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Section 1 – Introduction

1.1 This Statement of Investment Principles (“SIP”) has been prepared by BAE Systems Pension Funds Trustees Limited (the “Trustee”) of the BAE Systems Pension Scheme Airbus Section (“Scheme”) in accordance with the Pensions Act 1995 (as amended) and the Occupational Pension Schemes (Investment) Regulations 2005 (as amended).

1.2 This DB Statement of Investment Principles sets out the Trustee’s policies for investment of assets held for the purpose of providing defined benefits under the Scheme. The Trustee’s policies for investment of assets representing members’ money-purchase or defined contribution benefits are set out in the Trustee’s DC Statement of Investment Principles. That DC SIP and this DB SIP together comprise the Statement of Investment Principles for the Scheme required by section 35 of the Pensions Act 1995.

1.3 The Scheme’s investment arrangements, based on the principles set out in this SIP, are described in detail within the Investment Policy Implementation Document (“IPID”).

1.4 In preparing this SIP the Trustee has consulted Airbus Operations Limited (the “Principal Employer”), and obtained written investment advice. 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 it reviews this SIP. The Trustee has also obtained legal advice for this review.

1.5 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.

1.6 The Trustee’s investment responsibilities are governed by the Scheme’s Rules and this SIP takes full account of its provisions. A copy of the Rules is available for inspection by members, upon request.

1.7 The Trustee strives to ensure that the investment policies and their implementation are in keeping with the law (including the PA95 and the Investment Regulations) and best practice, including the Myners principles first published in 2001 and revised in 2008.

1.8 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 after any significant change in investment policy.

1.9 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.

1.10 Both the SIP and the IPID need to be reconfirmed on an annual basis with the Principal Employer.
Section 2 - Governance

2.1 The Trustee has ultimate responsibility for decision making on investment matters. The Trustee has agreed that all strategic policy decisions on investments will be taken by the Trustee Board after in depth consideration by the Funding & Investment Committee ("FIC") and following receipt of appropriate advice.

2.2 The Trustee has delegated authority for the consideration of investment issues to the FIC which operates within Terms of Reference which are reviewed from time to time by the Trustee. The Trustee believes the FIC has appropriate experience and receives appropriate training in order to make informed decisions. The FIC formally considers its effectiveness as a committee on an annual basis.

2.3 The Trustee has appointed BAE Systems Pension Funds Investment Management Ltd (BAPFIM) to be its principal investment manager and to give it investment advice. Where conflicts are identified, the FIC considers how these are managed and whether independent advice is required.

2.4 Day to day investment decisions both within the Common Investment Fund ("CIF") and in relation to assets held outside the CIF have been delegated to BAPFIM and a number of external investment managers in accordance with guidelines agreed with the Trustee. The investment managers are authorised and regulated by the Financial Conduct Authority or an equivalent regulatory authority, and are responsible for the management of the underlying investments.

2.5 Each of the investment managers' fees, with the exception of BAPFIM, are related to the amount of assets managed within their portfolio and in certain cases, the amount of performance generated relative to a benchmark. Minimum fees may also apply in some cases. BAPFIM charges its costs to the Scheme on a pro rata basis based on the total assets under management.

2.6 A minority of the Scheme's assets are invested via a Common Investment Fund (with its own Rules), a unitised structure consisting of distinct asset pools comprising pooled investment funds and direct holdings. Each pool is managed separately and has its own set of objectives, guidelines and restrictions. The board of directors of BAE Systems Pension Funds CIF Trustees Ltd ("CIF Trustee") is responsible for the governance of the CIF. The CIF has also appointed BAPFIM to be principal investment manager. The completion of the Scheme mergers in October 2019, largely eliminated the benefits of the CIF structure for the Scheme. As a result, there is an ongoing project to gradually transfer assets from the CIF directly into the Scheme. As this project progresses, the Schemes exposure to the CIF will reduce. This project is set to conclude in 2021.

2.7 Illiquid assets of the BAE Systems Pension Scheme held outside the CIF at the time of sectionalisation in April 2016 are held by the Trustee for both the BAE Systems and the Airbus Section in specified proportions.

2.8 The Custodian is responsible for the safekeeping of the Scheme's assets — with the exception of direct property holdings and holdings in collective vehicles, for which appointment of the custodian is the responsibility of the Investment Manager, and illiquid assets (such as limited partnerships held outside the CIF), private placements, certain loans derivative contracts etc.

2.9 An actuarial valuation of the Scheme is performed at least every three years, in accordance with statutory 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 and contributions payable can be found in the Statement of Funding Principles and Schedule of Contributions respectively.
Section 3 - Objectives

3.1 The objective of the Scheme is to hold sufficient and appropriate assets to meet the Scheme’s liabilities as and when they fall due.

3.2 The Scheme provides predominantly defined benefits, but it also provides other money purchase benefits in addition to additional voluntary contributions ("AVCs"). The defined benefits section is closed to new entrants and only existing active members are accruing further benefits.

3.3 Over time the Scheme’s membership and liabilities will 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.

3.4 The Trustee has therefore adopted a maturity driven approach to investments one of the aims of which is to maximise the probability that pension payments will be met in full and on time. This approach aims to achieve a return on the assets which, taken in conjunction with contributions, is sufficient over time to meet the Scheme’s liabilities.

3.5 The Trustee uses Asset Liability Modelling ("ALM") and considers expected returns to assist in setting investment policy. Further details can be found in the implementation framework in the IPID.
Section 4 - Strategy

4.1 The Trustee is required to set the overall investment strategy and has chosen to adopt a maturity driven approach to manage the Scheme’s investments.

4.2 Under this approach the assets in the Scheme have been divided into three broad categories – Growth, Matching Plus, and Matching.

4.2.1 Growth assets: The primary objective of assets in this category is to achieve high total returns to improve the overall performance of the Scheme’s assets and help to reduce the deficit. Similar to the Scheme’s existing return seeking assets, these assets will be exposed to equity risk, credit risk and risks associated with investing in alternative asset classes (as detailed in Section 5).

4.2.2 Matching Plus assets: These assets are expected to provide long-term stable cashflows in order to meet benefit payments as they fall due. They are likely to be held to maturity and may have a range of credit ratings or no formal ratings, but are on average, across the portfolio, will be BB+ rated. They are expected to generate higher returns than Matching.

4.2.3 Matching assets: The main characteristic for this category is secure return in order to meet benefit payments as they fall due. These assets will be of investment grade or above and, on average, have higher credit quality than Matching Plus with minimal default probability. These assets are expected to have a reasonable amount of liquidity, taking account of the specific needs of the Scheme.

4.3 Allocation of assets

The Trustee agreed a journey plan to reduce investment in Growth assets and increase investment in Matching and Matching Plus as the Scheme matures. The current investment parameters are broadly 31.3% in Matching, 20.0% in Matching Plus and 48.7% in Growth and the target allocation is 65% Matching, 25% Matching Plus and 10% in Growth by around 2037.

4.4 Realisation of assets

The Trustee's policy is that, where practicable, there will be sufficient investments in liquid or readily realisable assets to meet cashflow requirements in foreseeable circumstances so that the realisation of assets will not disrupt the Scheme’s overall investments. The Trustee, together with BAPFIM and the Scheme administrators, have a cashflow management policy in place and will also hold a balance of cash to help meet unanticipated benefit and other payment obligations.

4.5 Investment objectives

The table below sets out guidelines for BAPFIM to follow in implementing the Trustee’s investment strategy.

| Overall investment objective: To invest the assets so that taking capital, income and contributions together the Scheme’s assets are sufficient to meet its liabilities and statutory funding obligations. |
|---|---|---|---|
| Investment parameters | Growth assets | Matching Plus assets | Matching assets |
| Expected returns (p.a.) | Gordon growth model* | 50% (RPI + 1.5%) + 50% of 5.25% | 25% gilts + 25% swaps + 50% corporate bonds |
| Average term | NA | 8 years | In line with average scheme duration |
Gordon Growth Model: The Gordon Growth Model is a method for calculating the value of equities. This is the formula that was used to set the expected return on the growth assets within the discount rate agreed as part of the 2017 triennial actuarial valuation. The formula is set out below:

Current Dividend yield + Consumer Price Index inflation + real GDP growth

4.6 The day-to-day management of the Scheme’s assets is delegated to one or more investment managers as set out in the IPID.

4.7 The Trustee reviews the appropriateness of the Scheme’s investment strategy on an ongoing basis. This review includes consideration of the performance of the relevant pools within the CF and the performance of managers of assets held outside the CIF against any guidelines or benchmarks set. The Trustee must also consult the Principal Employer before amending the investment strategy.
Section 5 - Risk

5.1 The Trustee regards risk as any factor that may render the Scheme unable to meet its obligation to pay benefits as they fall due and/or its ongoing statutory funding obligations.

5.2 The Trustee has identified examples of its key risks which are set out in the below table along with control and/or mitigation in place. Please note that the Trustee also maintains a detailed risk register.

<table>
<thead>
<tr>
<th>Risk</th>
<th>Control and Mitigation</th>
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<tbody>
<tr>
<td>Investment Risk</td>
<td>The risk that the Scheme assets fail to deliver the returns expected. This risk is primarily addressed by: i) adopting an investment strategy where the strategic asset allocation evolves in line with the Scheme’s liabilities such that the cashflows from the assets provide a greater match for the expected benefit payments as the Scheme matures ii) setting risk tolerances around the strategic asset allocation to provide sufficient flexibility to the investment manager/(s) iii) ensuring the investment managers have in place appropriate policies setting out how they manage asset risks including concentration risk, default risk, illiquidity risk, currency risk, counterparty risk, active management risk iv) utilising investment tools and strategies which aim to deliver returns in a risk controlled manner, this includes the use of liability hedging techniques v) Ensuring BAPFIM has in place a policy for assessing the credit risk of assets which do not have a credit rating readily available in the market and a policy for allocating assets between the three asset classes vi) regularly monitoring investment performance using a range of risk and return metrics and taking appropriate action vii) regularly monitoring ongoing appropriateness of investment managers and selected CIF pools and taking appropriate action viii) That derivatives can only be used for efficient portfolio management or risk management and not for speculative purposes.</td>
</tr>
<tr>
<td>Demographic risk</td>
<td>The risk that longevity improves and other demographic factors change increasing the costs of the Scheme benefits. This risk is primarily addressed by: i) keeping informed about tools aimed specifically at managing these risks ii) keeping mortality and other demographic assumptions under review and considering and revising them as appropriate explicitly at each formal valuation</td>
</tr>
<tr>
<td>Liquidity risk</td>
<td>The risk of the Scheme not having sufficient liquid assets to allow it to meet benefit payments as they fall due. This risk is addressed through BAPFIM having a cashflow management policy. The Trustee also monitor the level of transfer value and other benefit activity and considers this as it impacts the levels of cash required.</td>
</tr>
<tr>
<td>Operational risk</td>
<td>The risk of mismanagement of Scheme assets either with intent or due to a lack of knowledge. This risk is primarily addressed by: i) using global custodians for the physical custody of assets who are not also managers of assets ii) taking professional advice and considering the appointment of specialist transition managers to help manage the transition risk</td>
</tr>
<tr>
<td>Risk Category</td>
<td>Details</td>
</tr>
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<td>--------------------------------------------------</td>
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<tr>
<td>iii) regular scrutiny of providers and audit of</td>
<td>The Trustee is insured against losses resulting from third party errors to the extent that the Trustee is unable to obtain full redress from the third party.</td>
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<tr>
<td>the operations they conduct for the Scheme</td>
<td></td>
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<tr>
<td>Sponsor risk</td>
<td>The risk of the Principal Employer being unable to make the necessary level of contributions in the future. The Scheme uses a specialist covenant adviser to carry out regular reviews of the Principal Employer. The Principal Employer reports on its financial results to the Trustee Board twice a year. The Trustee monitors key metrics in relation to the strength of the covenant of the Principal Employer every quarter and takes appropriate action in response to any adverse developments. Investment in employer related investments of Airbus Group is limited to a maximum of 5% of the market value of assets at any given time as required by section 40 of the Pensions Act 1995 and Occupational Pension Schemes Investment Regulations 2005. In addition, in relation to investment in the equity of Airbus Group, the Scheme has imposed a restriction which only permits investment in line with the proportion of shares of the Airbus Group within the FTSE All Share index 5% Capped.</td>
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<tr>
<td>Environmental, Social and Governance (&quot;ESG&quot;)</td>
<td>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 (&quot;ESG&quot;) factors are incorporated into the investment analysis and decision making process. The Trustee’s approach to the consideration of ESG risks and climate risk is set out in Section 6.</td>
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<td>risk</td>
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Section 6 – Socially Responsible Investment and Corporate Governance

6.1 The Trustee’s objective is to ensure the Scheme holds sufficient and appropriate assets to meet its obligation to pay benefits as they fall due and meet its statutory funding obligations.

6.2 Within the context of this objective, The Trustee considers the extent to which Environmental (including climate change), Social and Governance (ESG) factors should be taken into account in the selection, retention and realisation of investments.

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 that BAPFIM and external Investment Managers take account of all the relevant financially material factors, including the potential impact of ESG factors, in the implementation of the investment mandate and in the selection, retention and realisation of investments.

Strategic Considerations

6.4 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.

Given the inherent uncertainty, the Trustee has not made explicit allowance for the risks of climate change in setting their strategic benchmark.

Selecting Investment Managers and selection of direct investments with regard to ESG factors

6.5 The Trustee has delegated responsibility for the management of the Scheme assets to BAPFIM. In selecting new investment managers for the Scheme, BAPFIM, on the Trustee’s behalf, considers 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.

For Private Markets and unquoted assets, as part of the on boarding process, BAPFIM, on behalf of the Trustee, ask the fund relationship managers to confirm adherence to the UK Bribery Act and the BAE Systems Code of Conduct and conduct background checks on key principals using a specialist third party provider.

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 including member views.

Stewardship, Voting and Engagement

6.7 The Trustee recognises that stewardship encompasses the exercise of voting rights and engagement with investee companies (directly or via investment managers) in relation to various matters relevant to the long term performance of an investment, including their performance, strategy, capital structure and consideration of how they manage actual and potential conflicts of interest, as well as the monitoring of compliance with agreed policies. It has examined the issues in relation to corporate governance and on the exercise of voting rights. It recognises that good corporate governance creates the framework within which a company should be managed. The ultimate purpose of the Trustee’s duty of stewardship is to preserve
and enhance the long-term investor value and the Trustee understands that by actively engaging with financially material factors, which include ESG issues, contributes to identifying both investment opportunities and risks.

6.8 The BAE Systems Pension Scheme Trustee and the CIF Trustee have, in relation to quoted equity, delegated to Hermes Equity Ownership Service ("EOS") the exercise of voting rights on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value having regard to environmental, social and governance factors. Their role is to vote in accordance with the stated policy and engage with companies to ensure that companies follow the adopted policies.

6.9 Hermes EOS supports the BAE Systems Pension Scheme Trustee and the CIF with managing this matter in relation to the equity holding. If this were to change then appropriate written guidelines of processes and practices would need to be produced by the managers.

6.10 The Trustee delegates engagement activities with issuers of debt and private market investments to BAPFIM.

Monitoring

6.11 BAPFIM, on behalf of the Trustee, consider ESG (including climate change risks) when monitoring investments and carrying out its regular reviews and meetings with external managers.

6.12 The Trustee meets with BAPFIM on a periodic basis. In conjunction with BAPFIM, the Trustee agrees an agenda for discussion, which, where appropriate, may include ESG issues. Where considered appropriate, BAPFIM are challenged directly by the Trustee and their advisers on the impact of any significant issues that may affect the prospects for return from the portfolio.
Section 7 – Arrangements with investment managers

The Trustee appoints BAPFIM to implement the Scheme’s investment strategy, as detailed in the IPID, within the terms of an investment management agreement (the “IMA”). The targets and objectives for BAPFIM are set to align with the Trustees investment policies. And the Trustees, utilising detailed quarterly control panels, regularly monitor and review the effectiveness of BAPFIM against these objectives.

BAPFIM manages investments directly on behalf of the Trustee as well as having the delegated authority to appoint, monitor and change the Trustee’s external investment managers.

7.1 BAPFIM is a wholly owned subsidiary of the Principal Employer. The Trustees believe that on the basis that BAPFIM does not provide services to other clients, it has no conflicting duties or arrangements in place. The investment strategy and decisions made by BAPFIM will align with the Trustee’s investment policies. As the Principal Employer has representation on the board of BAPFIM, it is conceivable that conflicts of interest may arise for example, ESG views may differ between the Trustee and the company, or views regarding the appropriate level of investment risk to be taken may differ. Where conflicts are identified, the FIC considers how these are managed and whether independent advice is required.

7.2 The Trustee has an obligation to pay benefits as they fall due, its objective is to hold sufficient and appropriate assets to meet the Scheme’s liabilities as and when they fall due and meet its statutory funding obligation. The Trustees have adopted a maturity driven approach to investments. This approach aims to achieve a return on the assets which, taken in conjunction with contributions, is sufficient over time to meet the Scheme’s long-term liabilities. The Trustees expect BAPFIM to make decisions based on assessments about medium to long-term financial performance of an issuer of debt or equity and to engage with issuers of debt or equity in order to improve their, and thereby the Scheme’s performance in the medium to long-term. (And is incentivised to do so through the targets and objectives that are set for BAPFIM).

7.3 BAPFIM is run on a not for profit basis, and the Trustee intends that BAPFIM will continue to manage investments and external managers on behalf of the Trustee on a continuous basis.

7.3.1 BAPFIM employees are rewarded by a market related salary and a performance related bonus (assessed by reference to the targets and the objectives which have been set for BAPFIM). The Trustees believe that the targets and the objectives set for BAPFIM are sufficient to align BAPFIM to the needs of the Scheme and the Trustee’s policies in relation to the selection and balance of investments, the management of risk, return on and realisation of investments, and responsible investment and stewardship activities.

7.3.2 The Trustee has processes in place to review and monitor the services, performance and fees of BAPFIM regularly. The FIC reviews the performance of BAPFIM, the investment strategy overall and individual mandate investment performance. BAPFIM’s targets and objectives are set out in the IPID, which reflect the Trustee’s investment policies. The Trustee receives regular and detailed performance and risk reporting against these targets at an overall level and for significant individual investment mandates, across both public and private markets. BAPFIM conduct regular review meetings which focus on performance, process and governance with the individual investment managers and partners it utilises to facilitate the delivery of the investment strategy.

7.3.3 BAPFIM appoints and has processes in place to review external managers on behalf of the Trustee, including performance reviews, manager oversight meetings and operational due diligence reviews. The method and time horizon for evaluating and remunerating external managers is determined by
policies set by BAPFIM, rather than the Trustee. For example the majority of the externally managed active equity mandates have a target to outperform their benchmark by 2% annualised over a three year rolling period. The performance of the externally managed Property and US High Yield mandates are measured over longer time periods. BAPFIM undertakes periodic reviews of all external managers. These reviews incorporate benchmarking of performance and fees, with some managers on performance-related fees. On appointment or commitment to a new fund, BAPFIM reviews the governance structures of external managers and assesses whether their fees and expenses are in line with industry peers and also seeks assurances from the external managers of its private market fund investments, that the remuneration of key personnel is appropriately structured and aligned to incentivise investment performance over the long term.

7.4 The Trustee does not have a set definition of portfolio turnover costs or targeted turnover levels as it prefers to assess performance after all trading costs have been taken into account. However, the Trustee is developing processes to review the investment holding turnover costs incurred by BAPFIM and its external managers via reporting provided to the Trustee’s FIC on an annual basis. BAPFIM will develop standardised templates and reporting to ensure that an effective monitoring framework is in place to oversee the turnover costs incurred by BAPFIM and its external managers.

7.5 The duration of the agreement with BAPFIM is intended to be indefinite, however both parties are able to terminate the agreement by following the guidelines covered in section 26 of the IMA.

7.5.1 BAPFIM do not set a minimum tenure for external managers to demonstrate their ability to deliver to expectations. In practise if a manager is following the philosophy and process described and agreed ahead of selection and the investment returns produced are in line with agreed and articulated risk budgets, then BAPFIM would tend to give these managers a number of years to prove themselves. If an external manager underperforms consistently over a five year period then BAPFIM will typically instigate a detailed review of their performance with a view to replacing the manager if deemed necessary. BAPFIM, on behalf of the Trustees, can remove a manager at any point in time, having given the required notice as agreed in the IMA between the parties, if believed appropriate to do so, or for example if there is a wider strategic change. Some external managers are appointed to manage private market investments, which often have a fixed term duration, agreed at the outset of the investment.
Section 8 – Additional Voluntary Contributions

8.1 The Scheme also provides a facility for members to pay Additional Voluntary Contributions ("AVCs") to enhance their pensions at retirement.

8.2 Assets in respect of members’ AVCs are invested in a range of investment options.

8.3 The Trustee believes that members have differing investment needs and that these may change during the course of members’ working lives. They also recognise that members have different attitudes to risk.

8.4 As a consequence, the Trustee believes that members should make their own investment decisions based on their individual circumstances. The Trustee therefore regards their duty as making available a range of investment options sufficient to enable members to tailor their investment strategy to their own needs. For the avoidance of doubt, all AVCs are invested separately on behalf of each member.

8.5 AVC arrangements are reviewed periodically to ensure that the investment profile of the funds remain consistent with the objectives of the Trustee and the needs of the members.

8.6 Full details regarding the Trustee’s investment policies covering the open AVC arrangements with Standard Life are provided within a separate DC SIP.
Signatures

Signed for and on behalf of BAE Systems Pension Funds Trustees Limited, Trustee of the BAE Systems Pension Scheme.

**Signature Redacted**

Andrew Gallagher, Chair of the Trustees

24 September 2020

Signed for an on behalf of Airbus Operations Limited

**Signature Redacted**

Mark Stewart, Head of Data Protection, Social Policies, Industrial Relations and Environmental Health and Safety - Airbus

24 September 2020