Statement of Investment Principles

This is the Statement of Investment Principles (the “Statement”) made by Diageo Pension Trust Ltd (the “Trustee”), as Trustee of the Diageo Pension Scheme (“the Scheme”) in accordance with the Pensions Act 1995 (as amended). The Statement, which was approved by the Trustee on 7 July 2023, is subject to periodic review at least every three years and without delay after any significant change in investment policy.

In preparing this Statement, the Trustee has consulted with the employer to the Scheme (Diageo plc) and has taken and considered written advice from the Investment Practice of Hymans Robertson LLP.

The Trustee is supportive of the UK Stewardship Code which seeks to improve the quality of engagement between institutional investors and investee companies. Where appropriate, the Trustee expects investment managers to comply with the code and to produce a statement of their commitment to the code.

Scheme objective

The primary objective of the Scheme, for the majority of its liabilities, is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependants, on a defined benefits basis. A small proportion of the Scheme’s liabilities is in the form of Retirement Accounts for a group of members. The accounts accrue 25% of Pensionable Pay for each year of service and the accumulated funds can be used to provide a lump sum and/or to purchase an annuity in the open market.

The Trustee’s overall investment objective is to manage the assets of the Scheme prudently so as to ensure that the benefits promised to members can be provided when they fall due.

In order to meet this objective, the Trustee seeks to:

- build up assets to provide for new benefits of active members as they are earned plus an allowance for the costs of death in service benefits and administration expenses, including premiums levied by the Pension Protection Fund;
- ensure that there are always sufficient assets of the Scheme (at their realisable value) to meet 100% of benefits as they fall due for payment to members; and
- either to retain any surplus, or, recover any shortfall in assets relative to the value placed on accrued liabilities as determined by a triennial or other actuarial valuation over a defined recovery period as agreed with the Company. In the event of a shortfall any required recovery plan is normally determined by taking into account the size of the funding shortfall, the business plan of the Company, the Trustee’s assessment of the financial covenant of the Company, any contingent security offered by the Company and the Scheme’s investment strategy.

The value of liabilities is calculated on the basis agreed by the Trustee and the Scheme Actuary; the Trustee also considers the Scheme’s funding position on a more stringent minimum risk or “self-sufficiency” basis. The funding position is monitored regularly by the Trustee and formally reviewed at each triennial actuarial valuation, or more frequently as required by the Pensions Act 2004.

Investment strategy and structure

The Trustee has translated its objectives into a suitable strategic (asset allocation) benchmark for the Scheme. The strategic benchmark is consistent with the Trustee’s view on the appropriate balance between seeking an enhanced long-term return on investments and accepting greater short-term volatility and risk.

The level of investment risk in the Scheme will be reduced as far as practicable as the funding level improves towards the self-sufficiency target.

The strategic benchmark is reflected in the benchmarks given to individual investment managers which, in aggregate, are intended to deliver the overall strategy.

The investment strategy takes account of the maturity profile of the Scheme (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit (relative to the funding bases used) and the Trustee's view of the covenant of the principal employer.

The Trustee monitors strategy relative to its agreed asset allocation benchmark. It is intended that investment strategy will be reviewed at least every three years following actuarial valuations of the Scheme, and will normally be reviewed annually. Written advice is received as required from professional advisers.

The Trustee monitors the performance of Scheme investments relative to agreed criteria on a regular basis.

The Trustee has delegated all day to day investment decisions to authorised investment managers.

The Trustee considers Responsible Investment, defined as ESG (Environmental, Social and Governance) impacts, including those of climate change, and the requirement for asset owners and investment managers to consider stewardship.

Choosing investments

The Trustee appoints investment managers to manage Scheme investments. All investment managers are authorised under the Financial Services and Markets Act 2000 to undertake investment business. The Trustee, after taking appropriate advice, has given the investment managers specific guidelines including, but not limited to, asset allocation and geographic spread, on how investment mandates are to be managed. The investment managers are allowed some flexibility of choice subject to their benchmarks and other guidelines and are expected to maintain diversified portfolios.

The Trustee reviews the nature of Scheme investments on a regular basis, with particular reference to suitability and diversification. The Trustee seeks and considers written advice from a suitably qualified person when determining the appropriateness of each manager and mandate for the Scheme, particularly in relation to diversification, risk, expected return and liquidity. If, at any time, investment in a security or product not previously known to the Trustee is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.

Strategic benchmark

The investment managers are instructed to deliver a specific performance target, which overall will align to deliver the broader Scheme investment strategy. The Trustee ensures that all manager engagements have clearly defined benchmarks, objectives and management parameters.

Where appropriate, and where commercial considerations permit, the terms of the mandate and the basis on which the manager is engaged will be defined specifically for the Scheme. Where such tailoring is not directly achievable, the Trustee will invest in pooled funds where the objectives of the fund and the policies of the investment manager will be evaluated by the Trustee to ensure that they are appropriate for the needs of the Scheme. The Trustee is satisfied that the pooled funds selected are consistent with the objectives of the Scheme, particularly in relation to diversification, risk, expected return and liquidity.

Investment manager remuneration

Remuneration for each mandate is determined at the inception of each mandate based on commercial considerations and typically set on an ad valorem basis. Where appropriate to the nature of the mandate, the term of the mandate and the role the mandate plays within the investment strategy, the Trustee may agree to a fee structure where the manager is incentivised to deliver outperformance relative to an agreed benchmark, typically in conjunction with a lower ad valorem fee. The Trustee periodically reviews the fees paid to its managers.

Investment time horizon

The Trustee recognises the long-term nature of its liability profile and appoints its managers to invest in such a way that generates long-term sustainable returns. The Trustee will carry out necessary due diligence on the underlying investment decision making process, to ensure the manager makes investment decisions over an appropriate time horizon aligned with the Scheme's objective.

The duration of each mandate is determined by the Trustee at the inception of each mandate. For open-ended investments, the Trustee generally engages managers on an ongoing basis with no pre-determined term of appointment. For such mandates, the Trustee expects the minimum duration of the appointment will be three years, this being the period over which performance of the mandate can be appropriately evaluated although all mandates are subject to ongoing review against various financial and non-financial metrics in addition to their continued appropriateness within the investment strategy. For close-ended investments, the Trustee expects the term of the appointment to be the lifetime of the investment, although the Trustee may seek to exit such investments earlier if this is deemed appropriate for the Scheme.

Balance between different kinds of investments

The Scheme's investment managers will each hold a mix of investments which reflects their views relative to their respective benchmarks or return targets. Within each asset class each manager will maintain a diversified portfolio of investments.

Expected return on investments

Over the long term, the overall level of investment returns is expected to be broadly in line or exceed the rate of return assumed by the Scheme Actuary in calculating the required funding for the Scheme. The Trustee will consider any decisions aimed to reduce the level of risk and the expected returns in the context of the Scheme's funding position.

Realisation of investments

The majority of the Scheme's investments may be realised quickly if required. Floating rate loans, property, private equity and private debt, which together currently represent approximately 35% of total Scheme assets, may be difficult to realise quickly in certain circumstances. As part of its de-risking strategy, the Trustee has commenced a phased sale or run off of a number of the more illiquid investments within the Scheme.

Kinds of investment to be held

The Scheme may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds, floating rate loans, cash, property, private equity, hedge funds and commodities either directly or through pooled funds.

The Scheme may also make use of contracts of insurance, derivatives and contracts for difference (either directly or in pooled funds investing in these products) for the purpose of efficient portfolio management or to hedge specific risks. The Trustee considers all of these classes of investment to be suitable in the circumstances of the Scheme.

Risk

The Scheme is exposed to a number of risks which pose a threat to the Scheme meeting its objectives. The principal risks affecting the Scheme are:

Funding risks

- Financial mismatch – The risk that Scheme assets fail to move in line with the developing cost of meeting the liabilities.
- Changing demographics –The risk that longevity improves and other demographic factors change, increasing the cost of the Scheme benefits.
- Systemic risk – The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Scheme's liabilities. Climate change is a particular systemic risk that has the potential to cause economic, financial and demographic impacts.

The Trustee measures and manages financial mismatch in a number of ways.

- The Trustee has set a strategic asset allocation benchmark for the Scheme. The Trustee assesses risk relative to that benchmark by monitoring the Scheme's asset allocation and investment returns relative to the benchmark. The Trustee also assesses risk relative to liabilities by monitoring the delivery of returns relative to liabilities.
- The Trustee keeps mortality and other demographic assumptions, which could influence the cost of benefits, under review. These assumptions are considered formally at triennial valuations and the Trustee may enter into insurance contracts (bulk annuities or longevity swaps) to reduce these demographic risks.
- The Trustee seeks to mitigate systemic risks through a diversified portfolio and regularly meets with its investment managers to monitor performance. However, it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset risks

- Concentration – The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity – The risk that the Scheme cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Scheme's assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Manager underperformance – The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.
- Environmental, Social and Governance (ESG) risks – the extent to which ESG issues are not reflected in asset prices and/or not considered in investment decision making, which could result in underperformance relative to expectations. Climate risk is viewed as a subset of ESG risks and is the extent to which climate change causes a material deterioration in asset values as a consequence of factors including but not limited to policy change, physical impacts and the expected transition to a low-carbon economy.

The Trustee manages asset risks as follows.

- The Trustee provides a practical constraint on Scheme investments deviating greatly from the intended approach by investing in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrain risk within their expected parameters.

- By investing across a range of assets, including quoted bonds (and possibly in the future bulk annuity policies), the Trustee recognises the need to access funds in the short term to pay benefits. The Trustee also acknowledges that the need for liquidity will increase as the Scheme matures and has reflected these considerations in its de-risking strategy for the Scheme.
- In appointing several investment managers, the Trustee has considered the risk of underperformance by any single investment manager.
- The Trustee does not expect managers to take excess short-term risk and will regularly monitor the manager's performance against an appropriate benchmark on a short, medium and long-term basis.
- The Trustee's approach to the consideration of ESG risks including climate risk is set out in further detail below.

Other provider risk

- Transition risk – The risk of incurring unexpected costs in relation to the transition of assets among managers.
- Custody risk – The risk of loss of Scheme assets or losing economic rights to Scheme assets, when held in custody or when being traded.
- Credit default – The possibility of default of a counterparty in meeting its obligations.
- Operational risk – The risk of loss as a result of fraud, cyber attacks, poor advice, acts of negligence or lack of suitable process
- Legislative risk – The risk that managers of the Scheme fail to comply with changes to legislation.

The Trustee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Scheme, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). When carrying out significant transitions, the Trustee seeks professional advice.

Manager engagement

Performance evaluation

The Trustee carries out regular monitoring of the Scheme's investments and managers through regular meetings with the managers, review of investment performance relative to the benchmark and reporting on strategic and funding risks. The Trustee also seeks information from its investment managers on meeting objectives of the mandates and exercising stewardship responsibilities (including engagement with issuers) as set out in greater detail below, and the management of other risks. Material deviation from performance or risk targets is likely to result in the mandate being formally reviewed.

Portfolio turnover

The Trustee has expectations of the level of turnover within each mandate which is determined at the inception of the mandate, based on the Trustee's knowledge of the manager, investment process and the nature of the portfolio. Whilst the Trustee expects performance to be delivered net of costs, including the costs of trading within the portfolio, the Trustee expects managers to report on at least an annual basis on the underlying assets held within the portfolio and details of any transactions over the period. The Trustee will challenge the manager if there is a sudden change in portfolio turnover or if the level of turnover seems excessive.

Consideration of financially material factors in investment arrangements

The Trustee recognises that the consideration of financially material factors over the appropriate time horizon of the investments, including ESG factors, is relevant at different stages of the investment process. The Trustee further recognises that the financial materiality of any factor, including ESG factors, is context specific and that whilst some factors may be relevant to certain stocks/assets, they may not be relevant to others.

The Trustee will consider such factors in the development and implementation of their investment arrangements, for the purposes of determining the selection, retention and realisation of investments, where there is sufficient data or evidence to allow them to systematically do so. Where there is not sufficient data or evidence, they will engage with their investment managers to ensure they take such considerations into account within their decision making. The Trustee has explicitly acknowledged the relevance of ESG factors in framing its investment beliefs and these beliefs are detailed in the Trustee's separate Responsible Investment policy, reflected in the principles set out below and the broader implementation of strategy.

Strategic considerations

The strategic benchmark has been determined using appropriate long-term economic and financial assumptions from which expected risk/return profiles for different asset classes have been derived. These assumptions apply at a broad market level and are considered to implicitly reflect all financially material factors.

The Trustee regularly discusses the impact of climate change on investment decisions with its investment adviser/investment managers to consider the potential implications for the Scheme's investments. The Trustee has not yet made explicit allowance for the risks of climate change in setting its strategic asset allocation nor in setting its benchmark given current inherent uncertainty but carries out regular reviews when meeting with managers The Trustee recognises the significance of climate change- related risks and has carried out scenario analysis and stress testing and reported against the Taskforce for Climate-related Financial Disclosures (TCFD). As part of TCFD the Trustee has set climate metrics and targets for some of the Scheme's mandates and a Net Zero aspiration for the Scheme as a whole. So far, the targets have been set for the mandates with sufficient data availability and quality but the Trustee will continue to work with its investment managers to introduce targets for the remaining mandates as and when data quality and availability improves.

Structural considerations

Given the discretion afforded to the active Investment Managers, the Trustee expects that its Investment Managers will take account of all financially material factors including the impact of ESG factors in the implementation of their respective mandates.

Within active mandates, the Trustee has delegated responsibility for the consideration of stock specific issues to its individual investment managers. The Trustee has discussed the extent to which ESG issues, where relevant to the investment mandate, are integrated into the investment processes of its investment managers and is satisfied that the investment managers are following an approach which takes account of all financially material factors.

Selecting and monitoring investment managers

The Scheme's managers have produced statements setting out their ESG policy and authority has been delegated by the Trustee to the managers to act accordingly. However, the Trustee recognises that the ESG policies may not be specific to the Scheme's assets. The Trustee reviews ESG activity as part of the monitoring process with each manager – a standard approach to reporting on ESG factors across all managers has been adopted through the use of a portfolio mapping document, to enable more efficient monitoring of ESG activity. The Trustee reviews the Scheme's Responsible Investment policy, which includes the Trustee's policy on mandate exclusions, annually, and maintains the portfolio mapping document which summarises each manager's ESG policy and their progress to continuously improve their ESG risk management framework. Additionally, the

Trustee meets with managers regularly to receive updates on their progress and to encourage improvements on their ESG practices.

In selecting new investment managers for the Scheme, where relevant to the investment mandate, the Trustee explicitly considers potential managers' approaches to responsible investment and the extent to which managers integrate ESG issues in the investment process as a factor in their decision making.

Consideration of non-financially material factors in investment arrangements

Given the objectives of the Scheme, the Trustee has not considered any non-financially material factors in the development and implementation of its investment strategy.

The Trustee has not imposed any restrictions or exclusions to the investment arrangements based on non-financially material factors.

However, the Trustee may consider investing in specific ESG-focused opportunities within the existing mandates or introduce new portfolios which explicitly consider ESG factors in the asset selection process. In doing so, the Trustee will take into account the investments' risk-return profile to ensure the overall risk within the strategy is within the Trustee's tolerance level and does not compromise security of members' benefits.

Stewardship

The Trustee recognises that stewardship encompasses the exercise of voting rights, engagement of investment managers with the entities they invest in, engagement with investment managers and the monitoring of compliance with agreed policies.

Voting and engagement

The Scheme no longer has any investments in company shares and so does not have voting rights over any of its investments.

Where appropriate, the Trustee will engage with and may seek further information from its investment managers on how portfolios may be affected by a particular issue.

The Trustee does not engage directly but expects its investment managers to engage with key stakeholders which may include corporate management, regulators and governance bodies, relating to its investments in order to consider the management of conflicts of interest, improve corporate behaviours, improve performance and mitigate financial risks. The Trustee will review engagement activity undertaken by its investment managers as part of its broader monitoring activity.

The Trustee separately considers any conflicts of interest arising in the management of the Scheme and its investments and has ensured that each manager has an appropriate conflicts of interest policy in place.

Monitoring

The Trustee meets with all its investment managers regularly. Managers are challenged both directly by the Trustee and by its investment advisers on the impact of any significant issues including, where appropriate, ESG issues that may affect the prospects for return from the portfolio. They are also asked to confirm awareness of any investments that breach or contradict the Trustee's Responsible Investment policy.

Additional Voluntary Contributions (AVCs)

The Trustee gives eligible members the opportunity to invest in a range of funds at the individual member's discretion.

Signed for and on behalf of the Trustee of the Diageo Pension Scheme

P. Goshawk

Peter Goshawk
Chairman
Diageo Pension Trust Limited
Trustee of the Diageo Pension Scheme