on the platform to report on at least an annual basis on the underlying assets held within funds with details of any transactions and turnover costs incurred over the Scheme's reporting year.

Where a fund has significantly under or outperformed its benchmark, the Trustee will seek to ascertain where necessary whether a higher or lower than normal turnover has been a contributory factor. The Trustee will challenge the investment manager if there is a sudden change in portfolio turnover, or if the level of turnover seems excessive.

Portfolio duration

The Trustee recognises the long-term nature of defined contribution pension investments and chooses funds which are expected to deliver sustainable returns over the Scheme members' (and pensioners') investment horizon. The Trustee will carry out necessary due diligence on the underlying investment decision making process, to ensure the manager makes investment decisions over an appropriate time horizon aligned with the objectives for the related investment option.

The Trustee expects that each fund will be used for at least three years, this being the period over which performance of the fund can be appropriately evaluated and the costs of change amortised, although all funds are subject to ongoing review against various financial and non-financial metrics in addition to their continued appropriateness within the investment strategy.

Realisation of investments

The Trustee expects that the investment platform provider and the fund managers will normally be able to sell the funds within a reasonable timescale. There may, however, be occasions where the investment platform or fund managers need to impose restrictions on the timing of sales and purchases of funds (most notably for funds investing in property) in some market conditions to protect the interests of all investors in that fund.

From time to time the suspension of trading in a fund or closure of a fund by the platform provider or fund manager and resulting temporary redirection of contributions to another fund may create an unintended default arrangement.

Stewardship

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

The Scheme offers members the primary default arrangement and an alternative lifestyle option, as well as a range of self-select funds. The Trustee's stewardship activities are focused on the primary default arrangement, as this constitutes the largest number of members, and accounts for the majority of the assets.

Members' financial interests

The Trustee expects that the investment platform provider and fund managers will have the members' financial interests as their first priority when choosing investments.

ESG

The Trustee believes that environmental, social and governance ("ESG") considerations have a bearing on the funds' risks and returns.

The Scheme uses standard funds offered by investment platform providers and fund managers. This gives access to a range of funds while keeping down costs to members, but means that the Trustee cannot adopt an ESG specific approach to the Scheme. The Trustee nevertheless seeks to manage financially material considerations to protect long-term returns by:

Belief	**Recommended Trustee Action**
Choosing fund managers who have clearly articulated policies for managing financially material considerations including climate change;	The Trustee will consider adopting an ESG-focussed fund within the primary default arrangement and alternative lifestyles.
Considering the extent to which ESG issues including climate risk, where relevant, are integrated into the fund managers' investment processes and benchmark indices as appropriate and are satisfied that the fund managers follow an approach which takes account of financially material factors;	The Trustee will ask their Equity and Diversified Growth Fund (DGF) managers for a copy of their policies on ESG issues, with a view to reviewing these on an annual basis.
For passively managed funds, the Trustee recognises that the funds' objectives are to deliver returns in line with its benchmark (which may or may not take into account ESG factors), which the Trustee believes will deliver appropriate risk adjusted returns.	The Trustee will review the index benchmarks employed for the Scheme and periodically compare these to a specialist ESG index to assess the impact of any differences.
For all funds, expect underlying fund managers to engage with companies in which the fund invests to encourage business strategies which should	The Trustee will request from the Scheme's fund managers their voting records, engagement

improve or protect the value of those investments (this would also apply for passive managers but there is an understanding that it could be a lesser form of engagement); and	policies, and the impact of any formal engagement procedures.
Prefer fund managers who are signatories to the Financial Reporting Council's Stewardship Code in the UK and the United Nations principles for responsible investment.	The Trustee will include this as part of the criteria for a manager selection process.

Fund managers are only expected to take environmental, ethical or social considerations into account when these do not conflict with a fund's investment objectives.

Voting Rights

The Scheme invests via an investment platform provider, who in turn invest in funds which are pooled with other investors to keep costs down and ensure adequate diversification. As a result, the Trustee has adopted a policy of delegating voting decisions on stocks to the underlying fund managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. The fund 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.

Where relevant, the Trustee has reviewed the voting and engagement policies of the fund managers as well as the approach to governance of the investment platform provider and determined that these policies are appropriate.

The Trustee does not engage directly with companies but believe it is appropriate for the fund managers to engage with key stakeholders which may include 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 request, where appropriate and practicable, that the platform provider or investment managers notify the Trustee of any issue on which it may be beneficial for the Trustee to undertake further engagement. The Trustee will review the engagement activity undertaken by the fund managers as part of its broader monitoring activity.

The Trustee expects the investment platform provider to adopt similar practices with regards to the inclusion and ongoing oversight of fund managers on their platform. The Trustee also expects the platform provider to be able to evidence their own governance practices on request.

Monitoring

The Trustee reviews the fund managers' voting activity at least annually in conjunction with their investment advisor and uses this information as a basis for discussion with the investment platform provider and fund managers. Where the Trustee deems it appropriate, any issues of concern will be raised with the manager for further explanation.

For the record

The Trustee obtains and considers proper advice from suitably experienced and qualified persons when choosing investments and preparing the Statement of Investment Principles.

Funds are chosen by the Trustee to give an expected level of return with an appropriate level of investment risk which meets the objectives of each investment option.

The funds used at each stage of the primary default arrangement and the alternative lifestyle option is intended to deliver good member outcomes at retirement from an appropriate balance of investment growth relative to inflation and the then pertinent investment risks.

The investment platform uses a life insurance company based legal vehicle for its funds. The fund managers used by the platform use a variety of different legal vehicles for their funds. The funds may invest in quoted and unquoted securities traded in regulated UK and overseas markets:

Equities (company shares); Fixed interest and index-linked bonds issued by governments and companies; Cash and other short-term interest bearing deposits; Commercial and residential property; Infrastructure and commodities through collective investment vehicles and Derivatives to facilitate changes in where funds are invested or to help control investment risks.

Funds provided through a life insurance company must comply with the Financial Conduct Authority (“FCA”) “Permitted Links” rules, which place limits on the degree of leverage a fund can use. Fund managers using other fund vehicles subject to the European “UCITS IV” and the FCA’s “Non-UCITS” regulations have to meet requirements on the security and concentrations of assets.

Subject to the funds’ benchmarks and guidelines, the fund managers are given full discretion over the choice of securities and, for multi-asset funds, choice of asset classes. Fund managers are expected to maintain well-diversified and suitably liquid portfolios of investments.

The Trustee considers that these types of investments are suitable for the Scheme. The Trustee is satisfied that the funds used by the Scheme provide adequate diversification both within and across different asset classes.