

O2 Pension Plan

Statement of Investment Principles

This Statement of Investment Principles (“the SIP”) covers both the Defined Benefit and the Defined Contribution sections of the O2 Pension Plan (“the Plan”), and clarifies the Trustee’s policy relating to Governance.

Defined Benefit (“DB”) Section

Investment objective

The Trustee’s overall investment policy is guided by the following objectives:

- The Trustee recognises the importance of the Plan in providing a reasonable level of benefit, at a reasonable cost to the sponsor. The primary investment objective is thus to invest the assets in such a way that the expected cost of providing the benefits is maintained at an acceptable level without reducing the security (solvency) of the Plan to an unacceptable level.
- The Trustee is aiming to achieve a greater return than that assumed by the Plan Actuary and thereby contribute to the repair of a deficit and possibly create a surplus. An investment strategy which strives for higher return without significantly increasing the level of risk is acceptable.

The Plan’s funding position will be estimated and reviewed quarterly to assess the position relative to the funding target and whether the investment policy remains appropriate to the Plan’s circumstances.

Risks

Before deciding whether and how much investment risk to take relative to the liabilities, the Trustee receives advice from the Investment Advisor and Plan Actuary, and holds discussions with the sponsor. In particular, it considers carefully the following possible consequences:

- The assets might not achieve the excess return relative to the liabilities anticipated over the longer term. This would result in deterioration in the Plan’s financial position and consequently higher contributions from the sponsor than are currently expected.
- The relative value of the assets and liabilities will be more volatile over the short term than if investment risk had not been taken. This will increase the likelihood of there being a shortfall of assets relative to the liabilities in the event of discontinuance of the Plan. This consequence is particularly serious if it coincides with the sponsor being unable to make good the shortfall.
- This volatility in the relative value of assets and liabilities may also increase the short-term volatility of the sponsor’s contribution rate set at successive actuarial valuations, depending on the approach to funding adopted.

The Trustee’s willingness to take investment risk is dependent on the continuing financial strength of the sponsor and its willingness to contribute appropriately to the Plan. The

Trustee would consider reducing investment risk relative to the liabilities should either of these deteriorate.

The degree of investment risk the Trustee is willing to take also depends on the financial health of the Plan and the Plan's liability profile. The Trustee monitors these with a view to altering the investment objectives, risk tolerance or return target should there be a significant change in either.

Investment strategy

The Trustee has opted to follow a strategy which is tailored to meet the specific demands of the Plan's liability profile and funding status, and to be consistent with the Plan's own objectives. In particular, the Trustee has taken advice from the Plan Actuary and from their Investment Advisor regarding the likely sensitivity of the Plan's financial position to different investment strategies.

The Plan's present investment objective is to achieve a return of around 2.8% per annum above the return on UK Government bonds (which are considered to move in a similar fashion to the calculated value of the Plan's liabilities).

The Plan's present strategy is to invest according to the following broad asset allocation:

Asset Class	Proportion	Expected Return ⁽¹⁾ (relative to UK Government bonds)
UK Equities ⁽²⁾	25.0%	2.85%
Global Equities	37.0%	2.85%
Hedge Funds	20.0%	2.50%
Active Currency	3.0%	14.50%
Long Lease Property	7.5%	1.50%
Sterling Non-Gilts	3.75%	0.60%
Index-Linked Gilts	3.75%	0.00%
Total	100.0%	2.84%

Note: ⁽¹⁾ Net of investment management fees. ⁽²⁾ There is an element of UK Equities included in the Global Equities asset class.

The expected returns shown in the above table represent long-term expectations of asset classes as a whole. Where the Plan has appointed "active" fund managers, their objective is to outperform the market average. Short-term returns in some asset classes may exhibit considerable variability.

The Trustee recognises that the investment strategy is subject to risk, in particular the risk of a mismatch between the performance of the assets and the calculated value of the liabilities. This risk is monitored by regularly assessing the funding position and the characteristics of the assets and liabilities. The risk is managed by investing in assets which are expected to perform in excess of the liabilities over the long term, and also by investing in a suitably diversified portfolio of assets with the aim of reducing (as far as possible) volatility relative to the liabilities. The assets of the Plan consist predominantly of investments admitted to trading on regulated markets.

Investment mandates

The Trustee has appointed various Investment Managers to manage the assets of the Plan – their mandates are detailed below. All the Investment Managers are regulated under the Financial Services and Markets Act 2000.

Investment Managers	Benchmark Allocation	Control Ranges
BlackRock Investment Management (“BlackRock”)	25.0%	±5%
Gartmore Investment Management (“Gartmore”)	25.0%	±5%
Neptune Investment Management (“Neptune”)	12.0%	±3%
Gottex Fund Management (“Gottex”)	20.0%	±3%
Record Currency Management Limited (“Record”)	3.0%	±1.5%
M&G Investment Management (“M&G”)	7.5%	±3%
Legal & General Investment Management Limited (“L&G”)	7.5%	±2%

Note: The control ranges are for guidance only

The Trustee monitors the overall allocation between the investment managers on a quarterly basis and takes any corrective action, as it sees appropriate. Rebalancing will be effected by cashflows, where possible, to avoid unnecessary transaction costs. The transfer of assets/cash between Investment Managers will be used to rebalance where cashflow is insufficient.

BlackRock Investment Management – UK equities

BlackRock manage a concentrated portfolio of UK equity assets. Their performance objective is to outperform the FTSE All-Share Index. Although BlackRock’s mandate has no formal outperformance target the Trustee expects BlackRock to return around 3% per annum above the FTSE All-Share Index over rolling 3 year periods (gross of fees).

Gartmore Investment Management – global equities

Gartmore manage a concentrated portfolio of global equity assets. Their performance objective is to outperform the MSCI World Index by 3% per annum (gross of fees) over rolling 3-5 year periods.

Neptune Investment Management – global equities

Neptune manage a concentrated portfolio of global equity assets. Their performance objective is to outperform the MSCI World Index by 4% per annum (gross of fees) over rolling 3 year periods.

Gottex Fund Management – fund of hedge funds

The Plan invests in the Market Neutral Plus Fund which is a fund of hedge funds managed by Gottex. Their performance objective is to outperform the return of 1 Month LIBOR by 4-6% per annum (net of fees). Their target level of volatility is 2-3% per annum.

Record Currency Management – active currency

The Plan invests in the Cash Plus Fund which is an active currency fund managed by Record.

Their performance objective is to outperform 1 Month LIBOR–0.1% per annum over a three year period (gross of fees). Although the Cash Plus Fund has no formal outperformance target the Trustee expects Record to return around 14% per annum above 1 Month LIBOR over a 3-5 year period (net of fees). Their expected level of volatility is around 30% per annum.

M&G Investment Management – long lease property

The Plan invests in the Secured Property Income Fund which is a property fund managed by M&G. Their performance objective is to achieve an average net equity internal rate of return of gilts (of equivalent duration) plus 1.5%, over the medium to long-term. The Trustee uses an objective of 1.5% per annum (gross of fees) above a composite benchmark (50% FTSE Over 15 Year Gilt Index and 50% FTSE 1-15 Year Index-Linked Gilt Index) over rolling 3-5 year periods for performance measurement purposes.

Legal & General Investment Management - bonds

The Plan invests in the following pooled bond funds managed by L&G. Their performance objective is to match the return of the benchmark index for the respective funds.

Pooled fund	Proportion	Benchmark Index	Control Range
Investment Grade Corporate Bond-All Stocks	50.0%	iBoxx £ Non-Gilts	±2.5%
Over 5 Year Index-Linked Gilts	50.0%	FTSE-A Index-Linked (Over 5 Year)	±2.5%
Total	100.0%		

L&G invest/disinvest any cashflows to maintain the allocations as close as possible to the central benchmark. Should this be insufficient to maintain the allocations within the control ranges, L&G will rebalance back to the central benchmark on a monthly basis.

Investment Restrictions and Sponsor-Related Investments

Most decisions about the day-to-day management of the assets have been delegated to the Investment Managers via written agreements. This delegation includes decisions about:

- Realisation of investments;
- Social, environmental and ethical considerations in the selection, retention and realisation of investments; and
- The exercise of rights (including voting rights) attached to the investments.

The Trustee takes the Investment Managers’ policies in the above respects into account when selecting and monitoring them. The Investment Managers are expected to exercise their powers of investment with a view to giving effect to the principles contained within the SIP, so far as reasonably practicable.

The Trustee’s policy is not to hold any direct sponsor-related investments as defined in the Pensions Act 1995 and the Occupational Pension Schemes (Investment) Regulations 2005.

In particular, other than to the extent that pooled funds are invested in securities issued by Telefónica S.A. (or any other related group company) the Investment Managers are not permitted to invest in such securities without the Trustee's prior consent. Where the Plan invests in pooled vehicles that may hold sponsor-related investments the total exposure to sponsor-related investments will not exceed 5% of the Plan's value.

Investment Management Fees

The Investment Managers' remuneration is based upon a percentage value of the assets under management. BlackRock, Gartmore, Neptune, Gottex and Record receive additional remuneration based on the level of outperformance. The fees have been negotiated to be competitive.

Custodian

The assets managed by BlackRock, Gartmore and Neptune are segregated portfolios, which are held by the Plan's global custodian, Bank of New York Mellon ("BNYM"). BNYM is responsible for the safekeeping of the Plan's individual securities and for performing the associated administrative duties such as trade settlement, dividend collection, corporate actions, tax reclamation and proxy voting (under instruction from the Investment Managers). In addition, BNYM monitors the Plan's investment performance on a quarterly basis, performs cash management and organises securities lending.

The Plan's assets managed by Gottex, Record, M&G and L&G are invested in pooled funds. The custody of the holdings is arranged by the Investment Managers. In addition, BNYM hold record of the Plan's pooled fund investments.

Defined Contribution (“DC”) Section

Investment objective

In investing the assets of the Plan in a prudent manner, the Trustee’s key aim is to provide a range of investments that are suitable for meeting members' long and short-term investment objectives. They have taken into account their understanding of members' circumstances, in particular members' attitudes to risk and term to retirement.

The DC section’s investment objective is implemented using the range of investment options set out in the table below.

Investment Option	Investment description	Investment characteristics
Default	Lifestyle	More than 5 years from retirement invests in the L&G Global Equity Fixed Weights (50:50) Index Fund. 5 years before retirement switches are made to the L&G Over 15 Years Gilts Index Fund and into the L&G Cash Fund
UK equity fund	UK equities	Invests in UK company shares. The returns will be more volatile and less secure than from UK government bonds. To compensate for this extra risk, investors expect higher investment returns from this asset class
Global equity fund	Worldwide equities	Similar comments as for UK equities. There will also be additional risk due to currency movements. However, the additional diversification will help to reduce risk.
UK fixed interest fund	UK fixed interest gilts and corporate bonds	Investment returns are fairly stable although the expected returns are lower than for equities.
UK index-linked gilts fund	UK index-linked gilts	Similar comments as for UK fixed interest. In addition, investment returns are not eroded by unanticipated inflation.
Cash Fund	Short-term cash instruments	Produces fairly reliable nominal investment returns

The structure of the default fund was chosen so as to try to maximise expected long term investment returns, but to protect against changes in annuity prices as members near retirement.

It is the Trustee’s policy to provide suitable information for members so that they can make the appropriate investment decisions. The initial range of funds was chosen to replicate the arrangements previously available to members through the BT arrangements. The Trustee has since added further options to the fund range that are managed using an active management approach. The Trustee also holds a closed policy with Equitable Life in respect of the AVCs of a small number of DB members who transferred from the BT arrangements.

The Trustee expects the long-term return on the investment options that invest predominantly in equities to exceed price inflation and general salary growth. The long term returns on the bond and cash options are expected to be lower than the predominantly equity options. However, bond funds are expected to broadly match the price of annuities, giving some protection in the amount of secured pension for members closer to retirement. Cash funds will provide protection against changes in short-term capital values, and may be appropriate for members receiving part of their retirement benefits in the form of tax-free cash.

Risk

The Trustee recognises the key risk is that members will have insufficient income in retirement or an income that does not meet their expectations. The Trustee considered this risk when setting the investment options and strategy for the Plan. The Trustee's policy in respect of risk measurement methods and risk management processes is set out below.

The Trustee considers the following sources of risk:

- Risk of not meeting the reasonable expectations of members, bearing in mind members' contributions and fund choices.
- Risk of fund manager not meeting its objectives ("manager risk"). This risk is considered by the Trustee and its advisers both upon the initial appointment of the fund manager and on an ongoing basis thereafter.
- Risk of the default fund being unsuitable for the requirements of some members.
- The risk of fraud, poor advice or acts of negligence ("operational risk"). The Trustee has sought to minimise such risk by ensuring that all advisers and third party service providers are suitably qualified and experienced and that suitable liability and compensation clauses are included in all contracts for professional services received.

Due to the complex and interrelated nature of these risks, the Trustee considers these risks in a qualitative rather than quantitative manner as part of each formal strategy review. The Trustee's policy is to regularly review the range of funds offered and the suitability of the default option.

These risks are considered as part of each normal strategy review. In addition, the Trustee measures risk in terms of the performance of the assets compared to the benchmarks on a quarterly basis, along with monitoring any significant issues with the fund managers that may impact their ability to meet the performance targets set by the Trustee.

Implementation

The investment options chosen by the Trustee are as follows:

Legal & General Investment Management ("L&G")

A range of funds managed by L&G using an index tracking (or passive) management approach. This means that they will hold almost all securities in the markets in line with the weight of each security in the respective benchmark index. The L&G arrangement represents a direct investment in the form of an insurance policy held with Legal & General Assurance (Pensions Management) Ltd, which in turn holds units in a range of L&G pooled funds,

managed by L&G Investment Management.

The funds are set out below:

Pooled fund	Benchmark Index	Risk characteristics
UK Equity Index	FTSE All Share	Expected long term returns above bonds and cash but more volatile
Global Equity Fixed Weights (50:50) Index	Composite: 50% UK; 17.5% Europe (ex UK); 17.5% North America; 8.75% Japan; 6.25% Pacific (ex Japan)	Expected long term returns above bonds and cash but more volatile
Over 15 Years Gilts Index	FTSE A Gilts (Over 15 Years)	Expected returns are lower than for equities but more stable
Over 5 Year Index-Linked Gilts Index	FTSE A Index-Linked (Over 5 Years)	Expected returns are lower than for equities but more stable
Cash Fund	7-Day LIBID	Provides short-term capital protection but may not keep pace with price and salary inflation.
Default	Dependant on underling fund	Dependant on underling fund

Note: All L&G's funds aim to track the relevant benchmark index

UBS Global Asset Management ("UBS")

A range of funds managed by UBS using an active management approach. This means that they try to outperform a benchmark index.

The funds are set out below:

Pooled fund	Performance target	Benchmark	Risk Characteristics
UK equity	To outperform the benchmark by 1% pa over rolling 3 year periods	FTSE All Share	Expected long term returns above bonds and cash but more volatile
Global equity	To outperform the benchmark by 2% pa over rolling 3 year periods	FTSE All World Developed (ex UK) Index	Expected long term returns above bonds and cash but more volatile

HSBC Investments ("HSBC")

A further fund, which is managed in line with principles which comply with Islamic law, is managed by HSBC using a passive management approach. It is set out below.

Pooled fund	Performance target	Benchmark	Risk Characteristics
Global equity	To track the benchmark	Dow Jones Islamic Market Titans 100 Index	Expected long term returns above bonds and cash but more volatile

UBS, L&G and HSBC are remunerated through a fee that is a percentage of the Plan's assets under their management. The charges have been negotiated to ensure competitiveness and are reviewed regularly.

In addition, UBS, L&G and HSBC pay commissions to third parties on trades they undertake in the management of the assets.

Governance

The Trustee is responsible for the investment of the Plan assets. The Trustee takes some decisions themselves and delegates others. When deciding which decisions to take themselves and which to delegate, the Trustee has taken into account whether they have the appropriate training and expert advice in order to make an informed decision.

When making such decisions, and when appropriate, the Trustee takes written advice. The Trustee's Investment Advisers, KPMG LLP, are qualified by their ability in and practical experience of financial matters, and have the appropriate knowledge and experience. The Investment Adviser's remuneration may be a fixed fee or based on time worked, as negotiated by the Trustee in the interests of obtaining best value for the Plan.

The Trustee has established the following decision making structure:

Party	Responsibility
Trustee	<ul style="list-style-type: none">• Monitors actual returns versus Plan benchmark.• Sets structures and processes for carrying out their role• Selects and monitors planned asset allocation• Selects and monitors direct investments• Selects and monitors Investment Advisers and Investment Managers• Determines investment structures and their implementation• Makes day-to-day decisions relevant to the operation of Plan's investment strategy
Investment Advisor	<ul style="list-style-type: none">• Advises on all aspects of the investment of the Plan assets, including implementation• Advises on this statement• Provides required training
Investment Managers	<ul style="list-style-type: none">• Operates within the terms of this statement and their written agreements• Selects individual investments with regard to their suitability and diversification• Advises Trustee on suitability of their benchmarks

Direct investments

Direct investments, as distinguished by the Pensions Act 1995, are products purchased without delegation to an Investment Manager through a written contract. These include the policies held with L&G, UBS and HSBC plus the closed policy held with Equitable Life in respect of a small number of DB members' Additional Voluntary Contributions. When selecting and reviewing any direct investments, the Trustee will obtain appropriate written advice from their Investment Advisers.

Compliance

This Statement has been prepared in compliance with the Pensions Act 1995, the Pensions Act 2004, and the Occupational Pension Schemes (Investment) Regulations 2005. Before preparing or subsequently revising this Statement, the Trustee consulted the sponsoring employer and took appropriate written advice. The Statement is reviewed at least every three years, and without delay after any significant change in investment policy.

Signed

Date:

For and on behalf of O2 Pension Trustee Limited (the Trustee of the O2 Pension Plan)