Babcock International Group Pension Scheme

Statement of Investment Principles – June 2020

1. Introduction

The Babcock Pension Trust Limited ("the Trustee") of the Babcock International Group Pension Scheme ("the Scheme") has drawn up this Statement of Investment Principles ("the Statement") to comply with the requirements of the Pensions Act 1995 ("the Act") and subsequent legislation. The Statement sets out the investment principles that govern decisions about the Scheme's investments.

In preparing this Statement, the Trustee has consulted[1] Babcock International Group PLC ("the Sponsoring Company") to ascertain whether there are any material issues of which the Trustee should be aware in agreeing the Scheme's investment arrangements.

The Scheme provides two types of benefit, one linked to final salary (the "Defined Benefit (DB) Section") and the other is a money purchase arrangement (the "Defined Contribution (DC) Section"). These are covered separately in this Statement in Sections 3 and 4 respectively.

In preparing this Statement, the Trustee has considered written advice on the DB Section received from the Scheme's investment adviser, Mercer Ltd., and on the DC Section from the Scheme's investment adviser, Towers Watson Limited. Both are considered to be suitably qualified and are authorised under the Financial Services and Markets Act 2000 (as amended). 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).

2. Process For Choosing Investments

The process for choosing investments is:

- The Trustee identifies appropriate investment objectives and considers its own investment beliefs.
- The Trustee sets the investment strategy based on a level of risk that is consistent with meeting the Scheme's objectives.
- The Trustee is responsible for the investments of the Scheme. However, the implementation of the investment strategy determined by the Trustee has been delegated to the Scheme's Investment Committee ("IC").

For the Defined Benefit Section, the Babcock IC has been created in order to ensure that investment matters receive a sufficient degree of attention. Its responsibilities are set out in its Terms of Reference, under which the Babcock IC operates. The Babcock IC will regularly monitor the performance of appointed investment managers and the

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[1] *Consultation will be via minuted discussions at the Investment Committee or Trustee meeting for minor revisions, for more significant changes consultation will be in writing.*

continued appropriateness of the asset classes used by the Scheme to achieve the investment objectives.

For the Defined Contribution Section, the Defined Contribution Committee ("DC Committee") has been created to manage its operation under the oversight of the Trustee. Its responsibilities are set out in its Terms of Reference, under which the DC Committee operates.

The Trustee sets formal performance objectives for its investment advisers (for the DB and DC sections) and these objectives are subject to regular monitoring by the Babcock IC and the DC Committee respectively.

3. Defined Contribution Section

3.1 Investment Objectives

The Trustee recognises that members have differing investment needs and that these may change during the course of members' working lives. The Trustee also recognises that members have different attitudes to risk. The Trustee believes that members should make their own investment decisions based on their individual circumstances but acknowledges that few members do take active decisions regarding their investments.

The following encapsulates the Trustee's objectives:

- To make available a range of investment funds that enable members to tailor their own investment strategy to meet their own personal and financial circumstances.
- Offer funds that facilitate diversification and long term capital growth (i.e. in excess of price and wage inflation) in order to maximise the value of members' assets.
- Offer funds that enable members to reduce risk in their investments as they approach retirement. Specifically, make available investments that provide protection for members' accumulated assets against sudden (and sustained) reductions in capital values or in the amount of pension that can be purchased.
- Offer funds that provide members good value-for-money both in terms of financial cost and administrative, operational and other relevant features.
- To restrict the number of funds to avoid unnecessarily complicating members' investment decisions.
- To provide a default investment option for members who do not make their own investment decisions.
- To offer funds that appropriately reflect the Trustee's investment beliefs.

The Trustee is responsible for deciding the range of funds to offer, but has no influence on how the investment managers choose the underlying investments within the funds as the assets are pooled with many other investors to obtain economies of scale. Nevertheless, notwithstanding how the assets are managed, the Trustee has taken investment advice regarding the suitability of the relevant investment vehicles.

The Trustee regularly obtains professional advice and through the DC Committee monitors and reviews the suitability of the funds provided. The DC Committee may change the managers or investment options.

The Trustee prepares a Chair's Statement on an annual basis for the DC section of the Scheme. Amongst other things it covers the Trustee's assessment of the Scheme's default fund and the charges and costs associated with all the funds available for members. A copy can be accessed at www.myoneday.co.uk

3.2 Risk

The Trustee has considered risk from a number of perspectives. These are:

- *Risk of capital loss in nominal terms.* The protection of capital, over at least the medium-term (i.e. periods over 3 years), is fundamental in supporting the long-term growth of the members' individual accounts.

- *Risk of erosion by inflation.* If investment returns lag inflation over the period of membership, the real (i.e. post inflation) value of the members' individual accounts will decrease.

- *Annuity pricing risk.* This refers to the risk of a downturn in markets in the period leading up to retirement resulting in a reduction in the amount of pension that can be purchased.

- *Conversion risk.* The risk arising from market movements, relative to a member's retirement objective (i.e. annuity purchase, cash lump sum, etc.)

- *Market risk.* The value of securities, including equities and interest bearing assets, can go down as well as up. Members may not get back the amount invested. However, the Trustee realises that this risk is implicit in trying to generate returns above that earned by cash and accepts this by investing in assets other than cash.

  - *ESG risk.* See section 7 for the Trustee's overall view on ESG. With regard to the DC funds the Trustee writes periodically to the Fund managers to assess how they meet the Trustee's principles.

- *Liquidity risk.* The Scheme must be able to meet its liabilities as and when they become due. Members invest in a range of pooled investment vehicles that facilitate the availability of assets to meet benefit outflows.

The Trustee has considered these risks when setting the Investment Strategy and ultimately when choosing the funds to make available to members as detailed in the following section.

3.3 Investment Strategy

The Trustee believes, having taken expert advice, that it is appropriate to offer a range of investment funds to allow members to tailor their own investment strategy if they wish. Other members may prefer to use the packaged Lifestyle strategies or to remain in the default option.

3.3.1 Lifestyle Strategies (including default)

The Trustee recognises that, while the fund range should help members choose funds, from an administrative and practical perspective there is merit in providing a default option and self-select Lifestyle strategies for members who are unlikely to want to make their own choice of funds. With the introduction of auto-enrolment there is also a requirement to have a default option available. The Trustee has decided that this default should take the form of Lifestyle strategies which are also available for members to choose deliberately. In reviewing the default, the Trustee gave due consideration to the profile of the Scheme membership and its likely needs in accordance with the Pensions Regulators Code of Practice.

All the Lifestyle strategies progressively and automatically switch members from higher risk/higher returning funds to lower risk/lower returning funds as the member approaches their selected retirement date.

The Trustee has decided to offer the following Lifestyle strategies to members:

Target Lump Sum – for members likely to draw the whole pot as cash at retirement (default option).

Having taken appropriate advice, the Trustee has decided that the Target Lump Sum (default) Lifestyle strategy will be:

- Invested in the Global Equity Fund until 20 years before retirement
- Gradually switched from the Global Equity Fund to the Diversified Growth Fund for the period from 20 to 10 years before retirement
- Invested in the Diversified Growth Fund for the period 10 to 5 years before retirement
- Gradually switched to hold 40% in the Diversified Growth Fund and 60% in the Money Market Fund over the final five years before retirement.

The expected return of the fund is to achieve returns similar to the underlying funds and their respective benchmarks set out in section 4.3.2

The Trustee and DC Committee will review the appropriateness of the default option periodically.

Target Flexibility – for members likely to facilitate drawdown of capital at retirement (self-select option).

Having taken appropriate advice, the Trustee has decided that the Target Flexibility Lifestyle strategy will be:

- Invested in the Global Equity Fund until 20 years before retirement
- Gradually switched from the Global Equity Fund to the Diversified Growth Fund for the period from 20 to 10 years before retirement
- Invested in the Diversified Growth Fund for the period 10 to 5 years before retirement

- Gradually switched to hold 70% in the Diversified Growth Fund, 20% in the Target Level Annuity Fund and 10% in the Money Market Fund over the final five years before retirement.

The expected return of the fund is to achieve returns similar to the underlying funds and their respective benchmarks set out in section 4.3.2.

Target Annuity – for members likely to purchase an annuity at retirement (self-select option).

Having taken appropriate advice, the Trustee has decided that the Target Annuity Lifestyle strategy will be:

- Invested the Global Equity Fund until 20 years before retirement

- Gradually switched from the Global Equity Fund to the Diversified Growth Fund for the period from 20 to 10 years before retirement

- Gradually switched to hold 50% in the Diversified Growth Fund and 50% in the Target Level Annuity Fund for the period from 10 to 5 years before retirement

- Gradually switched to hold 75% in the Target Level Annuity Fund and 25% in the Money Market Fund over the final five years before retirement.

The expected return of the fund is to achieve returns similar to the underlying funds and their respective benchmarks set out in section 4.3.2.

The Trustee is aware that no default fund or Lifestyle strategy can be appropriate for all members because of their varying needs and attitudes to risk. The Trustee would therefore encourage members to make their own investment decisions.

3.3.2 Additional single asset class fund options

The Trustee has decided to offer the following funds to self-select members:

Funds	**Benchmark**
Emerging Market Equity Fund	MSCI Emerging Markets
Global Equity Fund	10% FTSE All-Share Index 75% FTSE All-World Developed (ex UK) Index 15% MSCI Emerging Markets
Diversified Growth Fund	60% MSCI World, 40% iBoxx £ Non-Gilts
Target Increasing Income Fund	FTSE UK Gilts Index-Linked Over 5 Years Index
Target Level Income Fund	60% iBoxx Sterling Non-Gilts, 40% FTSE A Gilts Over 15 Years

Shariah Fund	Dow Jones Islamic Market Titans 100 Index
Stewardship Fund	FTSE All-Share Index
Money Market Fund	7 Day GBP LIBID

Day-to-day management of the assets is at the discretion of the managers of the pooled funds.

Members should not make investment decisions on the basis of this document.

The Trustee believes that this strategy meets the investment objectives outlined in section 4.1 and controls the risks identified in section 4.2.

4. Day-to-Day Management of the Assets

The day to day management of the assets has been delegated to a number of investment managers. The Babcock IC and DC Committee have taken steps to satisfy themselves that the managers have the appropriate knowledge and experience for managing the Scheme's investments and that they are carrying out their work competently.

For the DB section assets, the Babcock IC has determined, based on expert advice, a benchmark mix of asset types and ranges within which each appointed investment manager may operate.

The Babcock IC and DC Committee regularly review the continuing suitability of the Scheme's investments, including the appointed managers and the balance between active and passive management, which may be adjusted from time to time and reported to the Trustee. However, any such adjustments would be done with the aim of ensuring the overall levels of risk and return are consistent with those being targeted by the Trustee.

5. Additional Assets

Additional Voluntary Contributions ("AVCs") are invested in the same fund options as the Defined Contribution arrangements through a bundled arrangement with Aviva. In addition, a small number of members retain investments with Utmost Life & Pensions (previously via policies with Equitable Life) although these are expected to move to Aviva within the next 6-12 months.

6. Realisation of Investments

The investment managers have discretion in the timing of realisation of investments.

For the DB section the Babcock IC monitors the allocation between the appointed managers and between asset classes.

7. Responsible Investment and Corporate Governance

The Trustee believes that environmental, social, and corporate governance ("ESG") factors may have a material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration. The Trustee takes a pragmatic approach to ESG issues and considers the materiality in terms of both risk and return.

The Trustee has given appointed investment managers full discretion in evaluating ESG factors, including climate change considerations, and exercising voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code. The Trustee encourages the Scheme's DB and DC managers to comply with the UK Stewardship Code.

The Trustee has communicated to the DB section managers (via the IC) clear expectations that the Scheme's investment managers consider the risks and return opportunities that may arise by considering ESG factors within their overall investment processes. The Trustee (via the DC Committee) undertakes annual ESG monitoring of several of the DC Section managers and will consider how to extend this to other DC Section managers in future.

The Trustee considers how ESG, climate change and stewardship is integrated within investment processes in appointing new investment managers and monitoring existing investment managers.

The Trustee also considers the investment adviser's assessment of how each of the DB section investment managers embed ESG into their investment process and how the managers' responsible investment philosophy aligns with the Trustee's responsible investment policy. This includes the investment managers' policy on voting and engagement. The Trustee will use this assessment in decisions around selection, retention and realisation of manager appointments.

The Trustee can regularly review the decisions made by their managers, including voting history (in respect of equities) and engagement activity, and can challenge such decisions to try to ensure the best long term performance over the medium to long term. In addition, the Trustee carries out regular reviews of the DB managers' ESG policies and actively engages with DB managers to better understand their processes.

Monitoring is undertaken on a regular basis. The Trustee has not currently set any investment restrictions on the appointed investment managers in relation to particular products or activities. Investment managers are aware that their continued appointment is based on their success in delivering the mandate for which they have been appointed to manage. If the Trustee is dissatisfied, then they may look to replace the manager.

Member views are not taken into account in the selection, retention and realisation of investments. DC members have the opportunity to choose from a range of funds which includes an ESG focussed fund and a Shariah fund to allow them to express their views in this regard.

8. Investment Manager Appointment, Engagement and Monitoring

In line with sections 2-3 of the SIP, investment 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 for which they are selected.

DC Section

Alignment between an investment manager's management of the DC Section's assets and the Trustee's policies and objectives is a fundamental part of the appointment process of a new investment manager. As the DC Section only invests in pooled investment funds, the Trustee cannot directly influence or incentivise investment managers to align their management of the funds with the Trustee's own policies and objectives.

However, the Trustee will seek to ensure that, in aggregate, its portfolio is consistent with the policies set out in this Statement, in particular those required under regulation 2(3)(b) of the Occupational Pension Schemes (Investment) Regulations (2005). The Trustee will also seek to ensure that the investment objectives and guidelines of any particular investment fund used are consistent with its own policies and objectives. Furthermore, the Trustee will seek to understand the investment manager's approach to sustainable investment (including engagement).

The Trustee is responsible for monitoring the investment funds and managers. As part of this, the Trustee will provide investment managers with the most recent version of this Statement of Investment Principles (SIP) on an annual basis and ask managers to explicitly confirm whether they believe there is any misalignment between the objectives and guidelines of the fund(s) they manage on behalf of the Plan, or the manager's approach to sustainable investment, and the Trustee's policies as documented in the SIP.

Should the Trustee's monitoring processes reveal that an investment fund's objectives and guidelines, or an investment manager's approach to sustainable investment, do not appear to be sufficiently aligned with the Trustee's policies, the Trustee will engage with the investment manager to ascertain the reasons for this and whether closer alignment can be achieved. If this is not possible the Trustee may look to replace the fund.

The Trustee appoints its investment managers with an expectation of a long-term partnership, which encourages active ownership of the Plan's assets. For most of the DC Section investments, the Trustees expects the investment managers to invest with a medium to long time horizon, and to use their engagement activity to drive improved performance over these periods.

When assessing an investment manager's performance, the focus is on longer-term outcomes, and the Trustee would not expect to terminate an investment manager's appointment based purely on short term performance. However, an investment manager's appointment could be terminated within a shorter timeframe due to other factors such as a significant change in business structure or the investment team

Investment managers are paid a fee expressed as a percentage of assets managed, in line with normal market practice, for a given scope of services which includes consideration of long-term factors and engagement.

The Trustee reviews the costs incurred in managing the Plan’s assets on an annual basis, which includes the costs associated with portfolio turnover. In assessing the appropriateness of the portfolio turnover costs at an individual investment manager level, the Trustee will have regard to the actual portfolio turnover and how this compares with the expected turnover range for that type of fund.

9. Review of this Statement

The Trustee will review this Statement at least annually and without delay after any significant change in investment policy. Any change to this Statement will only be made after having obtained and considered the written advice of someone who the Trustee reasonably believes to be qualified by their ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of pension scheme investments. The Sponsoring Company will also be consulted regarding any change to this Statement.

10. Compliance with this Statement

The Trustee monitors compliance with this Statement on a regular basis or after any review.

Dated 17 June 2020