STATEMENT OF INVESTMENT PRINCIPLES – SEPTEMBER 2021

ROLLS-ROYCE RETIREMENT SAVINGS TRUST

1. Introduction

The Rolls-Royce Retirement Savings Trust (the “Trust”) is a wholly-insured scheme as defined in Regulation 8 (2) of The Occupational Pension Plans (Investment) Regulations 2005. As a result, the asset held by the Trustee is the policy of insurance issued by the Provider. This Statement of Investment Principles (“SIP”) sets out the required principles governing decisions about the investment options available under this Policy for the Trust and the reasons why it is a wholly-insured scheme. The Pensions Act 1995, and subsequent legislation, requires the Trustee to document matters in the Statement which include the Trustee’s policy to choosing investments, the kinds of investments to be held, the balance between different kinds of investments, risk, the expected return on investments, the realisation of investments, and such other matters as may be prescribed.

Before preparing this Statement of Investment Principles, the Trustee has consulted with the Employer (Rolls-Royce Plc), and obtained and considered written professional advice from Mercer Limited, the Trust’s investment consultants, regarding the Trust’s investment strategy.

2. The Trustee

The Trustee’s investment powers are set out within the Trust’s governing documentation and relevant legislation. If necessary, the Trustee will take legal advice regarding the interpretation of these. The Trustee notes that, according to the law, the Trustee has ultimate power and responsibility for the Trust’s investment arrangements. The Trustee will regularly review the Trust’s investment policies and their implementation against the DC Code of Practice. The Trustee appoints a professional consultant (the “Investment Consultant”) to provide them with relevant advice where necessary. The Trustee also takes advice as appropriate from other professional advisers.

The Trustee remains accountable for the investment of the Trust’s assets, but may delegate some aspects of the investment arrangements. When determining which decisions to delegate, the Trustee has taken into account whether they have the appropriate training and are able to secure the necessary expert advice in order to take an informed decision.

3. Reasons for the wholly insured approach

A wholly-insured scheme is where all the assets (excluding cash held in the Trustee's bank account) are held in one or more qualifying insurance policies. The Trustee, having reviewed the different options available in 2014 and having received the advice of its Investment Advisors, Mercer, continues to consider that a wholly-insured approach is an appropriate arrangement, having regard to the needs of the membership and the preferences of the Sponsoring Company.

This route enables the Trustee to provide Trust members with access to a comprehensive range of investment options that are sufficient to meet the Trustee's objectives (as set out in 4.1 below). These investment options are managed by a number of leading fund managers, via a single contractual relationship with the chosen provider, Aviva (formerly Friends Life), who deliver investment, administration and communications services, for the Trust. Fund switches and manager changes can be processed more efficiently with less risk than through alternative options, and members gain access to a reasonable range of services in addition to the Trust's investment options.

The Trustee will review the continued appropriateness of the wholly-insured approach at least triennially or more frequently if required.

4. Investment Policy

4.1 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 members are responsible for their own investment decisions based on their individual circumstances. However, the Trustee recognises that members may not believe themselves qualified to take investment decisions.

The following encapsulates the Trustee's objectives:

- To make available a range of investment funds and lifestyle strategies that should enable members to tailor their own investment strategy to meet their own individual needs.
- Offer funds and lifestyle strategies which facilitate diversification and long term capital growth.
- Offer funds and lifestyle strategies that enable members to reduce risk in their investments as they approach retirement.
- Offer funds which mitigate the impact of sudden and sustained reductions in capital values or rises in the cost of providing benefits at retirement (cash, annuity purchase or drawdown).
- To structure the range of funds and lifestyle strategies, to provide a suitable number of funds and present this range in a manner which may make it easier for members to make investment decisions.

- To provide a default investment option for members until they make their own investment decisions.

The Trustee is responsible for deciding the range of funds and lifestyle strategies to offer to members. In determining what types of funds and lifestyle strategies are offered, the Trustee has taken investment advice regarding the suitability of investment vehicles considering factors such as: the asset class (or classes), the level of diversification and the nature of the investment objectives.

However, the Trustee has no influence over the investment aims of each fund used or how the investment managers choose the underlying investments within each fund, as the assets are pooled with many other investors to obtain economies of scale. Nevertheless, notwithstanding how the assets of each fund are managed, the Trustee regularly obtains professional advice to monitor and review the suitability of the funds provided and from time to time may change the managers or investment options.

The Trustee takes account of what it considers 'financially material considerations'. The above, as well Section 4.3 (Risk), sets out the Trustee's policies in relation to financially material considerations. The Trustee believes the appropriate time horizon for which to assess these considerations within should be viewed at a member level. This will be dependent on the member's age and when they expect to retire.

4.2 Environmental, Social and Corporate Governance (ESG) including Climate Change

The following encapsulates the Trustee's ESG beliefs:

- The Trustee believes that environmental, social, and corporate governance factors can 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 require explicit consideration within the investment decision making process.

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. Managers are also expected to be signatories to the United Nations-supported Principle for Responsible Investment (PRI) unless a suitable reason is provided for not being. As the assets of the Trust are invested in wholly insured arrangements with investments in pooled vehicles the Trustee accepts that the assets are subject to the investment fund managers' own policies in this area.

The Trustee considers how ESG, climate change and stewardship is integrated within investment processes when appointing new investment managers and monitoring existing investment managers. The Trustee has set a target that all equity investment managers be highly rated by Mercer for ESG integration and active ownership with a minimum rating of ESG3 or better, where possible. Monitoring is undertaken on a regular basis and is documented at least annually. The Trustee does not take into account ethical views when choosing the funds available to members and in the investment strategies. However, the Trustee does offer a specific ethical fund in the self-select fund range.

The Trustee will engage with the provider and the investment managers as appropriate, and will ask investment managers to include appropriate risk metrics within their portfolio reporting within the framework of the Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD).

The Trustee also periodically reviews the appropriateness of offering individual ESG or sustainable investment choices available to members.

4.3 Implementation and Engagement Policy

4.3.1 Aligning Manager Investments Strategy and Decisions with Trustee's policies

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 being selected. These characteristics will differ for each asset class so appointing a single manager is unlikely to be the most appropriate approach.

The Trustee will seek guidance from the Investment Consultant, where appropriate, for their forward looking assessment of a manager's ability to outperform over a full market cycle. This view will be based on the Investment Consultant's assessment of the manager's idea generation, portfolio construction, implementation and business management, in relation to the particular investment fund that the Plan offers to its members. The Investment Consultant's manager research ratings assist with due diligence and are used in decisions around selection, retention and realisation of manager appointments. The manager ratings are incorporated into the Trustee's monitoring reports,

The Trustee will review an appointment if the investment objective for a manager's fund changes to ensure it remains appropriate and consistent with the Trustee's wider investment objectives.

The Trustee invests in pooled investment vehicles so they accept that they have no ability to specify the risk profile and return targets of the manager, but appropriate mandates can be selected to align with the overall investment strategy.

The Trustee accesses funds via a platform, the chosen investment managers' 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 it will look to review the appointment.

4.3.2 Evaluating Investment Manager Performance

The Trustee receives investment manager performance reports on a quarterly basis, which present performance information over 3 months, 1 year, 3 years and 5 years (where available). The Trustee reviews the absolute performance and relative performance against a suitable index used as the benchmark and against the manager's stated target performance objective for both active and passive managers (over the relevant time period) on a net of fees basis.

The Trustee focuses on long-term performance but as noted above, may review a manager's appointment if:

- There are sustained periods of underperformance;
- There is a change in the portfolio manager;
- There is a change in the underlying objectives of the investment manager; or
- There is a significant change to the Investment Consultant's rating of the manager.
- There is a material change to the process used by the managers that will impact on its ability to meet the objectives set.

The investment manager is remunerated by way of a fee calculated as a percentage of assets under management.

4.3.3 Portfolio Turnover Costs

The Trustee receives some Markets in Financial Instruments Directive (MiFID II) reporting from the investment manager. The Trustee will continue to monitor industry improvements concerning the reporting of portfolio turnover costs. In future, the Trustee may ask managers to report on portfolio turnover cost. They may assess this by comparing portfolio turnover across the same asset class, on a year-on-year basis for the same fund, or relative to the manager's specific portfolio turnover range in the investment guidelines or prospectus.

The Trustee considers portfolio turnover costs as part of the transaction cost charges disclosures provided for the annual Value For Members' assessment.

4.3.4 Manager Turnover

The Trustee is a long-term investor and is not looking to change the investment arrangements on a frequent basis. For open-ended funds, there is no set duration for the manager selections. The Trustee will therefore retain an investment manager unless:

- There is a strategic change to the overall strategy that no longer requires exposure to that asset class or manager;
- The basis on which the manager was selected changes materially (e.g. manager fees or investment process); or
- The manager selected has been reviewed in line with 4.3.2 and the Trustee has decided to terminate the mandate

4.4 Risk and Return

The Trustee has considered risk from a number of perspectives. Risk is not considered in isolation, but in conjunction with expected investment returns and outcomes for members. The risks considered include:

- Risk of capital loss in nominal terms. The protection of capital, in the approach to retirement, in supporting the provision of benefits from the members' individual accounts is considered important and is managed by offering lifestyle options that naturally reduce risk over time and giving members access to options where loss of capital might be low.

- Risk of erosion by inflation. If investment returns lag inflation over the period of membership, the real (i.e.net of inflation) value of the members' individual accounts will decrease. The Trustee acknowledges that unexpectedly high future inflation is likely to cause a reduction in the real value of members' accounts. Members are provided with a choice of funds with a number expected to protect the real value of their savings. The impact is measured by considering long term performance trends.

- Risk of returns from day-to-day management not meeting expectations. This will lead to lower than expected returns to members. The Trustee recognises that the use of active investment management involves such a risk and offer a range of passive options to manage this risk. Manager performance is measured in the quarterly performance reports.

- 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 accept this by investing in assets other than cash. The market risk experienced is considered within the triennial investment strategy reviews, which is an appropriate timeframe.

- Liquidity risk. Members are able to switch between investments on short notice, and may withdraw assets from the Trust when leaving employment, retiring or opting out of the Trust. The Trustee has been mindful of these liquidity requirements when selecting the range of fund options available to members and all options are daily dealing to mitigate this risk.

- Default risk. The value of interest bearing securities would be at risk if a bond issuer or licensed deposit taker defaults on their commitments. The Trustee offers options to members that offer investment grade or above bond investments to manage this risk

- Conversion risk. The costs of converting a member's accumulated defined contribution account into pension benefits at retirement is influenced by a number of factors and depends on how the member intends to take their benefits at retirement.

- Environmental, social and corporate governance (ESG) risks. ESG factors present financially material risks for companies and investors. These risks can take many forms but are often operational and/or reputational in nature. The Trustee's policy on managing these risks is provided in 4.2

- Climate change risk. Climate change is a systemic risk which may materially affect the financial performance of certain asset classes, sectors and companies.

The Trustee recognises that all forms of investment carry some degree of risk. The Trustee has considered these risks when setting the investment strategy and ultimately the choice of funds and lifestyle strategies made available to members. Fund selections are also based on the Investment Managers' perceived likelihood of achieving the expected return and risk characteristics required for the asset class being selected for. The Trustee understands that this is not an exhaustive list of all the risks that the Trust faces.

The above items are in relation to what the Trustee considers 'financially material considerations'. The Trustee believes the appropriate time horizon for which to assess these considerations within should be viewed at a member level. This will be dependent on the member's age and their Selected Retirement Age.

5. Investment Strategy

5.1 Range of Funds

The Trustee believes, having taken expert advice, that it is appropriate to offer a range of investment funds and lifestyle strategies to allow members to tailor their own investment strategy. The Trustee will determine the range of funds and lifestyle strategies to be made available to meet a range of member needs taking into account the risks set out above. Members can combine the investment funds in any proportion in order to determine the balance between different kinds of investments. This will also determine the expected return on a member's assets and should be related to the member's own risk appetite and tolerances. Each of the available funds is considered to be diversified across a reasonable number of underlying holdings / issuers.

A range of asset classes has been made available, including: developed market equities, emerging market equities, money market investments, gilts, index-linked gilts, diversified growth funds and pre-retirement funds. Details of the range of funds available, including fees, benchmark and objectives are set out in the Appendix to the SIP.

The Trustee has also provided the option for members to select one of three lifestyle strategies targeting an annuity purchase, withdrawing savings in the form of income drawdown and thirdly, a cash lump sum at retirement. Two of these lifestyle strategies are also default investment options (see Section 5.2), where members who do not make their own choices are automatically invested, depending on their categorisation.

Following an investment strategy review carried out in 2018, the Trustee decided to consolidate the lifestyle strategies from six to the three strategies noted above to offer one lifestyle strategy per targeted retirement objective.

In moving members to these new lifestyle strategies, the Trustee decided to introduce a temporary Interim Lifestyle for three years to facilitate the change, specifically for members in the previous Medium Risk Lifestyles with 39 to 20 years to retirement, with the view to avoid an immediate significant change in their equity allocation. Further details of the lifestyle strategies and the interim lifestyle strategy, including the underlying allocations of the lifestyle strategies throughout a member's working life are set out in the Appendix to the SIP. Members within two years from their selected retirement dates at 23

January 2019 i.e. the transition date remained in the legacy lifestyle strategies unless they chose otherwise. These legacy lifestyle strategies are closed to new members but will continue to be monitored by the Trustee until members are no longer invested and are noted under 5.2.2.The Trustee regularly reviews the suitability of the funds provided and from time to time may change funds or introduce additional investment options.

5.2 Default Investment Options

5.2.1 Current Lifestyle Strategies

The Trustee recognises that the Trust has three distinct groups of members:

- **Top-up members** - who have a Defined Benefit entitlement through a separate occupational pension arrangement with the Sponsoring Company;

- **AVC members** - who have a Defined Benefit entitlement through a separate occupational pension arrangement with the Sponsoring Company and whose money purchase AVCs were transferred into the Trust in late 2016; and

- **2008, Energy and Standard ("2008") members** - who have only DC benefits.

Following the investment strategy review carried out in 2018, the Trustee has chosen default investment options which they believe to be suitable, for each group. The Default Investment Option for AVC and for 2008 members is the Drawdown Lifestyle and for Top-up members is the Cash Lifestyle.

The aims of the Default Investment Options, and the ways in which the Trustee seeks to achieve these aims, are detailed below:

- To generate long term growth during the accumulation phase of the strategies whilst mitigating downside risk.

  The default investment options' growth phase invests in equities and other growth-seeking assets (through two multi-asset diversified growth funds) to reduce the risk of poor investment outcomes.

- To provide strategies that reduce investment risk for members as they approach retirement.

  As a member's pot grows, investment risk will have a greater impact on member outcomes. Therefore, the Trustee believes that a strategy that seeks to reduce investment risk as the member approaches retirement is appropriate. Moreover, as members approach retirement, the Trustee believes the primary aim should be to provide protection against a mismatch between asset values and the expected costs of retirement benefits.

<u>2008, Energy and Standard and AVC Members</u>

Based on the Trustee's understanding of 2008 and AVC members' circumstances, and having regard to likely future developments, the Trustee believes that an investment strategy that targets income drawdown at retirement is likely to reflect a typical member's choice of how they take benefits at retirement.

These aims are achieved via automated lifestyle switches over the 10 year period to a member's target retirement date. Investments are gradually switched from the growth investment with a significant equity content into a blend of multi-asset diversified growth funds (that aim to deliver the potential for future investment growth while gradually reducing the level of volatility experienced by members) and Cash, for capital preservation purposes and in the expectation that members will typically want to take maximum permitted tax free cash at retirement.

Top-Up members

Based on the Trustee's understanding of Top-Up members' circumstances, the Trustee believes that an investment strategy that targets full cash withdrawal at retirement is likely to reflect a typical member's choice of how they take benefits at retirement.

These aims are achieved via automated lifestyle switches over the 10 year period to a member's target retirement date. Investments are gradually switched from the growth investment with a significant equity basis into Cash, for capital preservation purposes, at retirement.

5.2.2 Interim and Historic Arrangements

The Trustee regularly reviews the lifestyle strategies and self-select fund range and, if deemed appropriate, makes changes to the managers. Making changes within the lifestyle strategies and moving members to these new allocations without member consent results in these funds also being determined to be 'default investment options' according to legislation and as such, requires additional disclosures. Therefore, from 6 April 2018, changes made as a result of the investment strategy review in 2017-8 meant the following lifestyle strategies are considered default investment options:

- Annuity Lifestyle
- Interim Lifestyle

Annuity Lifestyle

The Annuity Lifestyle aims to protect members' investments against annuity price fluctuations in the run up to retirement and is suitable for members considering taking a level or fixed annuity in retirement. These aims are achieved via automated lifestyle switches over the ten year period to a member's target retirement date. Investments are gradually switched from the growth investment with significant equity content to the Pre-Retirement Fund (a fund whose aim is to match ongoing changes in annuity prices) and Cash, for capital preservation purposes and in the expectation that members will typically want to take the maximum permitted tax free cash at retirement.

Further details of the Annuity Lifestyle option are set out in the Appendix to the SIP.

Interim Lifestyle

The Trustee has introduced a temporary Interim Lifestyle over three years, for members in the Medium Risk Lifestyles with 39 to 20 years to retirement, with the view to avoid an immediate significant change in their equity allocation. This however, excluded all members who joined the Trust less than one year before the implementation date.

The interim lifestyle strategy intends to smooth the change in asset allocation of members 39 – 20 years to retirement, over a three year period, on the basis that these members would likely experience the most significant change in fund value due to equity market volatility. The interim lifestyle strategy contains a transition portfolio that would gradually increase its equity allocation over the three years so that members reach the desired new strategy allocation by the start of the fourth year. The shape of the allocation to the Transition Portfolio was designed to minimise (but not completely remove) the short term trades arising due to equities being sold in the interim lifestyle glidepath and bought in the transition portfolio.

Further details of the Interim Lifestyle option are set out in the Appendix to the SIP.

The Trustee will continue to review the Default Investment Options over time, taking into consideration retirement experience and changes in member demographics and apply the necessary governance actions for default investment options.

5.2.3 Default Policies

The Trustee’s policies in relation to the Default Investment Options are detailed below:

- The Default Investment Options manage investment risks through a diversified strategic asset allocation consisting of traditional and alternative assets. Risk is not considered in isolation, but in conjunction with expected investment returns and outcomes for members. In designing the Default Investment Options, the Trustee has explicitly considered the trade-off between risk and expected returns. All the risks outlined in Section 4.3 are also considered as part of designing the Default Investment Options.

- Assets in the Default Investment Options take into account the objectives in section 4.1 and the policies in relation in risk in 4.4 and are considered together to ensure that assets are invested in the best interests of members, taking into account the profile of members and which investment option would be suitable for them. In particular, the Trustee considered the make-up of the Trust’s membership when deciding on the Default Investment Options.

- Members are supported by clear communications regarding the aims of the Default Investment Options and the access to alternative investment approaches. If members wish to, they can opt to choose their own investment strategy or an alternative Lifestyle Fund on joining but also at any other future date. Moreover, members do not have to take their retirement benefits in line with those targeted by the Default Investment Options; the target benefits are merely used to determine the investment strategy held pre-retirement.

- Assets in the Default Investment Options are invested in daily traded pooled funds which hold highly liquid assets. The pooled funds are commingled investment vehicles which are managed by various Investment Managers. The selection, retention and realisation of assets within the pooled funds are managed by the respective Investment Managers in line with the mandates of the funds. Likewise, the Investment Managers have full discretion (within the constraints of their mandates) on the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. The Trustee's full policies on social, environmental or ethical considerations are detailed in Section 4.2 of this statement.

Taking into account the demographics of the Trust's membership and the Trustee's views of how the membership will behave at retirement, the Trustee believes that the current Default Investment Options are appropriate and will continue to review these over time, at least triennially, or after significant changes to the Trust's demographic, if sooner. The Trustee does not take into account member views when choosing the funds available to members and in the investment strategies.

Further details of the Default Investment Options are set out in the Appendix to the SIP.

6. Day-to-Day Management of the Assets

The Trustee delegates the day-to-day administration and management of the assets to the Provider and the underlying investment managers. The Trustee has taken steps to satisfy themselves that the Provider and underlying fund managers have the appropriate knowledge and experience for managing the Trust's investments and they are carrying out their work competently.

The Trustee regularly reviews the continuing suitability of the Trust's investments including the appointed Provider and the funds and lifestyle strategies utilised, and these may be amended from time to time. However, any such adjustments would be done with the aim of ensuring the overall level of risk is consistent with that targeted.

7. Realisation of assets

The Investment Managers have responsibility for the realisation and trading of the underlying assets. The day-to-day activities which the Investment Managers carry out for the Trustee are governed by the arrangements between the Investment Managers and the Provider. All funds available are daily priced and trade daily.

8. Compliance

The Trustee will monitor compliance with this Statement regularly, and in any event will review this Statement at least once every three years or sooner if there is any significant change in investment strategy. The Statement will also be reviewed in response to any material changes to any aspects of the Trust and its finances, which are judged to have a bearing on the stated investment policy. Any such review will be based on written expert investment advice and will be in consultation with the Trustee and Sponsoring Company.

9. Legacy Additional Voluntary Contributions ("AVCs")

In addition to the current investment arrangements, the Trust also has legacy AVC investments (which are closed to future contributions) in With Profits Funds through policies with Prudential.

Following the sale of Equitable Life to Utmost, the assets held in the Equitable Life With Profits Fund moved to Utmost in January 2020. These assets were subsequently moved across to Aviva in May 2020. Members' assets were invested in the current Default Investment Option for AVC members, the Drawdown Lifestyle, unless they chose otherwise.