

Royal Ordnance Senior Staff Pension Scheme

Statement of Investment Principles

November 2023

Royal Ordnance Senior Staff Pension Scheme

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Section 1 – Introduction

- 1.1 This Statement of Investment Principles (“SIP”) has been prepared by the Trustee of the Royal Ordnance Senior Staff Pension Scheme (the “Scheme”) in accordance with the Pensions Act 1995 (as amended) and the Occupational Pension Schemes (Investment) Regulations 2005.
- 1.2 The Scheme’s investment arrangements, based on the principles set out in this SIP, are detailed in the Investment Policy Implementation Document (“IPID”).
- 1.3 In preparing this SIP the Trustee has consulted BAE Systems plc (the “Principal Employer”), and obtained written investment advice from the Scheme’s Investment Adviser. Where matters described in this SIP may affect the Scheme’s funding policy, input has also been obtained from the Scheme Actuary. The Trustee will obtain similar advice whenever they review this SIP.
- 1.4 The Trustee will seek to maintain a good relationship with the Principal Employer, and will discuss any proposed changes to this SIP with the Principal Employer.
- 1.5 The Trustee investment responsibilities are governed by the Scheme’s Trust Deed and Rules and this SIP takes full account of its provisions. A copy of the Trust Deed and Rules is available for inspection by members, upon request.
- 1.6 The Trustee strives to ensure that the investment policies and their implementation are in keeping with best practice, including the Myners principles first published in 2001 and revised in 2008.
- 1.7 The Trustee does not expect to revise this SIP frequently as it covers broad principles, however it will be reviewed at least every three years and without delay, if there are relevant, material changes to the Scheme and/or Principal Employer.
- 1.8 The IPID will be reviewed at least every year, and without delay, if there are relevant, material changes to the Scheme and/or Principal Employer.
- 1.9 Both the SIP and the IPID need to be reconfirmed on an annual basis with the Principal Employer.

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Section 2 - Governance

- 2.1 The Trustee has ultimate responsibility for decision making on investment matters. The Trustee has agreed that they will take all strategic policy decisions on investments, following receipt of advice from its Advisers.
- 2.2 During 2019 a whole of Scheme buy-in was secured for the Scheme with the policy provider Legal and General Assurance Society Ltd (“Legal & General”). This is an irrevocable contract which provides benefits to the beneficiaries of the Scheme broadly in line with the Trust Deed and Rules. The contract was entered into, with the Trustee having received advice on its suitability from Hymans Robertson LLP (“Hymans”). Legal & General is authorised and regulated by the Financial Conduct Authority.
- 2.3 A small amount of Additional Assets remains invested with the investment manager.
- 2.4 Day to day investment decisions in respect of the invested assets have been delegated to the investment manager in accordance with guidelines agreed with the Trustee. The investment manager is authorised and regulated by the Financial Conduct Authority, and is responsible for the management of the underlying investments. The Trustee has entered into a signed Investment Management Agreement with the investment manager, the terms of which are consistent with the principles in the SIP.
- 2.5 The Custodian is responsible for the safekeeping of the Scheme’s assets. As the Scheme only invests in collective vehicles, the appointment of the custodian is the responsibility of the Investment Manager.
- 2.6 An actuarial valuation of the Scheme is performed at least every three years, in accordance with regulatory requirements. The main purpose of the actuarial valuation is to assess the extent to which the assets cover the accrued liabilities and agree an appropriate funding strategy for the Scheme. Full details of the current funding strategy can be found in the Statement of Funding Principles and Schedule of Contributions respectively.

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Section 3 - Objectives

- 3.1 The main objective of the Scheme is to hold sufficient and appropriate assets to meet the Scheme's liabilities and statutory obligations as and when they fall due. Over time the Scheme's membership and liabilities are projected to mature with the average period to payment of the liabilities decreasing and the requirement for investment income to pay ongoing pensions becoming an increasing priority. This income requirement will be met from the buy-in policy.
- 3.2 In light of the above, the Trustee has entered into a whole of Scheme buy-in with Legal & General. The policy has not been structured with expected return in mind, but instead aims to broadly match the Scheme's benefit obligations.

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Section 4 - Strategy

- 4.1 The Trustee has entered into a whole of Scheme buy-in with Legal & General. As a result, all of the Scheme's assets are represented by this contract, with the exception of a small amount of Additional Assets held with the Scheme's investment manager.
- 4.2 The Trustee has selected Legal & General as their annuity provider having obtained and considered the written advice of Hymans, whom the Trustee believes to be suitably qualified to provide such advice. The advice received and arrangements implemented are, in the Trustee's opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended). Should anything change that brings into question the suitability of Legal & General the Trustee will take appropriate advice.

Investment Strategy of Additional Assets

- 4.3 The Target Allocation for the Scheme's Additional Assets is 75% held as cash and 25% in Index-Linked Gilts.

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Section 5 - Risk

- 5.1 The Trustee regards risk as any factor that may render the Scheme unable to meet its liabilities or satisfy its funding objectives.
- 5.2 The Trustee has identified a number of risks which have the potential to cause deterioration in the Scheme's funding level and therefore contribute to funding risk. These are detailed in the below table along with control and mitigation.

Risk	Control and Mitigation
Investment risk	<p>The Trustee recognises the following main sources of risk as relevant to their situation in relation to investment:</p> <p>i) The principal risk facing the Trustee and Scheme members is that Legal & General may default on its obligations under the bulk annuity policy. To mitigate this, the Trustee obtained and carefully considered professional advice regarding the financial strength of Legal & General, and concluded that this risk was acceptably low.</p> <p>ii) Lack of diversification. The Trustee recognises that a decision to invest in an annuity contract with a single provider represents a concentration of risk and has addressed this through scrutiny of the provider.</p> <p>iii) Illiquidity. The Trustee does not expect to be able to obtain cash from the bulk annuity policy other than to meet promised benefits as agreed with the provider.</p> <p>iv) Credit risk. The risk that the issuer of a financial asset, such as a bond, fails to make the contractual payments due. The Trustee considers the risk of an issuer defaulting on its debts to be non-material (as the main issuer is the UK government).</p>
Investment Manager risk	The risk that the investment manager underperforms its objectives, fails to carry out operational tasks, does not ensure safe-keeping of assets or breaches agreed guidelines. This risk is addressed through regular manager performance monitoring by the Trustee.
Demographic risk	The risk that longevity improves and other demographic factors change increasing the costs of the Scheme benefits. This risk has been addressed by the implementation of the buy-in policy.
Operational risk	<p>The risk of mismanagement of Scheme assets either with intent or due to a lack of knowledge. This risk is primarily addressed by:</p> <p>i) Taking professional advice and considering the appointment of specialist transition managers to help manage the transition risk</p> <p>ii) Regular scrutiny of providers and audit of the operations they conduct for the Scheme</p>
Sponsor risk	The risk of the Principal Employer being unwilling or unable to make the necessary level of contributions in future. The Scheme uses a specialist covenant adviser to carry out regular reviews of the Principal Employer.

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<p>Environmental, Social and Governance (ESG) risk</p>	<p>The risk that ESG factors can have a significant effect on the long-term performance of the assets held. This risk is primarily addressed by ensuring that Environmental (including exposure to climate change risks), Social and Governance factors are incorporated into the investment analysis and decision making process, where relevant.</p> <p>The Trustee’s approach to the consideration of ESG risks and climate risk is set out in Section 6.</p>
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5.3 From 31 December 2016, the Trustee has provided narrative disclosures in the Scheme’s Annual Report and Accounts on the credit and market (currency, interest rate and other price related) risks arising from the investment arrangements of the Scheme.

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Section 6 – Socially Responsible Investment and Corporate Governance

- 6.1 The Trustee has considered the extent to which social, environmental or ethical factors should be taken into account in the selection, retention and realisation of investments but do not take into account the views of individual members on the subject.
- 6.2 The Trustee believes that its duty is to act in the best financial interest of the beneficiaries, and has given investment managers full discretion when evaluating Environmental, Social and Governance issues. The Trustee will review the policies of the investment manager on a triennial basis.

Consideration of financially material factors in investment arrangements

- 6.3 The Trustee recognises that the consideration of financially material factors, including ESG factors, needs to be assessed in the context of the long-term nature of the Scheme's investments and is relevant at different stages of the investment process. Furthermore, the Trustee expects the investment manager to take account of all the relevant financially material factors, including the potential impact of ESG factors, in the implementation of the investment mandate.

Strategic Considerations

- 6.4 The Trustee has entered into a bulk annuity contract with Legal & General. The policy has not been structured with expected return in mind, but instead aims to broadly match the Scheme's benefit obligations. A small amount of additional assets remains invested in an index linked gilt and cash fund.

Given the nature of the contract and the way the additional assets are invested; the Trustee has not made explicit allowance for the risks of climate change in setting their strategic benchmark.

Selecting Investment Managers

- 6.5 The Trustee has delegated responsibility for the management of the Scheme assets to the investment manager. If the Trustee was to select new investment managers for the Scheme, the Trustee would consider potential managers' approaches 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-financial factors in investment arrangements

- 6.6 The Trustee has not imposed any restrictions or exclusions to the investment arrangements based on non-financial factors.

Stewardship, Voting and Engagement

- 6.7 Since the Trustee is invested in an annuity contract a cash and index linked gilt funds, stewardship and voting are not considered relevant to their circumstances. As the Scheme invests in pooled vehicles, the Trustee understands that engagement activity is undertaken in line with the stated policies of the investment manager.

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Section 7 – Investment Manager Arrangements

How the arrangements with the Investment Manager ("Manager") incentivises them to align its investment strategy and decisions with the trustees' policies

- 7.1 Managers are appointed based on their capabilities and, therefore, their perceived likelihood of achieving the expected return and risk characteristics required for the asset class they are selected to manage.
- 7.2 As part of this, the Trustee undertakes due diligence¹ ahead of investing and the views of its investment advisers are sought to support decisions around selection and retention. Should the Manager make changes to any of these factors, the Trustee will assess their impact and (where no longer aligned) consider what action to take.

How the arrangements incentivise the Manager to make decisions based on assessments of medium to long-term financial and non-financial performance of an issuer

- 7.3 The Trustee will meet with the Manager as deemed appropriate, to discuss performance and other investment related matters (e.g. integration of ESG and climate change into the investment process, etc), and will challenge decisions that appear out of line with the stated objectives and/or policies.
- 7.4 The Manager is aware that their ongoing appointment is based on their success in delivering the mandate for which they are appointed over the long term. Consistent periods of underperformance could lead to termination.

How the method (and time horizon) of the evaluation of the Manager's performance and the remuneration for asset management are in line with the policy of the Trustee

- 7.5 The Trustee reviews the performance of the Manager on a regular basis versus agreed benchmarks and targets, over multiple time periods, with an emphasis on the long-term. The Manager is remunerated by way of a fee calculated as a percentage of assets under management (an 'ad valorem' fee).

How the Trustee monitors portfolio turnover costs and how they define and monitor it

- 7.6 The Trustee periodically considers portfolio turnover costs with the Manager in absolute terms and relative to what might be reasonably expected given the underlying asset class(es) and investment style of the manager. The Trustee does not define set ranges in respect of portfolio turnover and costs as it prefers to assess performance after all trading costs have been taken into account.

Duration of arrangement with Managers

- 7.7 As the Trustee is a long-term investor, it does not expect to make changes to the Managers on a frequent basis. As the Scheme only invests in open-ended vehicles, the Trustee expects to retain them unless:
- There is a strategic change to the overall strategy that no longer requires exposure to that asset class or manager;
 - The Manager appointment has been reviewed and the Trustee has decided to terminate the mandate.

¹ Includes but not limited to: the underlying assets held and associated risks, steps taken to mitigate them, the expected return and liquidity details and impact of financial and non-financial factors e.g. ESG and climate change) over the long term.

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