STATEMENT OF INVESTMENT PRINCIPLES

August 2020

BAA Pension Scheme

Private and Confidential

Introduction

This Statement of Investment Principles ("SIP") has been prepared by the BAA Pension Trust Company Limited ("the Trustee") in its capacity as the current Trustee of the BAA Pension Scheme ("the Scheme") in consultation with LHR Airports Limited ("LHRA"). The SIP is designed to comply with the requirements of the Pensions Act 1995, as amended by the Pension Act 2004, and The Occupational Pension Schemes (Investment) Regulations 2005 (the Investment Regulations) and subsequent legislation (collectively referred to as the 'Pensions Acts').

Effective Date

This SIP is effective from August 2020.

STRATEGY

Investment Objectives

The Trustee aims to invest the assets of the Scheme prudently to ensure that the benefits promised to Members and their Beneficiaries are provided as and when they fall due. The overall aim is to reach and maintain a position where sufficient assets are held to cover all liabilities, plus an additional reserve for unforeseen events such as improvements in life expectancy, and to have a contribution rate which the Principal Employer (as defined in the Scheme's Rules), LHR Airports Limited ("LHRA"), can afford.

The investment strategy agreed between the Trustee and LHRA targets an expected return over the liabilities (currently valued using gilt yields) with the aspirational target of reaching a 108% funding position on a gilts + 0.5% basis (based on expected returns) by 2028. In choosing the investment strategy, the Trustee recognises the level of risk compared to the liabilities that accompanies the outperformance target. A Pension Risk Management Framework ("PRMF") exists to ensure that both the level of risk and outperformance target are monitored by the Trustee and LHRA on a regular basis, and calls to action for funding, risk, hedging and liquidity are easily identified.

Investment Advisor

Redington Limited has been appointed as Investment Advisor. The Trustee believes that the Investment Advisor meets the requirements of the Pensions Acts. In matters where the investment policy may affect the Scheme's funding policy, input will also be obtained from the Scheme Actuary.

Allocation of Assets

The Trustee regards the selection of asset classes as the decision which has most influence on its ability to achieve its investment objective.

The strategic asset allocation is set taking into account the nature and timing of both actual and potential future liabilities, which are sensitive to interest rates, inflation, mortality and other financial and demographic factors. It is also set having regard to the Trustee's funding objectives. To meet these, the Trustee has set an investment objective, after seeking the advice of the Investment Advisor, comprising a return target and risk appetite consistent with the Trustee's investment beliefs.

The asset allocation is split into:

Return-seeking assets, which have the objective of outperforming the liabilities by investing in a suitably diversified range of assets which together are expected to reduce investment volatility.

Liability-matching assets, which have the objective of using a liability-driven investment strategy to provide a hedge against a portion of the interest rate and inflation risks associated with the non-insured liabilities, by investing predominantly in a range of UK government bonds alongside other financial instruments such as gilt repos, interest rate and inflation swaps.

Choosing and realising investments

The day-to-day fund management of the Scheme's assets is performed by external professional investment managers (each of which is authorised and regulated by the Financial Conduct Authority or a similar local regulatory authority as required). The Trustee believes that the appointed investment managers meet the requirements of the Pensions Acts and have taken advice from the Investment Advisor in selecting and retaining investment managers.

In general, individual investment managers have discretion in the timing of the purchase and sale of investments and in considerations relating to the liquidity of those investments. Additional realisations may be required to ensure that the Scheme's benefit outgoings and other expenditure can be met. The Trustee will notify the investment managers of any amounts that need to be realised from their portfolios for the payment of benefits or expenses, and the timing and regularity of such realisations.

Investment manager policy

Due to the benefits of cost and ease of implementation, the Trustee mainly invests in pooled investment vehicles. The Trustee recognises that due to the collective nature of these investments, there is less scope to directly influence how the asset manager invests. However, the Trustee's investment advisors ensure the investment objectives and guidelines of the manager are consistent with that of the Trustee.

When relevant, the Trustee requires its investment managers to invest with a medium- to long-term time horizon, and use any rights associated with the investment to drive better long-term outcomes.

For some asset classes, the Trustee does not expect the respective asset managers to make decisions based on long-term performance. These may include investments that provide risk reduction through diversification or through hedging, consistent with the Trustee's strategic asset allocation.

The Trustee appoints its investment managers with an expectation of a long-term partnership, which encourages active ownership of the Fund's assets. When assessing a manager's performance, the focus is on longer-term outcomes and is assessed over a medium- to longer-term timeframe, subject to a minimum of three years.

The Trustee would not expect to terminate a manager's appointment based purely on short-term performance. However, a manager's appointment could be terminated within a shorter timeframe than three years due to other factors such as a significant change in business structure or the investment team.

Managers are paid an ad valorem fee for a defined set of services. The Trustee reviews the fees annually to confirm they are in line with market practices, notably when the Trustee expects the manager to take an active ownership approach and consider long-term financially material ESG factors.

The Trustee policy towards monitoring non-financial performance is set out in the Responsible Investment section of the SIP.

The Trustee reviews the portfolio transaction costs and portfolio turnover range of managers annually, where the data is disclosed and available. The Trustee will then determine whether the costs incurred were within reasonable expectations.

Risks

The Scheme is exposed to a number of different investment risks. These include risks relating to:

- **Funding** – i.e. that the Scheme has insufficient assets to cover 100% of the accrued liabilities.
- **Mismatching** – arising from a difference in the sensitivity of asset and liability values to financial and demographic factors.
- **Cash flows** – arising from a shortfall of liquid assets relative to the Scheme's immediate liabilities.
- **Investment managers** – arising from a failure to meet target returns.
- **Diversification** – an inadequate spread of investments and sources of return.
- **Covenant** – the possibility of failure of the Scheme's sponsor.
- **Counterparty** – arising from the failure of a third party to fulfil its obligations under a financial (e.g. derivative or bulk annuity) contract entered into with the Scheme.
- **Operations** – fraud, poor advice or negligence.

- **Leverage** – an additional risk introduced if the economic exposure arising from investing in a derivative is greater than the capital committed to the investment.
- **Regulatory** – arises from investing in a market environment where the regulatory regime may change.
- **Liquidity** – the ease with which assets are marketable and realisable.

These risks are reduced by careful structuring of the Scheme's funding and investment management arrangements, and through the contracts with the investment managers. The Trustee closely monitors these risks using – for example – the PRMF, and receives formal quarterly reports on funding, cash flows, investment managers (including performance) and diversification, and other such reporting as may be deemed necessary from time to time. Counterparty risk is reduced by limiting the exposure to any one counterparty, together with the use of a collateral mechanism for derivative positions that is calculated daily.

Operational risk is reduced as far as possible by due diligence on the appointment and review of investment managers, annuity providers and advisors, and by contracts of engagement.

GENERAL

Additional Voluntary Contributions (AVCs)

AVCs and money purchase members are invested in policies with Equitable Life Insurance, Aviva and Santander (formerly Abbey National Building Society).

Direct Investments

The Pensions Act 1995 distinguishes between investments where the management is delegated to an investment manager with a written contract and those where a product is purchased directly, e.g. the purchase of an insurance policy or units in a pooled vehicle. The latter are known as direct investments. Assets directly held by the Trustee, including policies of assurance such as AVCs, will be regularly reviewed to ensure that they continue to be appropriate, and written advice will be obtained from the Investment Advisor. The Trustee will use the criteria set out in the Occupational Pension Schemes (Investment) Regulations 2005 when selecting direct investments.

Responsible Investment

The Trustee wishes to encourage best practice in terms of engagement with the companies in which the Scheme invests. Where appropriate and practical, the Scheme requires its investment managers to:

- Consider any financially material issues in investment decision making over the Scheme's time horizon. As the Scheme is currently open to accrual, the appropriate time horizon is generally longer term.

- Engage with issuers of debt or equity on financially material issues to positively influence their corporate governance framework by utilising their greater negotiating power to put pressure on issuing companies to adhere to certain standards.

Environmental, Social and Governance "ESG" issues, including risks around climate change, are considered by the Trustee to be financially material to the investment portfolio over the Scheme's time horizon. As the Scheme is currently open to accrual, the appropriate time horizon is generally longer term. The Trustee considers the long-term financial interests of the Scheme to be paramount, and, where appropriate and practical, requires its investment managers to:

- Consider financially material ESG issues (including climate change risks), in investment decision making.

- Practice good stewardship which includes engaging with issuers of debt or equity on financially material ESG issues. Good stewardship in this context relates to the investment managers gaining alignment with the Trustees to fulfil their fiduciary duties to the members of the Scheme, by undertaking a number of activities that serve to secure the member's benefits in a sustainable way. Such activities include monitoring assets, exercising voting rights where stock is held, and utilising their greater negotiating power to put pressure on issuing companies to adhere to certain standards.

The rationale for delegating ultimate ESG responsibility to the investment managers is as follows:

- The investment managers are the closest party in the investment process to the underlying companies in which the Scheme holds investments.

- Through managing investments of multiple investors, the investment managers possess greater negotiating power and thus are more able to meaningfully influence the ESG characteristics of issuers.

Non-financial matters, including ethical views of beneficiaries and members, are not ordinarily taken into account in the selection, retention and realisation of investments.

The Trustee considers ESG integration as an element in the selection and ongoing monitoring of investment managers, by considering research carried out by the Investment Advisor, which includes:

- Manager Selection Process: each time an investment manager is selected or reviewed, ESG integration is one of the key selection factors considered by the Investment Advisor's manager research team.

- Annual survey: The Investment Advisor's recommended investment managers are surveyed annually to ensure any changes to the ESG integration process are captured (e.g. data sources, reporting lines, etc.).

- UN Principles for Responsible Investment "PRI" reporting: The Investment Advisor requests PRI assessment scores from all investment managers for funds in which clients are invested on an annual basis. The Investment Advisor reports Strategy & Governance scores as part of standard quarterly manager monitoring reports.

Scheme Governance

The Trustee has established the Investment Committee ("IC"). The Trustee has delegated responsibility for overseeing and monitoring the Scheme's investments to the IC:

Items to be monitored;

- The Scheme's funding level, on a quarterly basis.
- The investment managers, at least annually and more often on an exceptions basis (in the event of negative organisational developments, poor performance etc.).
- The Scheme's asset allocation and rebalancing.
- Any ad-hoc projects, such as manager selection exercises.
- Triennial investment strategy reviews.

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 Scheme's assets cover the accrued liabilities and agree any Recovery Plan deemed necessary after consulting with LHRA.

Corporate Governance

The Trustee recognises that good stewardship practices, including engagement and voting activities, are important as they help preserve and enhance asset owner value over the long term.

The investment managers discharge their responsibilities in respect of the Scheme's ownership of companies in accordance with the Financial Reporting Council's UK Stewardship Code published in July 2010, and in the best interests of beneficiaries.

The Trustee expects their investment managers to practice good stewardship. This includes monitoring, engaging with issuers of debt or equity on relevant matters such as performance, strategy, risks, capital structure, conflicts of interest and environmental, social or governance considerations, and using voting rights to effect the best possible long-term outcomes.

The Trustee's investment advisors assess the ability of each investment manager in engaging with underlying companies in order to promote the long-term success of the investments, and reports to the Trustee on an annual basis covering how the investment managers have acted in line with this policy.

When selecting, monitoring and de-selecting asset managers, stewardship is factored into the decision-making process to the appropriate level for the specific asset class in question.

Engagement with relevant persons includes the exercise of rights (including voting rights) attaching to the Scheme's equity investments which are exercised by the asset managers of the Scheme. The Trustee monitors and discloses the voting records of its managers on an annual basis.

The rationale for delegating responsibility to the investment managers with respect to the rights attached to the Scheme's investments is as follows:

- The investment managers are the closest party in the investment process to the underlying companies in which the Scheme holds investments.
- Through managing investments of multiple investors, the investment managers possess greater negotiating power and thus are more able to meaningfully influence the corporate governance of debt and equity issuers in a positive way.

Custody & Accounting

The Trustee currently employs JP Morgan Chase as the Scheme's global custodian (the 'Custodian'). The Custodian provides safekeeping of the Scheme's segregated mandates and performs administrative duties, including certain accounting functions on behalf of the Scheme.

The responsibility for selecting and monitoring the custodians of the investments managed within collective investment vehicles does not reside with the Trustee. The Trustee is satisfied with the arrangements in place.

For pooled investments, the Trustee accepts that the custody and safekeeping of assets are arranged by the investment managers themselves and no direct custody relationship with the Scheme exists.

The current bulk purchase annuity agreement policy with Legal and General Group plc is held by the Trustee.

Review of SIP

This SIP will be reviewed at least every three years or immediately following a significant change of investment policy or any material change to the Scheme. Written advice on any changes will be taken from the Investment Advisor. The Trustee seeks to maintain a good working relationship with LHRA and will consult them on any proposed changes to the SIP.

Signed on behalf of BAA Pension Trust Company Limited (the Trustee of the BAA Pension Scheme).