Statement of Investment Principles

This is the Statement of Investment Principles (the "Statement") made by Diageo Pension Trust Ltd, as Trustee (the "Trustee") of the Diageo Lifestyle Plan ("the Plan") in accordance with the Pensions Act 1995 (as amended). The Statement, which was approved by the Trustee on 4 August 2020, 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 Plan (Diageo plc) and has taken and considered written advice from the Investment Practice of Hymans Robertson LLP.

In relation to the Myners Code of Conduct for Investment Decision Making, the extent of the Trustee's adoption of the Code is provided in a separate document named the Myners Code Adherence Document.

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.

Plan objective

The primary objective of the Plan is to provide members with a Retirement Account that can be used on their retirement to provide a lump sum and/or annuity purchased from the open market. In addition, it provides benefits on death, before retirement, for their dependants.

The Plan is a trust based, cash balance plan, providing retirement and death in service benefits. There is a Normal Retirement Date of age 65 and for retirement benefits members accrue 25% of Pensionable Pay for each year of service. This is then credited to an individual retirement account. Whilst in service, the retirement account is revalued each year by the lower of inflation or 5%. The Trustee then uses the proceeds of a member's retirement account to provide benefits in the form requested by the member. In the event of death in service, a lump sum of a minimum of six times Pensionable Pay is payable.

The Trustee's overall investment objective is to manage the assets of the Plan prudently so as to ensure that the benefits promised to members are provided when they fall due.

The value of liabilities is calculated on the basis agreed by the Trustee and the Scheme Actuary. 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

The Trustee has translated its objectives into a suitable strategic (asset allocation) benchmark for the Plan. 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; it also takes account of the maturity profile of the Plan (in terms of the expected retirement date of the members of the Plan), together with the level of disclosed surplus or deficit (relative to the funding bases used).

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 Plan (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 Plan and will normally be reviewed annually. Written advice is received as required from professional advisers.

The Trustee monitors the performance of Plan 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 Plan 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 investment managers are instructed to deliver a specific performance target, which overall will align to deliver the broader Plan 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 Plan. 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 Plan.

The Trustee is satisfied that the pooled funds selected are consistent with the objectives of the Plan, particularly in relation to diversification, risk, expected return and liquidity.

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 all of its managers against industry standards.

The Trustee reviews the nature of Plan 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 Plan, particularly in relation to diversification, risk, expected return and liquidity. The Trustee seeks and considers written advice from a suitably qualified person in undertaking such a review. 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.

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 Plan'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.

The Trustee carries out regular monitoring of the Plan's investments and managers through biannual manager monitoring group meetings, 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.

Kinds of investment to be held

The Plan 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 and commodities either directly or through pooled funds.

The Plan may also make use of contracts of insurance, derivatives and contracts for difference (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 Plan.

Balance between different kinds of investments

The Plan's investment managers will 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.

Risk

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

Funding risks

- Financial mismatch – The risk that Plan assets fail to grow 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 Plan 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 Plan'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 two ways. As indicated above, the Trustee has set a strategic asset allocation benchmark for the Plan. The Trustee assesses risk relative to that benchmark by monitoring the Plan'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 Plan cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Plan'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 leading to 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 Plan 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 its expected parameters.

By investing across a range of assets, including quoted equities, 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 risk of manager underperformance is mitigated by the inclusion of passive investment mandates within the investment portfolio. The Trustee carries out regular monitoring of the Scheme's investments and managers through biannual manager monitoring group meetings and review of investment performance relative to the benchmark.

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-terms basis.

The Trustee's approach to the consideration of ESG risks and 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 Plan assets or losing economic rights to Plan assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.

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 Plan, 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.

Expected return on investments

The investment strategy aims to achieve a return on Plan assets, which taken in conjunction with, contributions is sufficient over time to match growth in the Plan's pension liabilities.

Realisation of investments

The majority of the Plan's investments may be realised quickly if required. Senior syndicated loans, which represent approximately 25% of total Plan assets at the date of writing, may be difficult to realise quickly in certain circumstances.

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.

The Trustee will request turnover costs incurred by the asset manager over the Plan reporting year. Where possible the Trustee will compare costs to the theoretical portfolio turnover and cost for an appropriate index.

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 periodically discusses the impact of climate change on investment decisions with its investment adviser/investment managers to consider the potential implications for the Plan'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 at manager monitoring meetings. The Trustee recognises significance of climate change as an emerging risk and may take a more active approach to managing this risk in the future, for example by adopting the Task Force on Climate-related Financial Disclosures ("TCFD") framework.

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 potential impact of ESG factors in the implementation of their mandates.

Selecting investment managers

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.

In passive mandates, the Trustee recognises that the choice of benchmark dictates the assets held by the investment manager and that the manager has minimal freedom to take account of factors that may be deemed to be financially material. The Trustee accepts that the role of the passive manager is to deliver returns in line with the benchmark and believe this approach is in line with the basis on which its current strategy has been set.

In selecting new investment managers for the Plan, where relevant to the investment mandate, the Trustee explicitly considers potential managers' approach 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 Plan, 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 Trustee has adopted a policy of delegating voting decisions on stocks to its investment managers on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. The investment managers are expected to exercise the voting rights attached to individual investments in accordance with their own house policies.

Where relevant, the Trustee has reviewed the voting policies of its investment managers and determined that these policies are appropriate.

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 Plan and its investments and has ensured that each manager has an appropriate conflicts of interest policy in place.

Monitoring

Investment managers report on voting activity to the Trustee on a periodic basis. The Trustee will monitor investment managers voting activity and may periodically review managers voting patterns. The Trustee may also monitor investment managers' voting on particular companies or issues affecting more than one company.

The Trustee aims to meet with all its investment managers on a biannual basis. The Trustee provides their managers with an agenda for discussion, including where appropriate, ESG issues. 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 statement of Responsible Investment policy.

For and on Behalf of the Trustee of the Diageo Lifestyle Plan

Charles Coase
Chairman
Diageo Pension Trust Limited
Trustee of the Diageo Lifestyle Plan