ULTRA ELECTRONICS PENSION SCHEME
STATEMENT OF INVESTMENT PRINCIPLES – September 2020

1. Introduction

The Trustee of the Ultra Electronics 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"), the Occupational Pension Schemes (Investment) Regulations 2005 and the Pension Regulator's guidance for defined benefit pension schemes (March 2017). The Statement is intended to affirm the investment principles that govern decisions about the Scheme's investments.

In preparing this Statement the Trustee has consulted Ultra Electronics Limited ('the Company') to ascertain whether there is any material issue of which the Trustee should be aware in agreeing the Scheme's investment arrangements. The Trustee has also received and considered written advice from Lane Clark & Peacock LLP ('the Investment Consultant').

2. Process For Choosing Investments

The process for choosing investments is as follows:

- Identify appropriate investment objectives.
- Construct a portfolio of investments in an efficient manner, consistent with the agreed investment objectives.

The ultimate responsibility for the investment policy and specifically the setting of investment objectives, which the policy aims to achieve, lies with the Trustee. The Trustee has, however, delegated responsibility for matters such as recommending and implementing an investment policy to achieve these objectives, to an Investment Sub-Committee ("ISC"). The terms of reference of the ISC have been set out in a separate document which is available to members upon request in writing.

In considering the appropriate investments for the Scheme, the Trustee will obtain and consider the written advice from the Investment Consultant whom the Trustee believes to be suitably qualified to provide such advice. The advice received and arrangements implemented will be, in the Trustee's opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended).

3. Investment Objectives

The Trustee is required to invest the Scheme's assets in the best interest of the members, beneficiaries and the Company and, in the case of a potential conflict of interest, in the sole interest of the members and beneficiaries.

Within this context the Trustee has agreed a number of objectives to help guide the strategic management of the assets and control the various risks to which the Scheme is exposed. The Trustee's primary objectives are:

- The acquisition of suitable assets of appropriate liquidity which will generate income and capital growth to meet, together with contributions from the

Company, the cost of the current and future benefits which the Scheme provides, as set out in the Trust Deed and Rules.

- To limit the risk of the assets failing to meet the liabilities over the long term, in particular in relation to the Technical Provisions under Section 222 of the Pensions Act 2004, by considering the liability profile of the Scheme when setting the asset allocation policy.

- To ensure that in all circumstances there will be sufficient liquid assets available in order to meet benefit payments as they fall due.

- To invest in assets so as to meet the required return to achieve full funding on a Technical Provisions basis (ie the asset value should be at least that of its liabilities on this basis), with a secondary objective of being fully funded on a self-sufficiency basis in the longer term, with the constituent weightings between asset classes determined so as to reduce the overall volatility of the funding level over the same period.

4. Portfolio Construction and Investment Restrictions

The Trustee has adopted the following control framework in structuring the Scheme's investments subject to the overriding constraint that at the total Scheme level the expected level of risk is consistent with the investment objectives.

- There is a role for both passive and active management. Passive management will be used for one of a number of reasons, namely:

  - To reduce costs as ongoing monitoring requirements and management fees are significantly lower for passive management than for active management.

  - To invest in markets deemed efficient where the scope for active management to add value is limited.

- To help diversify manager specific risk, multiple manager appointments are preferred to the extent that this is practical and desirable.

- At the total Scheme level and within individual manager appointments, investments should be broadly diversified to ensure there is not a high concentration of investment with any one issuer. This restriction does not apply to investment in UK government debt.

- Investment in securities issued by the Company or affiliated companies is limited to the extent that such securities may be represented within the pooled funds in which the Scheme invests. The diversification inherent in the overall investment arrangements means that it is not expected that regulatory limits on such investments will be breached.

- Whilst the Trustee recognises that borrowing on a temporary basis is permitted, this option will only be utilised when it is deemed absolutely necessary or where the Trustee has received advice from the Investment Consultant that the Scheme's overall exposure to risk can be reduced through temporary borrowing, e.g. during an asset transfer.

- Investment in derivatives is permitted, either directly or within pooled funds as long as they contribute to a reduction in risk, facilitate efficient portfolio management or are used by the Investment Managers to help achieve their respective performance objectives, to the extent this is allowed within the investment guidelines and restrictions in place with each Investment Manager.

Appendix II sets out the Trustee's policy towards risk appetite, capacity, measurement and management.

5. Investment Strategy

The Trustee, with the help of its advisers and in consultation with the employer, undertook a review of the investment strategy for the Scheme in late 2019 / early 2020, taking into account the objectives and restrictions outlined in sections 3 and 4 above. The result of the review was that the Trustee agreed the investment strategy should be based on the initial allocation outlined in the table below, which itself is based on invested assets and future investment commitments as at 31 December 2019.

Asset Class	Initial Benchmark Allocation (%)
Return Seeking Assets	**54.0**
Equities (including Private Equity)	***23.0***
UK Equity	9.0
Global Equity	13.0
Private Equity[1]	1.0
Alternatives	***31.0***
Absolute Return	16.0
Property	7.5
Private Credit	7.5[2]
Matching Assets	**46.0**
Dynamic LDI[3]	46.0
Buy & Maintain Credit	
Money Market	
Absolute Return Bonds[4]	
Total	**100.0**

[1]The Scheme committed €7.0m to a private equity fund in 2008. This fund is now in run-off.
[2] The Scheme committed £5.75m to a commercial real estate debt fund in 2013. This fund is now in run-off. The Scheme committed a total of £24.0m to two private credit funds in 2017. The "investment period" for these funds will end in 2020 at which point they will begin to run-off. The Scheme committed a further £25m to another private credit manager in May 2020.
[3] The allocation to dynamic LDI is expected to hedge the Scheme's funding level (as measured on a technical provisions basis), although there is no specific target the LDI portfolio is managed to.
[4] The Scheme invests in an absolute return bond fund that is intended to provide collateral for the dynamic LDI portfolio, and more generally act as a source of liquidity for the Scheme's other investments and commitments.

The Trustee expects, and allows for, the actual allocation of the Scheme's assets to deviate from the initial benchmark allocation over time as a result of the Scheme's de-risking policy. This means that the investment strategy will gradually target a higher allocation to lower risk assets as progress against the Scheme's long-term objective is achieved. Please see section 9 for further details.

The actual allocation will also deviate due to changes in market conditions, the funding of, and future capital distributions from, the private equity, private credit and real estate debt allocations, and the need to sell assets to meet pension payments. Please see section 8 for further details of the Scheme's rebalancing policy.

6. Expected Return

The Trustee expects to generate a return, over the long term, consistent with that assumed in the Statement of Funding Principles for the most recent actuarial valuation. In setting this expectation the Trustee has taken into account the "best estimate" of future returns given the Scheme's current asset allocation and advice from the Investment Consultant.

The Trustee recognises that over the short term performance may deviate significantly from this long term expectation. This "best estimate" will also generally be higher than the estimate used for the actuarial valuation of the Scheme's liabilities. For this purpose a more prudent estimate of returns will generally be used, as agreed by the Trustee on the basis of advice from the Scheme Actuary.

7. Day-to-Day Management of the Assets

The Trustee delegates the day-to-day management of the assets to professional Investment Managers. The Trustee has taken steps to satisfy itself that the Investment Managers have the appropriate knowledge and experience for managing the Scheme's investments and that the work is carried out competently.

The Trustee has determined, based on advice, a benchmark mix of asset types and ranges within which the appointed Investment Managers may operate.

The Trustee reviews regularly the continuing suitability of the Scheme's investments, including the appointed Investment Managers and the balance between active and passive management, which may be adjusted from time to time.

The Trustee's view is that the fees paid to the investment managers, and the possibility of their mandate being terminated, ensure they are incentivised to provide a high quality service that meets the stated objectives, guidelines and restrictions of the fund. However, as the Scheme's assets are held in pooled funds, in practice managers cannot fully align their strategy and decisions to the (potentially conflicting) policies of all their pooled fund investors in relation to strategy, long-term performance of debt/equity issuers, engagement and portfolio turnover.

The Trustee evaluates investment manager performance by considering performance over both shorter and longer-term periods as available. Except in closed-ended funds where the duration of the investment is determined by the fund's terms, the duration of a manager's appointment will depend on strategic considerations and the outlook for future performance. Generally, the Trustee would be unlikely to terminate a mandate on short-term performance grounds alone.

The Trustee's policy is to evaluate each of its investment managers by reference to the manager's individual performance as well as the role it plays in helping the Scheme meet its overall long-term objectives, taking account of risk, the need for diversification and liquidity. Each manager's remuneration, and the value for money it provides, is assessed in light of these considerations.

The Trustee recognises that portfolio turnover and associated transaction costs are a necessary part of investment management and that the impact of portfolio turnover costs is reflected in performance figures provided by the investment managers. The Trustee expects its investment consultant to incorporate portfolio turnover and resulting transaction costs as appropriate in its advice on the Scheme's investment mandates.

Details of the appointed Investment Managers can be found in Appendix I.

8. Rebalancing Policy

There is no formal rebalancing policy. The ISC (on behalf of the Trustee) will monitor the Scheme's actual asset allocation over time. The ISC will consider, with its advisers, whether it is appropriate to rebalance the assets in line with the investment strategy outlined in section 5 and de-risking policy outlined in section 9, taking into account factors such as market conditions and anticipated future cash flows.

9. Long-Term Objective and De-Risking Policy

The Trustee has set a long-term objective (which has been agreed with the Company) for the Scheme to achieve full funding by 31 March 2030 on a "self-sufficiency", defined as gilts + 0.5% pa, basis (ie the asset value should be at least that of its liabilities on this basis by this date). Progress against this long-term objective is assessed and reported on a regular basis.

The Trustee has also agreed to implement a de-risking mechanism to de-risk the Scheme's investment strategy following reductions in the required return needed to achieve the Trustee's long-term objective. A high-level summary of this mechanism is provided below:

- The required return to achieve the long-term objective is monitored to assess whether any required return trigger has been breached.
- If a trigger is breached, the Trustee will consider switching out of higher risk assets into lower risk assets to target the desired overall best estimate return associated with each trigger.
- The de-risking step will also include increasing the Scheme's level of interest rate and inflation hedging through additional investments into the LDI portfolio and / or the Buy & Maintain Credit portfolio.

The exact details of the de-risking mechanism, including how this is to be monitored, are set out in a separate document maintained by the Trustee and its advisers.

The ISC (on behalf of the Trustee) will monitor and implement the de-risking mechanism. The ISC will retain the power to veto, defer or cancel any prospective de-risking move.

The ISC will review the de-risking policy from time to time and in conjunction with the completion of the Scheme's triennial actuarial valuation together with the Company's views on the de-risking policy.

10. **Realisation of Investments**

The Investment Managers have discretion in relation to the timing of realisation of investments and considerations relating to the liquidity of those investments within parameters stipulated in the relevant appointment documentation.

The activities carried out by the Investment Managers are governed by the appointment documentation between the Trustee and the Investment Managers. These are reviewed from time to time to ensure that the operating instructions, guidelines and restrictions remain appropriate.

The Trustee has considered how easily investments can be released for the types of assets in which they are currently invested. As such, the Trustee believes that the Scheme currently holds an acceptable level of readily realisable assets.

11. **Considerations of financially material and non-financial matters**

The Trustee believes that responsible investment in well governed companies and engaging as long-term owners can reduce risk over time and may positively impact Scheme returns.

The Trustee has considered how environmental, social, governance ("ESG") and ethical factors should be taken into account in the selection, retention and realisation of investments, given the time horizon of the Scheme and its members.

The Trustee expects its investment managers to take account of financially material considerations (including climate change and other ESG considerations). The Trustee seeks to appoint managers that have appropriate skills and processes to do this, and from time to time reviews how its managers are taking account of these issues in practice, including engaging with managers on this topic at regular ISC meetings.

The Trustee has limited influence over investment managers' practices where assets are held in pooled funds; this is due to the nature of these investments, but it encourages its managers to improve their practices where appropriate.

The Trustee does not explicitly take into account any non-financial matters (ie matters relating to the ethical and other views of members and beneficiaries, rather than considerations of financial risk and return) in the selection, retention and realisation of investments. However, the Trustee reviews, from time to time, whether and how its managers are taking account of non-financial matters, such as by engaging with managers on this topic at ISC meetings.

The Trustee will also continue to review its policies on financially material and non-financial matters, including as advice is received from its professional advisors and further guidance is released on these matters by the Pension's Regulator.

12. Stewardship

The Trustee recognises its responsibilities as owners of capital, and believes that good stewardship practices, including monitoring and engaging with investee companies, and exercising voting rights attaching to investments, protect and enhance the long-term value of investments.

The Trustee has delegated to its investment managers the exercise of rights attaching to investments, including voting rights, and engagement with issuers of debt and equity and other relevant persons about relevant matters such as performance, strategy, capital structure, management of actual or potential conflicts of interest, risks and ESG considerations.

The Trustee does not monitor or engage directly with issuers or other holders of debt or equity. The Trustee expects the investment managers to exercise ownership rights and undertake monitoring and engagement in line with the managers' general policies on stewardship, as provided to the Trustee from time to time, taking into account the long-term financial interests of the beneficiaries. The Trustee seeks to appoint managers that have strong stewardship policies and processes, reflecting where relevant the recommendations of the UK Stewardship Code issued by the Financial Reporting Council, and from time to time the Trustee reviews how these are implemented in practice.

13. Additional Voluntary Contributions ("AVCs")

The Trustee has historically provided a facility for members to pay AVCs to enhance their benefits at retirement. This facility was closed from 1 April 2015.

Member's AVCs paid into the Scheme prior to this date are invested in a range of funds through Legal & General Assurance Society ("L&G") and Clerical Medical Investment Group Limited ("Clerical Medical").

The AVC arrangements are reviewed from time to time to ensure that the investment performance achieved is acceptable and the investment profile of the funds remains consistent with the objectives of the Trustee and the needs of the members.

14. Custodian and Advisors

Custodian

The role of the custodian is to ensure the safe keeping of the assets and to facilitate all transactions entered into by the appointed Investment Managers.

The Trustee is not responsible for the appointment of the Custodian of the assets contained within the various pooled fund investments. The exception is for assets invested with BlackRock where the Trustee has a separate agreement in place with Bank of New York Mellon to act as custodian for these funds. The Trustee is comfortable that the Scheme's other Investment Managers have procedures in place for the appointment and monitoring of the relevant custodians.

Actuary

Robert Hunt of Xafinity Consulting Limited is the appointed Scheme Actuary.

The Scheme Actuary performs a valuation of the Scheme at least every three years, in accordance with regulatory requirements. The main purpose of the actuarial valuation is to assess the extent to which the assets cover the Technical Provisions liabilities and provide information to help determine the Company's contribution rate.

Investment Consultant

Whilst the day-to-day management of the Scheme's assets is delegated to Investment Managers, all other investment decisions including strategic asset allocation and selection and monitoring of Investment Managers is based on advice received from the Investment Consultant. Lane Clark & Peacock LLP has been appointed for this purpose.

15. **Fee Structures**

The Trustee recognises that the provision of investment management and advisory services to the Scheme results in a range of charges to be met, directly or indirectly, by deduction from the Scheme's assets.

The Trustee has agreed Terms of Business with the Scheme's actuarial and investment advisers, under which work undertaken is typically charged for on time-cost and fixed-fee bases, or on pre-agreed budgets.

The Investment Managers are paid management fees calculated by reference to the market value of assets under management, and also in some cases a performance related fee. The fee rates are believed to be consistent with the managers' general terms for institutional clients and are considered by the Trustee to be reasonable when compared with those of other similar providers.

16. **Compliance with this Statement**

The Trustee monitors compliance with this Statement annually, including reviewing whether the Investment Managers have given effect to the investment principles in this Statement so far as reasonably practicable and that in exercising any discretion the Investment Managers have done so in accordance with Section 4 of The Occupational Pension Schemes (Investment) Regulations 2005.

17. **Review of this Statement**

The Trustee will review this Statement at least once every three years 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.

Mike Jaffe ..... 24 September 2020 .....

Director for The Law Debenture Pension Trust Corporation p.l.c

Date

Trustee Director

The Trustee of the Ultra Electronics Pension Scheme

APPENDIX I

Investment Manager Performance Benchmarks and Objectives

Majedie

The Scheme invests in Majedie's UK Focus Fund. The fund is priced daily. It is open-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance / Objective	Target Tracking Error % p.a.
UK Equity	FTSE All-Share Index	To maximise return*	N/A

* Majedie does not have an explicit target but aims to outperform the benchmark index by +5% over 3 years.

Schroder Investment Management Ltd ("Schroders")

The Scheme invests in Schroder's QEP Global Blend Fund. The fund is priced daily. It is open-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance / Objective	Target Tracking Error % p.a.
Global Equity	MSCI AC World Index (GBP Hedged) NDR*	+3.0% p.a. (gross of fees)	Not targeted but typically c.3.0

*100% of the exposure is hedged back to Sterling.

BlackRock Investment Management (UK) Limited ("BlackRock")

Equity Portfolio

The Scheme can invest in several passive equity funds with BlackRock. The funds are priced daily. They are open-ended and unlisted. The funds include, but are not limited to:

Asset Class	Benchmark Allocation %	Benchmark Index	Target Outperformance / Objective	Target Tracking Error % p.a.
Global Developed Equities (ex UK)*	100.0	33.3% FTSE USA Index 33.3% FTSE AW Developed Europe ex-UK Index 16.7% FTSE Japan Index 16.7% FTSE AW Developed Asia Pacific (ex-Japan) Index	To match the benchmark (gross of fees)	Up to 1.0
Emerging Market Equities	100.0	S&P/IFC Investable Composite ex Malaysia Index	As above	Up to 1.0
UK Equities	100.0	FTSE All Share Index	As above	Up to 1.0

*The Trustee has the option of hedging overseas (non-Sterling) currency exposure back to Sterling.

Dynamic LDI Portfolio

The Scheme invests in various LDI funds and a cash fund managed by BlackRock. The funds are priced daily. They are open ended and unlisted. The funds include but may not be limited to:

Asset Class / Fund	Benchmark	Target Outperformance / Objective	Target Tracking Error % p.a.
LDI - Leveraged Short Liability Nominal Profile Fund	Returns referenced to a gilt and swap cash flow profile for comparison.	Seek to provide a leveraged return of nominal investments.	N/A
LDI - Leveraged Long Liability Nominal Profile Fund	Returns referenced to a gilt and swap cash flow profile for comparison.	Seek to provide a leveraged return of nominal investments.	N/A
LDI - Leveraged Short Liability Real Profile Fund	Returns referenced to a gilt and swap cash flow profile for comparison.	Seek to provide a leveraged return of real investments.	N/A
LDI - Leveraged Long Liability Real Profile Fund	Returns referenced to a gilt and swap cash flow profile for comparison.	Seek to provide a leveraged return of real investments.	N/A
Money market - ICS Sterling Liquidity Fund	GBP 1 Week LIBID	Seeks to maximise income consistent with maintaining capital and ensuring underlying assets can easily be bought or sold in the market	N/A

The objective of the LDI funds is to provide liability hedging by offering interest rate and inflation protection which replicates the liability profile of a typical UK defined benefit pension scheme. The overall allocation to the LDI funds has been designed to have a similar sensitivity to changes in interest rates and inflation as that of the Scheme's liabilities.

Absolute Return Bond Portfolio

The Scheme invests in BlackRock's Absolute Return Bond Fund. The fund is priced daily. It is open-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance / Objective	Target Tracking Error % p.a.
Absolute Return Bonds	3-month LIBOR	+ 3% p.a. to 5% p.a. (gross of fees) over a market cycle	N/A

Insight Investment Management (Global) Limited ("Insight")

The Scheme can invest in several of Insight's Maturing Buy & Maintain Bond Fund maturing buy & maintain credit funds. The funds are priced monthly. They are open-ended and unlisted. The funds include, but are not limited to:

Fund name	Benchmark Index	Target Outperformance / Objective	Target Tracking Error % p.a.
IIFIG Maturing Buy and Maintain Bond Funds 2026-2030	N/A	To generate a return investing primarily in a portfolio of debt securities with maturity of investments between 2026-30	N/A

Standard Life Capital Partners ("Standard Life")

The Scheme invests in Standard Life's European Strategic Partnership Private Equity Fund. The fund is priced quarterly. It is closed ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance / Objective	Target Tracking Error % p.a.
Private Equity	N/A	To maximise return subject to prudent diversification	N/A

Aberdeen Standard Investments ("ASI")

The Scheme invests in ASI's Long Lease Property Fund. The fund is priced daily. It is open-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance / Objective*	Target Tracking Error % p.a.
Property	FTSE A All-Stocks Gilts Index	+ 1.0% p.a. (net of fees)	N/A

* Outperformance target measured over rolling 3 year periods.

Fulcrum Asset Management LLP ("Fulcrum")

The Scheme invests in Fulcrum's Diversified Absolute Return Fund. The fund is priced daily. It is open-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance / Objective	Target Tracking Error % p.a.
Absolute Return	UK RPI **	+ 3.0 - 5.0% p.a. (net of fees)	6.0 – 8.0

*Outperformance target measured over rolling 5 year periods.
**Benchmark Index assumed for performance measurement purposes.

Ruffer LLP ("Ruffer")

The Scheme invests in Ruffer's Absolute Return Fund. The fund is priced weekly. It is open-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance / Objective	Target Tracking Error % p.a.
Absolute Return	6 Month Sterling LIBOR [(a)]	Absolute return of 8.0% - 10.0% p.a.	N/A

Outperformance target measured over rolling 3 year periods.
[(a)] Benchmark Index assumed for performance measurement purposes.

BlueCrest Capital Management (UK) LLP ("BlueCrest")

The Scheme invests in BlueCrest's AllBlue Ltd. Fund. The fund is priced monthly. It is closed-ended and is unlisted. This Fund is in the process of winding down, at which point BlueCrest will cease to be an investment manager for the Scheme.

Asset Class	Benchmark Index	Target Outperformance	Target Volatility % p.a.
Absolute Return	3 Month Sterling LIBOR [(a)]	Absolute return of 10.0% - 15.0% p.a. (net of fees)	6.0 – 8.0

[(a)] Benchmark Index assumed for performance measurement purposes.

M&G Investment Management ("M&G")

The Scheme invests in M&G's Real Estate Debt Fund III. The fund is priced quarterly. It is closed-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance	Target Tracking Error % p.a.
Real Estate Debt	N/A	Internal rate of return of 7.0% - 10.0% p.a. (gross of fees)	N/A

Arcmont Asset Management LLP ("Arcmont")

The Scheme invests in Arcmont's Senior Loan Fund 1. The fund is priced quarterly. It is closed-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance	Target Tracking Error % p.a.
Private Credit	N/A	Internal rate of return of 9.0% p.a. (gross of fees)	N/A

Baring Asset Management Limited ("Barings")

The Scheme invests in Barings' Global Private Loan Fund 2. The fund is priced quarterly. It is closed-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance	Target Tracking Error % p.a.
Private Credit	N/A	Internal rate of return of 7.5 – 8.5% p.a. (net of fees)	N/A

DRC Capital LLP ("DRC")

The Scheme invests in DRC's UK Whole Loan Fund 2. The fund is priced quarterly. It is closed-ended and is unlisted.

Asset Class	Benchmark Index	Target Outperformance	Target Tracking Error % p.a.
Real Estate Debt	N/A	Internal rate of return of 6.0 – 7.0% p.a. (net of fees)	N/A

APPENDIX II

Policy Towards Risk

1. Risk appetite and risk capacity

Risk appetite is a measure of how much risk the Trustee is willing to bear within the Scheme in order to meet its investment objectives. Risk capacity is a measure of the extent to which the Trustee can tolerate deviation from its long-term objectives before attainment of those objectives is seriously impaired. The Trustee aims to strike the right balance between risk appetite and risk capacity.

When assessing the risk appetite and risk capacity, the Trustee considered a range of qualitative and quantitative factors, including:

- the strength of the employer's covenant and how this may change in the near/medium future;
- the Scheme's cash flow requirements and employer contributions;
- the Scheme's long-term and shorter-term funding objectives and required return to achieve these objectives;
- the Scheme's liability profile, its interest rate and inflation sensitivities, and the extent to which these are hedged; and
- the level of expected return and expected level of risk, now and as the strategy evolves.

When deciding on the current investment strategy, the Trustee believed the level of risk to be appropriate given the Trustee's and employer's risk appetite and capacity, given the Scheme's objectives.

2. Approach to managing and monitoring investment risks

The Trustee considers that there are a number of different types of investment risk that are important to manage and monitor. These include, but are not limited to:

Risk of inadequate returns

A key objective of the Trustee is that, over the long-term, the Scheme should generate its target return so that it has adequate assets to meet its liabilities as they fall due. The Trustee therefore invests the assets of the Scheme to produce a sufficient long-term return in excess of the liabilities. There is also a risk that the performance of the Scheme's assets and liabilities diverges in certain financial and economic conditions in the short term. This risk has been taken into account in setting the investment strategy and is monitored by the Trustee on a regular basis.

Risk from lack of diversification

This is the risk that failure of a particular investment, or the general poor performance of a given investment type, could materially adversely affect the Scheme's assets. The Trustee believes that the Scheme's assets are adequately diversified between

different asset classes and within each asset class. This was a key consideration when determining the Scheme's investment arrangements and is monitored by the Trustee on a regular basis.

Investment manager risk

This is the risk that an investment manager fails to meet its investment objectives. Prior to appointing an investment manager, the Trustee receives written advice from a suitably qualified individual, and will typically undertake an investment manager selection exercise. The ISC (on behalf of the Trustee) monitors the investment managers on a regular basis to ensure they remain appropriate for their selected mandates.

Liquidity/marketability risk

This is the risk that the Scheme is unable to realise assets to meet benefit cash flows as they fall due, or that the Scheme will become a forced seller of assets in order to meet benefit payments. The Trustee is aware of the Scheme's cash flow requirements and believes that this risk is managed by maintaining an appropriate degree of liquidity across the Scheme's investments and by investing in income generating assets, where appropriate.

Environmental, social and governance (ESG) risks

Environmental, social and corporate governance (ESG) factors are sources of risk to the Scheme's investments, some of which could be financially material, over both the short and longer term. These potentially include risks relating to factors such as climate change, unsustainable business practices, and unsound corporate governance. The Trustee seeks to appoint investment managers who will manage these risks appropriately on their behalf and from time to time reviews how these risks are being managed in practice.

Collateral adequacy risk

The Scheme is invested in leveraged LDI arrangements to provide protection ("hedging") against adverse changes in interest rates and inflation expectations. The LDI manager may from time to time call for additional cash to be paid to the LDI portfolio in order to support a given level of leverage. Collateral adequacy risk is the risk that the Trustee, when requested to do so, will not be able to post additional cash to the LDI fund within the required timeframe. A potential consequence of this risk is that the Scheme's interest rate and inflation hedging could be reduced and that the Scheme's funding level could suffer subsequently as a result. In order to manage this risk, the Trustee ensures that the Scheme has a sufficient allocation to cash and/or other highly liquid assets which can be readily realised, so that cash can be posted to the LDI manager at short notice.

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.

The Scheme is subject to credit risk because it invests in sovereign government bonds, corporate bonds, loans, derivatives and cash via pooled funds. This arises

principally in relation to the Scheme's matching and alternatives allocations which includes the LDI allocation. Excluding the LDI allocation, credit risk arising from the Scheme's investments has deliberately been undertaken for return-seeking purposes. The expected returns from these investments are considered appropriate for the associated risk. Credit risk is mitigated through the diversification of credit instruments, within and between funds, the application of risk limits by the individual managers as well as security in the form of assets pledged against the debt.

Credit risk arising on cash held within financial institutions is mitigated by ensuring cash is held with a diversified range of institutions, which are at least investment grade credit rated.

Currency risk

The Scheme is subject to currency risk because some of the Scheme's investments are held in overseas markets. The Trustee considers the overseas currency exposure in the context of the overall investment strategy, and believes that the currency exposure that exists diversifies the strategy and is appropriate. Furthermore, the Trustee manages the amount of currency risk by investing in pooled funds that hedge currency exposure or implement separate currency hedging arrangements.

Interest rate and inflation risk

The Scheme's assets are subject to interest rate and inflation risk because some of the Scheme's assets are held in bonds and interest rate / inflation sensitive derivative instruments, via pooled funds.

However, the interest rate and inflation exposure arising from the LDI and Buy & Maintain Credit allocations hedges part of the corresponding risks associated with the Scheme's liabilities. The Trustee currently aims to hedge the Scheme's funding level against interest rate risk inflation risk through the allocations. The Trustee also has a plan in place to increase this level of hedging over time as the Scheme's funding level improves. The net effect of the Trustee's approach to interest and inflation risk will be to reduce the volatility of the funding level, and so the Trustee believes that it is appropriate to manage exposures to these risks in this manner and to review them on a regular basis.

The interest rate and inflation risk exposure from the Scheme's other investments is taken by the investment managers as part of their investment strategy to add value and manage risk.

Other non-investment risks

The Trustee recognises that there are other, non-investment, risks faced by the Scheme, and takes these into consideration as far as practical in setting the Scheme's investment arrangements as part of its assessment of the other aspects of the Scheme's Integrated Risk Management framework.

Examples include:

- longevity risk (the risk that members live, on average, longer than expected); and

- sponsor covenant risk (the risk that, for whatever reason, the sponsoring employer is unable to support the Scheme as anticipated).

Together, the investment and non-investment risks give rise generally to funding risk. This is the risk that the Scheme's funding position falls below what is considered an appropriate level. The Trustee regularly reviews progress towards the Scheme's funding objectives, both in the longer-term as well as against short-term milestones, comparing the actual versus the expected funding level.

The Trustee has also put in place a framework to monitor important investment, funding and covenant risks, through an Integrated Risk Management ("IRM") dashboard. This dashboard sets out key performance indicators ("KPIs") as potential indicators of a significant worsening in these risks, as well as contingency plans if this occurs.

By understanding, considering and monitoring the key investment, funding and covenant risks, the Trustee believes that it has appropriately addressed and is positioned to manage these risks.