

# 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 30 July 2024, 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.

The Trustee has delegated all day-to-day investment decisions to authorised investment managers.

### **Choosing investments**

The Trustee has appointed several 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 reference to suitability and diversification. The Trustee seeks and considers written advice from a suitably qualified person when determining the appropriateness of each manager and mandate for the Scheme, particularly in relation to diversification, risk, expected return and liquidity. 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.

### **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 may also utilise from time to time, temporary credit facilities to improve the liquidity of the Scheme. The Trustee considers all these classes of investment to be suitable in the circumstances of the Scheme.

### **Investment mandates**

The Trustee has appointed each of its investment managers to deliver a specific benchmark, which overall will align to deliver the Scheme's broader investment strategy. The Trustee ensures that all manager engagements have clearly defined objectives and management parameters. Where appropriate, and where commercial considerations permit, the terms of the mandate and the basis on which the manager is engaged will be defined specifically for the Scheme. Where such tailoring is not directly achievable, the Trustee will invest in pooled funds where the Trustee will evaluate the objectives of the fund and the policies of the investment manager to ensure that they are appropriate for the needs of the Scheme.

### **Investment manager remuneration**

Remuneration for each mandate is determined at the inception of each mandate based on commercial considerations and typically set on an ad valorem basis. Where appropriate to the nature of the mandate, the term of the mandate and the role the mandate plays within the investment strategy, the Trustee may agree to a fee structure where the manager is incentivised to deliver outperformance relative to an agreed benchmark, typically in conjunction with a lower ad valorem fee. The Trustee periodically reviews the fees paid to all its managers against industry standards.

### **Investment time horizon**

The Trustee recognises the long-term nature of its liability profile and appoints its managers to invest in such a way that generates long term sustainable returns. 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 Scheme objective.

The duration of each mandate is determined by the Trustee at the inception of each mandate. For open-ended investments, the Trustee engages managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Trustee expects the minimum duration of the appointment will be three years, this being the period over which performance of the mandate can be appropriately evaluated although all mandates are subject to ongoing review against various financial and non-financial metrics in addition to their continued appropriateness within the investment strategy. For closed-ended investments, the Trustee expects the term of the appointment to be the lifetime of the investment.

A summary of the Scheme's investment mandates, and the respective benchmarks and targets is included in the IPID.

### **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.

### **Expected return on investments**

The investment strategy aims to achieve a return on Scheme assets which is sufficient over time to match growth in the Scheme's pension liabilities.

### **Realisation of investments**

The Trustee intends to evolve the strategy such that most of the Scheme's investments may be realised quickly if required. Private equity and unquoted fixed income may be difficult to realise quickly in certain circumstances. The bulk annuity insurance contracts that the Trustee has entered into cannot be realised.

### **Risk**

The Scheme is exposed to several 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, 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 keeps under review mortality and other demographic assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation. The Trustee has entered into multiple bulk annuity insurance contracts in respect of a proportion of pensioner liabilities to help manage and reduce these risks. In return for the payment of a premium, the Trustee holds annuity policies with insurers. Under the policies, the insurers make monthly payments to the Scheme and carry 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 eventualities that may arise under this heading.

### Asset risks

- Concentration risk - 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.
- Collateral risk – The risk that there is insufficient capital in the LDI portfolio to support the desired level of hedging.
- Illiquidity risk - 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 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 policies, 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.

## ESG risk

Identifying and managing ESG risks is central to the Scheme's risk management framework:

ESG risks are identified via the following ways:

- **Investment strategy reviews** – climate scenario analysis will be considered alongside triennial investment strategy reviews. In addition, an annual assessment of the investment manager's RI credentials relative to best practice is carried out. This review considers the extent by which ESG factors are integrated into investment processes, the stewardship and engagement policies of the investment managers and the quality of ESG reporting provided by the managers.
- **Actuarial valuation and covenant reviews** – ESG risks are integrated into the models used by the Scheme's Actuary to determine the impact of climate change and upcoming environmental regulations. Specific ESG stresses are considered when assessing the strength of the Scheme's covenant.
- **Asset class deep dives** – when assessing the merit of integrating new asset classes within the Scheme's investment strategy, asset class specific ESG risks and opportunities are considered.
- **Selection of investment managers** – when appointing a new investment manager, the Scheme compares the ESG processes of the shortlisted managers to ensure adequate processes are in place to identify, manage and mitigate ESG risks. Where relevant, the Trustee considers integrating minimum ESG reporting standards into the investment manager agreement.

Once risks are identified, they are evaluated and prioritised based on the overall threat posed to the scheme. The Trustee prioritises risks with input from its advisors and investment managers. This helps the Trustee build up a picture of the Scheme's risks more widely and where ESG risks sit in the overall risk management framework.

Once the risks facing the Scheme have been considered and prioritised, mitigation strategies are established and monitored to ensure that they remain effective. Risks that are deemed to be high in likelihood, impact, or both after allowing for mitigating controls are deemed to take priority for future action.

Actions to address risk management will look to introduce an additional control to mitigate the likelihood of a risk occurring or reduce the impact of a risk should it occur. The discussion also considers whether additional trustee training is required. When best practice ESG risk management techniques have been established for an asset class then this should be used as precedent for all other managers within the space. This is particularly important for emerging risks that are deemed to be high in likelihood or impact.

## 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.

## **Manager engagement**

### **Performance evaluation**

The Trustee does not expect managers to take excess short-term risk and carry out regular monitoring of the Scheme's investments and managers. The monitoring includes a review of investment performance of each manager relative to their respective benchmark or performance target on a short, medium and long-term basis. The monitoring of the Scheme's investments and managers also includes a review of strategic and funding risks.

The Trustee also seeks information from their investment managers on meeting objectives of the mandates and exercising stewardship responsibilities (including engagement with issuers) as set out in greater detail below, and the management of risks. Material deviation from performance or risk targets is likely to result in the mandate being formally reviewed.

The Trustee draws input from their investment advisors to provide input and analysis to support any such review of and engagement with its investment managers. Where necessary, the Trustee will highlight any areas of concern identified during such reviews to the manager as part of its engagement process and request that the manager takes appropriate action. This may include concerns over performance, risk management, stewardship practices, investment process and operational issues and, where such concerns are raised, the Trustee will require the manager to demonstrate levels of improvement. Failure to achieve the desired improvements will result in the mandate being reduced or terminated.

### **Portfolio turnover**

The Trustee has expectations of the level of turnover within each mandate which is determined at the inception of the mandate, based on the Trustee's knowledge of the manager, investment process and the nature of the portfolio. Whilst the Trustee expects performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustee expects managers to report on at least an annual basis on the underlying assets held within the portfolio and details of any transactions over the period. The Trustee will challenge its managers if there is a sudden change in portfolio turnover or if the level of turnover seems excessive.

The Trustee will request turnover costs incurred by the asset manager over the Scheme reporting year.

## **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 adviser and actuary but given the inherent uncertainty over the implications of climate change, 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 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.

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 to consider the management of conflicts of interest and improve corporate behaviours, improve performance and mitigate financial risks. Where necessary, investment managers are expected to notify the Trustee of any issue on which it may be beneficial for the Trustee to undertake further engagement. The Trustee will review engagement activity undertaken by their investment managers as part of its broader monitoring activity.

Responsibility for investment decisions has been delegated to the investment managers which includes consideration of the capital structure and the appropriateness of any investment made. Where managers are responsible for investing in new issuance, the Trustee expects the manager to engage with the issuer about the terms on which capital is issued and the potential impact on the rights of new and existing investors.

### Monitoring

The Trustee aims to meet with all their Investment Managers on a periodic basis. The Trustee provides their managers with an agenda for discussion, and where appropriate, ESG issues. The agenda will be driven by the

priority themes identified by the Trustee and the extent to which the managers align with the RI beliefs agreed by the Trustee. 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.

### RI Beliefs and RI Policy

The Scheme has established the following Responsible Investment beliefs:

- **Belief 1** – Responsible Investment issues can have a material impact on the long-term performance of its investments

The Trustee integrates RI, including ESG factors and climate-related risks, into its investment processes because it believes that doing so should lead to better long-term returns on the Scheme assets.

- **Belief 2** – ESG factors, including climate risk, can have a positive and/or negative impact on long term returns and reputation. In the context of the Scheme's asset allocation, these factors should be managed to support the Scheme's long-term objectives.

The Scheme's asset allocation is determined using appropriate long-term economic and financial assumptions from which expected risk/return profiles for different asset classes have been derived. These assumptions apply at the asset class level and are periodically refined to better capture the implications of climate related risks. The Trustee will use scenario analysis periodically to optimise the resilience of the investment strategy.

- **Belief 3** – Investment managers are best placed to take action on ESG matters and should embed ESG considerations throughout their investment processes

The Trustee requires their investment managers to take account of all financially material factors including ESG factors, in the implementation of their mandate. The Trustee expects its managers to engage with key stakeholders to improve corporate behaviours. The Trustee will seek feedback from its managers on such engagements as part of the process of monitoring the performance of the managers.

- **Belief 4** – Transparency about the approach to managing ESG factors between both the Trustee and its suppliers, and the Trustee and its stakeholders is important

The Trustee makes appropriate disclosures on its RI activities and on ESG factors and climate related risks associated with its investments using available data. The Trustee engages with asset managers where data quality and availability could be improved.

- **Belief 5** – Exclusion is not always the best option.

The Trustee expects its investment managers to engage with investee companies about their ESG practices and to consider exclusion only when engagement has failed to achieve a satisfactory approach. The Trustee expects managers to clearly document the engagement undertaken, action plans agreed and timescales for achieving desired outcomes and targets.

- **Belief 6** – It is important to remain up to date on ESG developments

The Trustee will undertake training as required to increase their knowledge of emerging ESG development. The Trustee will raise ESG topics with its managers as part of the routine monitoring of the Scheme's investments.

- **Belief 7** – There should be no conflict between QinetiQ's sustainability approach and the Trustee's management of ESG factors



The Trustee maintains a register of interest for all relevant parties to ensure that any potential conflicts are dealt with appropriately.

The Trustee will analyse the current RI approach of the Scheme's managers relative to the Trustee RI beliefs outlined above and engage with the managers accordingly.

### 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. The Trustee separately considers any conflicts of interest arising in its investments and has ensured that each manager has an appropriate conflicts of interest policy in place.

Signed For and on Behalf of the Trustee of the QinetiQ Pension Scheme.

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Trustee

20/08/2024

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Date