Rosyth Royal Dockyard Pension Scheme

Statement of Investment Principles – September 2023

1. Introduction

The Rosyth Royal Dockyard Pension Trustees Limited ("the Trustee") of the Rosyth Royal Dockyard 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 and reviewing investment policy the Trustee has consulted[1] Rosyth Royal Dockyard Limited ("the Sponsoring Company") and its parent company, Babcock International Group PLC ("Babcock"), to ascertain whether there are any material issues of which the Trustee should be aware in agreeing the Scheme's investment arrangements. The Funding Agreement dated July 2020 details the funding agreement that is in place for the Scheme.

In preparing this Statement, the Trustee has considered written advice received from the Scheme's investment adviser, Isio Group Ltd ("Isio"), who is considered to be suitably qualified and is 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 as follows:

- Trustee identifies appropriate investment objectives and considers its own investment beliefs.
- 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 strategy determined by the Trustee has been delegated to the Scheme's Investment Sub-Committee ("ISC").

The ISC has been created in order to ensure that investment matters receive a sufficient degree of attention. Its responsibilities are set out in the Terms of Reference, under which the ISC operates. The ISC will regularly monitor the performance of appointed investment managers and the continued appropriateness of the asset classes used by the Scheme to achieve the investment objectives.

[1] Consultation will be verbal via discussions at the Investment Sub-Committee or Trust Board meeting for minor revisions, for more significant changes consultation will be in writing.

3. Investment Objectives

The Trustee's objective is to invest the Scheme's assets in the best interests of the members and beneficiaries. The Trustee has agreed a number of objectives to help guide its strategic management of the assets and control the various risks to which the Scheme is exposed. The Trustee's primary objectives are as follows:

- To ensure that the Scheme's benefit obligations can be met.
- That, overall, there is a high level of security of benefits.

While security is paramount, the Trustee recognises that a "least risk" approach to investment strategy would substantially increase the cost of the Scheme (possibly to unacceptable levels). The Trustee has thus decided to pursue a strategy which takes on some investment risk in a controlled fashion.

This leads to two further specific objectives:

- To aim for a long term return which, if achieved, should improve and then maintain the Scheme's funding level.
- To adopt a strategy which aims to limit the level of investment risk, and the resulting funding level, deficit and contribution volatilities, to an acceptable level.

This has led to the adoption of a Scheme-specific investment strategy, which is implemented on a day to day basis by the investment managers. The Trustee has also decided to adopt a long-term funding approach which would reduce, in the long term, dependence on the Sponsoring Company. The Trustee has agreed to move towards this target (which is measured on a gilts related basis) through a long-term de-risking strategy.

The Trustee will continue to monitor the appropriateness of the strategy and the path towards the long-term funding target, and revisit this approach should it be necessary to do so. The Trustee has considered the level of risk inherent in the chosen investment strategy, based on advice provided by Isio, its investment advisor, and is comfortable with this level of risk.

4. Risk Management and Measurement

The risks affecting the Scheme can be broadly split out into those that could directly affect the funding position of the Scheme and investment risks that could specifically affect the Scheme's assets. The Trustee's policy on risk management is as follows:

1. Funding Level Risks

- The primary risk arises through a mismatch between the Scheme's assets and its liabilities. The Trustee recognises that increasing the potential for additional returns through increasing investment risk also increases the risk of a shortfall in assets required to cover the Scheme's liabilities, as well as producing short-term volatility in the Scheme's funding position. The Trustee has taken advice on the matter and (in light of the objectives noted previously) considered carefully the implications of adopting different investment strategies with different levels of risk.

- The Trustee recognises the risks that may arise due to the sensitivity of the value of the Scheme's liabilities to changes in interest rates and inflation. The Trustee has considered these risks in the context of the Scheme's return requirements and has decided to hedge at least 80% of the Scheme's interest rate and inflation risk associated with the Scheme's liabilities, as measured on the Technical Provisions basis.

- In order to manage the overall risk of the Scheme, the Trustee has a 1- year 95% Value at Risk ceiling of £96m measured on an IAS19 basis. The Trustee has appointed an independent party to measure the risk of the Scheme relative to the ceiling on a quarterly basis. Should risk increase above this level, it will be reduced back to being below the ceiling at the earliest opportunity unless otherwise agreed.

- The Trustee recognises the risks that may arise from changes in the value of the Scheme's liabilities due to improving life expectancy. The Trustee has considered these risks and in 2009 decided to enter into a longevity swap agreement covering the pensioner liabilities at that time in order to mitigate some of this risk.

- The Trustee has to post collateral in relation to the longevity swap and other derivative instruments in which the Scheme invests. The Trustee understands the collateral requirements will change and these are reviewed regularly. The collateral requirement will be managed within the Scheme's Matching portfolio.

- The Trustee recognises that the funding level of the Scheme will be volatile and has adopted a de-risking approach to help protect improvements in the funding position when they are achieved.

2. Investment-Specific Risks

- Arrangements are in place to monitor the Scheme's investments to check that nothing has occurred that would bring into question the continuing suitability of the current investments. To facilitate this, the Trustee meets regularly and receives regular reports from the ISC and Isio. The Trustee recognises a number of additional risks and has delegated appropriate powers to the ISC to enable the ISC to manage these risks.

- The use of active management gives rise to the risk that the performance achieved within each asset class may be lower than expected. However, the Trustee believes that this risk is outweighed by the potential gains from successful active management if the manager's skills have been carefully assessed. The Trustee believes there is a role for both active and passive management. Passive management may be used for one of a number of reasons, including investment in markets deemed "efficient", where the scope for active management to add value is limited.

- The Trustee recognises the risks that may arise from a lack of diversification of investments and aims to ensure the policy in place results in an adequately diversified portfolio.
- The Trustee and ISC recognises that short and medium term investment opportunities will arise throughout the lifetime of the Scheme. The ISC will generally only look to take advantage of medium to long term investment opportunities, whilst shorter term decisions regarding the investment and the selection of specific stocks are delegated to the Scheme's investment managers.
- Where the Scheme holds investments denominated in foreign currencies, there is the risk that fluctuations in foreign exchange rates may reduce the returns on these investments. The Trustee hedges a proportion of currency risk.
- The safe custody of the Scheme's assets is delegated to professional custodians. Northern Trust is the global custodian for the Scheme.
- There should be no investment in securities issued by the Sponsoring Company or affiliated companies (other than any such securities held within a pooled fund in which the Scheme invests).
- Borrowing is only permitted to cover short term liquidity requirements and for hedging purposes.
- The Trustee and ISC recognises the risks that may arise from political developments both within the UK, and globally, and aim to keep sufficiently up to date on key developments, and market conditions to navigate these risks.When selecting a new mandate, the Trustee will consider the diversification of the underlying investor base of the fund.

In addition, the Trustee is required to provide narrative disclosures on the credit and market risks arising from its investment arrangements in the Trustee Annual Report and Accounts. These risks are defined as follows:

- **Credit risk:** this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.
- **Market risk:** this is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk, each of which is further detailed as follows:

  - **Currency risk:** this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates.

  - **Interest rate risk:** this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates.

  - **Other price risk:** this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. This includes liquidity risk, i.e. that there are difficulties in raising cash without adversely impacting the fair market value of the investment.

- **Environmental, Social and Governance ("ESG") risk:** ESG issues including climate change may have substantial impacts on the global economy and subsequently investment returns. The Trustee seeks to minimise this risk by monitoring and regularly reviewing that advisers and fund managers to the Scheme (via the ISC) are suitably experienced to consider these risks in the service they provide to the Scheme.

The above risks are in relation to what the Trustee considers to be 'financially material considerations'. The Trustee believes the appropriate time horizon over which to assess these considerations will be dependent on the maturity of the Scheme and the Trustee's view of the employer covenant.

5. Investment Strategy

The Trustee has adopted a strategy with the aim of generating sufficient investment returns to achieve the Scheme's investment objectives. During 2021, the Trustee reviewed the investment strategy and decided to maintain the expected return while reducing risk. Following the strategy review, the Trustee set an investment strategy consistent with a return objective of Gilts + 1.9% per annum (based on market conditions as at 30 September 2021).

The Trustees and Company agreed a revised strategy in June 2023. This is expected to be implemented over 2023.

The investment strategy takes account of:

- the maturity and evolving cashflow profile of the Scheme ;

- the funding level on the de-risking basis;

- the expected strength of covenant of the principal employer, and;

- the Scheme's liquidity requirements (which includes collateral requirements arising from the Scheme's investments in LDI assets). The Trustee monitors the Scheme's liquidity and collateral requirements on a regular basis (via the ISC) and adheres to all relevant regulatory guidance and requirements in relation to leverage and collateral management within the LDI and synthetic equity portfolio.

The ISC would request Trust Board authorisation (and consult with the Company) if any new investment was considered 'illiquid' e.g. a lock up of greater than 3 years. Further, the ISC would only invest in new asset classes having taken appropriate advice from the Trust Board's investment advisors.

In addition, the ISC can use equity futures as a short term measure to implement de-risking or re-risking.

The Trustee has a stated collateral management framework. The Trustee has agreed a process for meeting collateral calls should these be made by the Scheme's LDI manager. The Trustee will review and stress test this framework on a regular basis.

6. De-risking and Re-risking of Assets

The Technical Provisions required return and the required return under the Funding Agreement provides a hard floor for all de-risking decisions. The ISC discretion may not reduce the expected return below these levels (even if the expected return is above long term required return as set out below). The ISC must also be mindful of the risk ceiling and market conditions for any decision (de-risking and re-risking) taken.

The Trustee has put in place a dynamic risk management framework which stipulates that the level of risk from the Scheme's assets should be no greater than required for the long term funding objective to be achieved, subject to the requirements of the Technical Provisions funding and the requirements of the Funding Agreement. The ISC will oversee the de-risking or re-risking of the Scheme. The ISC will report back to the Trustee when any de-risking or re-risking takes place.

The Trustee can delegate discretion to its ISC representatives to increase or decrease the expected return of the Scheme's assets to within 0.2% p.a. either side of the long term required return. The Trustee can suspend the discretion at any time.

The required return is the return on assets required for the long term funding objective to be achieved. If the expected return is ahead of the long term required return by more than 0.2% p.a. the Scheme's representatives are required to de-risk such that the expected return is within +/-0.2% p.a. of the required return.

At any time, the ISC may propose de-risking or re-risking to the Trustee if they deem this to be appropriate beyond the discretion framework that has been agreed with the Trustee. Company consultation could be required if the Trustee supports the proposal.

The de-risking framework will be reviewed and updated once a year by the Trustee at a minimum or more frequently if there have been any material changes to the Scheme.

7. 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 ISC has taken steps to satisfy itself that the managers have the appropriate knowledge and experience for managing the Scheme's investments and that they are carrying out their work competently.

The ISC has determined, based on expert advice, a benchmark mix of asset types and ranges within which each appointed investment manager may operate.

The ISC regularly reviews 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. 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.

8. Additional Assets

Whilst the main Scheme assets are invested in line with the above, additional voluntary contributions ("AVC's") are invested in options made available in the Babcock International Group Pension Scheme with the exception of Utmost.

9. Realisation of Investments

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

The ISC monitors the allocation between the appointed managers and between asset classes and will rebalance to any parameters agreed by the Trustee.

10. 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 their 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 managers to comply with the UK Stewardship Code.

The Trustee has communicated to the managers (via the ISC) 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 ISC on behalf of the Trustee considers how ESG, climate change and stewardship is integrated within investment processes in appointing new investment managers and monitoring existing investment managers. Monitoring is undertaken on a regular basis.

The ISC also considers the investment advisor's assessment of how each of the 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 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 will look to replace the manager.

Member views are not taken into account in the selection, retention and realisation of investments.

Stewardship

The Trustees' policy on the exercise of rights attaching to investments, including voting rights, and in undertaking engagement activities in respect of the investments is that these rights should be exercised by the investment managers on the Trustees' behalf. In doing so, the Trustees expect that the investment managers will use their influence as major institutional investors to exercise the Trustees' rights and duties as shareholders, including where appropriate engaging with underlying issuers of debt or equity to promote good corporate governance, accountability and to understand how those companies take account of ESG issues in their businesses. The investment managers are also expected to use their influence to engage with the wider investment manager community. The Trustees have acknowledged responsibility for the voting and engagement policies that are implemented by the Scheme's investment managers on their behalf.

The ISC regularly reviews the decisions made by their managers, including 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 ISC carries out regular reviews of the investment managers' ESG policies and actively engages with investment managers about "relevant matters" and to better understand their processes at least annually.

11. 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.

The Trustee looks to its investment advisor for their forward looking assessment of a manager's ability to outperform over a full market cycle. This view will be based on the advisor's assessment of the manager's idea generation, portfolio construction, implementation and business management, in relation to the particular investment fund that the Scheme invests in. The advisor's manager research ratings assist with due diligence and questioning managers during presentations to the ISC/Trustee and are used in decisions around selection, retention and realisation of manager appointments.

As part of the ISC's regular reporting to the Trustee, the Trustee receives investment manager performance reports on a quarterly basis, which present performance information over 3 months, 1 year, 3 years and since inception. The Trustee reviews the absolute performance, relative performance against a suitable index used as the benchmark, and against the manager's stated target performance (over the relevant time period) on a net of fees basis. The Trustee's focus is on long term performance but will put a manager 'on watch' if there are short term performance concerns.

If a manager is not meeting performance objectives, or their investment objectives for the mandate have changed, the Trustee will review the fund appointment to ensure it remains appropriate and consistent with the Trustee's wider investment objectives and may ask the manager to review their fees – either the Annual Management Charge or the performance related fee element.

Some appointments are actively managed and the managers are incentivised through remuneration (via performance related fees, noting that some have hurdle rate structures in place to avoid the Trustee paying additional fees during periods of long term underperformance) and performance targets (an appointment will be reviewed following periods of sustained underperformance). The Trustee will review the appropriateness of using actively managed funds (on an asset class basis) regularly.

As the Trustee invests in some pooled investment vehicles 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 monitors portfolio turnover costs. However, the investment managers are incentivised to minimise costs as they are measured on a net of cost basis. The Trustees will seek to adhere to the Cost Transparency Initiative, under which ClearGlass will collect data on the costs of the Scheme's investment managers, and as part of regular governance reviews. The Trustee will engage with a manager if portfolio turnover is higher than expected. This is assessed by comparing portfolio turnover as reported by the investment managers, across the same asset class, on a year-for-year basis for the same manager fund, or relative to the manager's specified portfolio turnover range in the investment guidelines or prospectus (where applicable).

The Trustee is a long term investor and is not looking to change the investment arrangements on a frequent basis.

For open-ended funds in which the Scheme invests, there is no set duration for the manager appointments. The Trustee will 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; or the manager appointment has been reviewed and the Trustee has decided to terminate. For closed-ended funds, the Scheme is invested in a manager's fund for the lifetime of the fund. At the time of appointment, the investment managers provided an indication of the expected investment duration of their funds and have the discretion to extend the lifetime of the fund in line with the Investment Management Agreement. In order to maintain a strategic allocation to such asset classes, the Trustee may choose to stay with a manager in a new closed fund for that asset class or appoint a different manager.

12. 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.

13. Compliance with this Statement

The Trustee monitors compliance with this Statement annually.

Signed

Dated **11 October 2023**