

# JOURNEY

BECAUSE PLANNING IS PART OF THE JOURNEY

# 2011

www.baesystemspensions.com

**Your annual update**  
from the Trustees of your  
pension scheme

## NEED SOME HELP?

All the contact details  
are on the back page

## MEMBER CASE STUDY

Helen Bellamy gives us her view



See page 6

## VALUATION IN PROGRESS

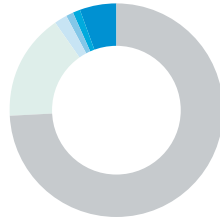
An update on the current  
actuarial valuation



See page 11

## INVESTMENT UPDATE

from the Scheme's  
Investment Officer



Starts on page 18

# WELCOME



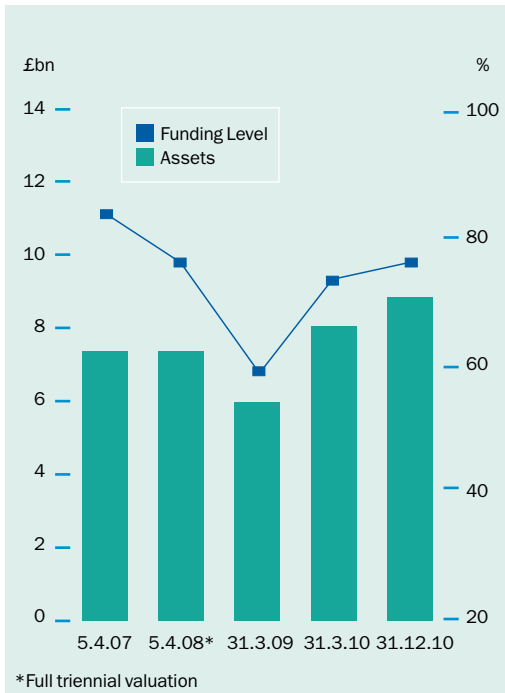
**Guy Griffiths**  
Chairman of  
the Trustees

Welcome to the 2011 Trustees' Annual Review of the BAE Systems Pension Scheme. In the following pages you will find a summary of the Report and Accounts together with an overview of the past year to keep you up to date.

## The Trustees' year

Pension schemes exist in an environment that is constantly changing and this year has been no exception. It is important that as Trustees we keep up to date with developments in the wider pensions world and understand how they affect the Scheme. The Trustee Board continues to focus on minimising risk to the Scheme and ensuring that sufficient funds are available to pay benefits to members when due.

During the year David Adam was appointed as Chief Investment Officer of our lead investment manager, BAPFIM, following David Brief's retirement. His appointment was made after an intensive search instigated by the Company, using a global executive search organisation and both internal and external appointments were considered.



At the end of the Scheme year the value of the investments had increased to £9bn (from £8bn in the previous year) and David provides more detail on investment performance on page 18. The chart on the left illustrates the trend of Scheme assets and the extent to which our long term liabilities are covered by these (the 'funding level').

The latest funding level shown is the Scheme Actuary's estimate at 31 December 2010 as the formal valuation as at 31 March 2011 is in progress at the time of writing.

The Trustee Board also continues to monitor the longer term funding levels of the Scheme and we have included information in this Annual Review that was previously presented as the Summary Funding Statement. During the year the Trustee Board collected contributions in accordance with the

Schedule of Contributions which have been supplemented by an additional employer contribution of £112m. The formal triennial actuarial valuation is being undertaken by the Actuary and once the outcome is known we will make you aware of this. As this work is important in understanding the Scheme's longer term funding, we have included an article on page 11 that explains the main stages of the valuation process.

I mentioned in last year's review that Xafinity Paymaster have been appointed to provide pensions administration services to the Scheme and I am pleased to report that the transfer of administration to them was made successfully in December. The second phase of the programme is currently under way and this will culminate in the transition to its new administration system in 2012. This will result in a significantly enhanced service.

### Scheme governance

We keep all aspects of the management of the Scheme under regular review, with the aim of adopting best practice in all that we do. Important parts of our role are maintaining a view of the Scheme's health independent from the Company, formulating the investment policy and acting in members' interests.

Our governance programme also includes the review of the performance of key

providers, advisers and the Company's pensions team. We recently reviewed and retained the services of Standard Life, who provides investment management for both the 100+ Retirement Accounts and AVCs. The range of funds and the structure of the Lifestyle Profiles available to members has changed following this review and the full list of funds is shown on page 22.

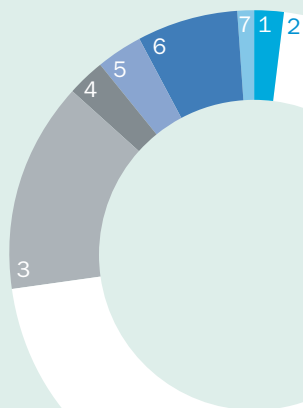
In last year's Annual Review we explained that much of the Scheme's governance is managed through our Audit, Discretionary and Investment Committees. In this issue we have included articles that explain how we manage risks that may threaten the well-being of the Scheme, together with an explanation of the training that is undertaken by Trustees to ensure we remain fully up to date with matters affecting the Scheme.

This year we have said farewell to five Trustees; Mark Dalton, Terry Dillon, David Moakes, Tom Royle and Neil Sheehan. I would like to take this opportunity to thank them all for their significant contributions to the Scheme and to wish them a long and happy retirement. Details of the current Trustee Board are provided on page 8.

If you would like to comment about any of the contents, or to suggest items that we could include in future, please contact me via the Pensions Service Centre, using the details on page 24.

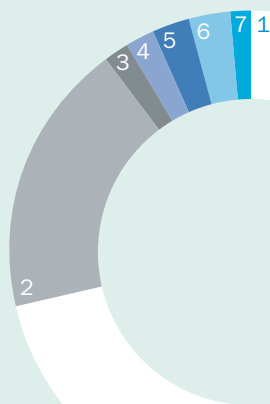


# FINANCIAL SUMMARY



## CONTRIBUTIONS AND OTHER INCOME TOTALLED £621 MILLION

	<b>2011</b>	2010
	<b>£m</b>	£m
<sup>1</sup> Members' contributions	<b>12.3</b>	12.2
<sup>2</sup> Company contributions	<b>441.0</b>	349.5
<sup>3</sup> Smart contributions	<b>85.7</b>	88.4
<sup>4</sup> Members' additional contributions	<b>15.7</b>	13.1
<sup>5</sup> National Insurance age related rebates	<b>19.5</b>	20.1
<sup>6</sup> Investment income from property	<b>40.0</b>	36.1
<sup>7</sup> Other income	<b>6.6</b>	6.6
<b>TOTAL</b>	<b>620.8</b>	526.0



## THE SCHEME PAID OUT £499 MILLION IN PENSIONS, BENEFITS AND EXPENSES

	<b>2011</b>	2010
	<b>£m</b>	£m
<sup>1</sup> Pensions paid	<b>356.6</b>	343.1
<sup>2</sup> Tax free lump sums at retirement	<b>91.8</b>	90.3
<sup>3</sup> Death benefits	<b>7.9</b>	8.9
<sup>4</sup> Leavers	<b>10.4</b>	9.0
<sup>5</sup> Administration expenses	<b>12.8</b>	15.5
<sup>6</sup> Investment management expenses	<b>13.1</b>	10.3
<sup>7</sup> Other outgoings	<b>6.6</b>	4.0
<b>TOTAL</b>	<b>499.2</b>	481.1

## INCOME AND EXPENDITURE

	Year ended 31.03.11 £m	Year ended 31.03.10 £m
<b>Fund at the beginning of the year</b>	<b>8,100</b>	5,978
Total income	621	526
Total outgoings	(499)	(481)
Surplus of income over outgoings	<b>122</b>	45
Increase in market value of investments	<b>690</b>	2,077
<b>Fund at the end of the year</b>	<b>8,912</b>	8,100
<b>Defined benefit sections</b>		
Net investments	<b>8,811</b>	8,003
Net current assets	<b>33</b>	46
<b>Total</b>	<b>8,844</b>	8,049
<b>Defined contribution section</b>		
Net investments	<b>68</b>	51
<b>Net assets of the Scheme at the year end</b>	<b>8,912</b>	8,100

The Scheme has continued to generate a surplus of income over outgoings. An increase in the employer contributions received in the year accounts for the increase from £45m to £122m. After adjusting for the increase in market value of investments, the fund ended the year at £8.9bn, a record high, compared with the value of £8.1bn last year.

There have been no payments to the Company in the year, other than the reimbursement of administration and investment fees at cost.

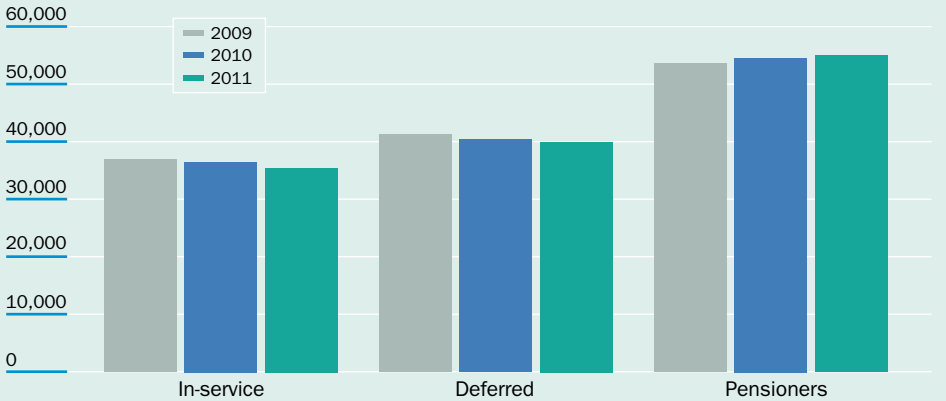
### NOTE REGARDING INVESTMENT INCOME

The majority of the Scheme's quoted investment assets are held within the BAE Systems Pension Funds Common Investment Fund (CIF). Investment income earned on these assets is reinvested in the CIF and the value of the units held by the Scheme increases to reflect this. This income amounted to £210m in the year and £199m in 2009/10 and is in addition to the investment income earned from property assets shown in the graphic on page 4.

# MEMBERSHIP

SERVING ALMOST  
130,600 MEMBERS

Membership of the Scheme overall has remained constant over the year. All new members of the Scheme join the Level 100+ Section, which has almost 15,000 members.



## MEMBER CASE STUDY



**Helen Bellamy**

**I joined BAE Systems in February 2011 after working in the public sector. As a new starter I became a Scheme member immediately unless I chose to 'opt out'.**

My knowledge of pensions is limited and as I had a public sector pension to transfer I felt that I needed to take independent financial advice before making my investment choices. My adviser was brilliant and he was able to look at the whole picture. It is also really useful to get an idea of investment choices from someone who works with the markets and is tailoring to your needs.

In evaluating the investment options, I did use the Scheme booklets. These were quite clear, but without the help of my adviser it would not have been easy to compare these with other commercial offerings.

I did visit the website and honestly found it easier to navigate through the intranet pages than I did reading the brochures. From an environmental perspective I would have been happy not to have all the hardcopy information.

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# ACCOUNTS AND AUDIT

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**KPMG LLP has confirmed to the Trustees that the financial information set out in this Review has been extracted from the statutory accounts of the Scheme, which are independently audited by them.**

A copy of the full statutory Report and Accounts, which received unqualified audit opinions on the financial accounts and summary of contributions, is available on request from the Pensions Service Centre. The auditor's unqualified opinion means the auditor had no material issues with the accounts or payment of the contributions.

The auditors compare the Scheme's overall financial controls with those of other large pension schemes. The Trustees are pleased to note that the Scheme compares favourably.

KPMG has reviewed the content of this Review for compliance with the latest Pensions Research Accountants Group Guidelines for the Preparation of Summary Reports and has confirmed to the Trustees that in all material respects the report is consistent with those guidelines.




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# CONTRIBUTIONS

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**Members and the Company pay contributions to the Scheme so that the Scheme can pay pensions or other benefits to Scheme beneficiaries.**

The money to pay for members' pensions is held in a common fund on behalf of the members by the Trustees. It is not held in separate funds for each individual. However, contributions to Retirement Accounts of members of Level 100+ and others who hold Additional Voluntary Contributions (AVCs) are held in separate funds for each individual.

Contributions are paid in accordance with a Schedule of Contributions agreed between the Trustees and the Company.

The Schedule of Contributions sets out the regular contributions in respect of future service benefits as well as Company payments to reduce the deficit. All contribution levels will be reviewed following the next actuarial valuation, which is currently being carried out.

The Company operates an arrangement for members electing to make a salary sacrifice in return for the employer being responsible for all contributions to the Scheme (SMART Pensions). Company contributions also include additional payments to the Scheme to help meet the cost of members' early retirement pensions on redundancy. These amounted to £19m in the year compared with £36m in the previous year.

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# YOUR TRUSTEES

Guy Griffiths CBE	Chairman
Andy Dean MND*†	Vice Chairman
Mark Dalton MND*	From 6 May 2010 until 28 February 2011
Terry Dillon MND*	Until 30 June 2011
Rory Fisher†	
Andrew Gallagher†	
Bill Hardy MND◊	From 18 January 2011
Nick Hubbard◊	
Trevor King*	From 15 December 2010
David Moakes MND◊	Until 31 December 2010
Steve Olsson MND◊	From 18 January 2011
Carol Paul MND*◊	From 2 July 2010
Tom Royle MBE MND*◊	Until 2 July 2010
Neil Sheehan MND †	Until 31 December 2010
Mark Stewart◊	
Louise Wallwork*	
Chris Williams MND †	From 6 May 2010
Andy Wishart MND	From 1 March 2011
Secretary: George Bayer	

MND Member Nominated Director

◊ Audit Committee

\* Discretionary Committee

† Investment Committee

## THE SCHEME'S ADVISERS

The Trustees appoint a number of professional advisers to help them run the Scheme. The current advisers are as follows:

### Actuary

Mike Parker, Aon Hewitt Limited

### Auditor

KPMG LLP

### Legal Adviser

Travers Smith LLP

### Lead Investment Manager

David Adam  
BAE Systems Pension Funds Investment Management Ltd (BAPFIM)

### Custodian

The Northern Trust Company

### Administrator

Paymaster (1836) Limited  
(trading as Xafinity Paymaster)

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# SCHEME GOVERNANCE

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**One of the principal objectives of the Trustees is to perform all aspects of Scheme management in accordance with the highest standards of governance.**

The Trustee Board delegates certain functions to three standing committees – the Audit Committee, the Discretionary Committee and the Investment Committee. This enables in-depth analysis and review to take place at the committees. From time to time ad-hoc committees/ working parties are formed to deal with specific issues, for instance the triennial actuarial valuation.

The standing committees, which meet on average four times each year, report back to the Trustee Board and make recommendations where decisions have to be made that require the agreement of the full Trustee Board. Membership of these committees is decided by and drawn from the Trustee Board and the committees are supported by the BAE Systems Pensions Director and his team and by external professional advisers as appropriate.

The Trustee Board and the committees each have a set meeting schedule and maintain a business plan, which enables all of the work to be scheduled for review during the year. Each year the Trustee Board reviews the effectiveness of its own operation.

Group Pensions has overall responsibility for management of the Scheme on behalf of the Trustees. This includes, for example, instructing and co-ordinating the work of advisers and providers in order that when a particular item is discussed at a Board meeting, the Trustees have all of the papers and presenters available to enable proper consideration of the subject matter.

## **Why is risk management important to the Scheme and the Trustees?**

A risk is the possibility that an event may happen in the future that adversely affects the Scheme in some way and may prevent the Trustees from achieving their aim of delivering the promised benefits to members. Clearly, the Trustees' aim is to prevent such events whenever possible and so managing these risks is an important part of their role.

The Pensions Regulator recommends that trustees should look at the functions and activities carried out by their schemes and identify the key risks that may prevent them being completed successfully. The Regulator also recommends that controls are put in place that will reduce the chances of the risks occurring.

The risks are carefully assessed and appropriate mitigating actions agreed to minimise any likely impact.

The Audit Committee keeps the risk register and the agreed actions under review, reporting to the Trustee Board on a regular basis. The Board also undertakes a full review on an annual basis.

### Trustee training

An important component in meeting the Trustee governance objective is to ensure that the Trustees are properly equipped to deal with all aspects of Scheme management through appropriate training.

All new Trustees to the Scheme attend an external introductory training course. This is followed by induction sessions held with the BAE Systems Group Pensions team and BAPFIM, the lead investment manager. New Trustees also receive detailed training on topics related to the Committee they will sit on. They are further encouraged to undertake the Pension Regulator's on-line Trustee Toolkit, which sets a pensions industry standard for all aspects of pension scheme management.



Every year a trustee training day is held for the trustees of all of the BAE Systems schemes, at which a number of topical areas are presented by external pension professionals.

The Trustees complete an annual self-assessment return on their training needs and this is used to focus future training, which may be at Trustee or Committee meetings, through external courses or at the annual trustee training day.



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# VALUATION IN PROGRESS

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**Mike Parker**

The appointed Actuary to the Scheme, has been involved with the Scheme for around three years.

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**This year I will be helping the Trustees through the formal actuarial valuation.**

This valuation is a thorough health check of the Scheme's finances and is used to agree the funding arrangements. Normally, it is carried out every three years; although it is now also a requirement for Trustees to obtain interim updates in the years between valuations. This year's formal actuarial valuation is based on the membership and asset data taken as at 31 March 2011.

The process involves looking at many of the risks facing the Scheme but the task that receives most attention is to decide what the funding target should be and then to compare that with the Scheme's assets to see if there is a shortfall or a surplus.

The funding target assesses how much money is likely to be needed in order to provide for all the pensions and other benefits that are payable over many years into the future. In doing this we have to use assumptions about future events such as investment returns, price inflation and how long people are likely to live.

In the event that there is a shortfall, or deficit, the Trustees will work with the Company to agree a recovery plan that sets out the level of contributions required and the size and timing of any additional Company contributions calculated to eliminate the shortfall over an agreed period.

The Pensions Regulator may wish to be involved in reviewing the recovery plan depending upon the size of the shortfall and the period in which it is planned to clear the deficit.

The volume and complexity of the calculations involved, together with the time needed to reach the necessary decisions, mean that a valuation can take a long time to carry out. Under current rules, we have 15 months from 31 March 2011 to complete it.

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# FUNDING UPDATE

## RESULTS OF THE LAST VALUATION

**The most recent funding valuation of the Scheme was completed as at 5 April 2008 and showed the funding position to be as follows:**

Assets	£7.4 billion
Liabilities	£9.8 billion
Deficit	£2.4 billion
Funding level	76%

The Trustees and the Company agreed a recovery plan targeted to remove the deficit by 2026. The Company agreed to extend the period over which it will pay its regular contributions, at the previously agreed increased rate of 20% of Pensionable Earnings, to the end of the recovery period in 2026.

In addition, the Company will pay annual lump sum deficit contributions of £40m for the period to 2016 and a further one-off lump sum deficit contribution of £275m in September 2012.

Due to difficult economic conditions following the last full valuation, the update provided in last year's Annual Review showed an estimated funding level of 73% as at 31 March 2010.

The position as at 31 March 2011 will be fully assessed as part of the current valuation. Based on the results of the valuation, the Trustees and the Company will review the future level of contributions. When the valuation has been completed and the results are finalised, they will be communicated to you.

## WHAT WOULD HAPPEN IF THE SCHEME STARTED TO WIND UP?

There is no intention to wind up the Scheme but it is a requirement to provide information if that were to be the case. As at 5 April 2008, the date of the last completed actuarial valuation, the estimated additional amount that would have been needed to be paid to an insurance company to enable your benefits to be completely secured was £2.9bn at that time. However, even though funding may be temporarily in deficit, the Company is committed and able to support the Scheme and benefits continue to be paid in full.

In the unlikely event that the Company became insolvent and unable to pay the required amount, the Pension Protection Fund (PPF) might be able to take over the Scheme and pay compensation to members.

Further information and guidance is available on the PPF's website [www.pensionprotectionfund.org.uk](http://www.pensionprotectionfund.org.uk) or you can write to: PPF, Knollys House, 17 Addiscombe Road, Croydon, Surrey CR0 6SR.





## THE IMPORTANCE OF THE COMPANY'S SUPPORT

A key objective of the Trustees is to have sufficient assets in the Scheme to pay benefits now and in the future. To achieve this, the Trustees have to review the funding position and set the future contribution rates accordingly. The most significant part of the funding comes from the Company and so its continuing success and support is essential.

The Trustees have a formal process for the ongoing monitoring of the strength of the Company's covenant which was developed in conjunction with a specialist external adviser. This process involves periodic review of a range of published information about the Company, including its current and future trading prospects, cash flows and credit rating.

The Company presents its interim and full year financial results to the Trustee Board and at these presentations the Trustees discuss with the Company the potential impact on the Company covenant of any changes identified in this monitoring report.

## Where can I get more information?

Below is a list of documents that provide further information. If you would like any of these, or have any other questions, please get in touch with the Pensions Service Centre using the contact details on page 24.

- **Statement of Investment Principles**, which explains how the Trustees invest the money paid into the Scheme
- **Statement of Funding Principles**, which explains how the Trustees work out how much money is needed in the Scheme to pay members' benefits
- **Actuarial Valuation Report**, which includes details of the Scheme's financial situation as at 5 April 2008
- **2008 Recovery Plan**, which shows how the funding deficit is being met
- **Schedule of Contributions**, which shows how much money is being paid into the Scheme
- **2011 Annual Report and Accounts**, which shows the Scheme's income and expenditure in the year up to 31 March 2011
- **Actuarial Reports** as at 31 March 2009 and 2010, which include an estimate of the Scheme's financial position as at each date



# UPDATE ON SCHEME MANAGEMENT



## Nigel Tinsley

Pensions Director of BAE Systems, leads the team responsible for the day to day management of the Scheme. Here he brings members up to date on what has been happening within the Scheme administration and the wider world of pensions.

### Maintaining an effective service

My team aims to provide the highest standard of service and support to the Trustees, to help them to manage the Scheme in line with the Pensions Regulator's requirements and pension industry best practice.

We oversee the payment of contributions to the Scheme and monitor that pensions and other benefits are calculated correctly and paid when due. These and other administration services are currently outsourced and my team monitors closely the delivery of the service provided.

I can confirm that for the Scheme year, 99.9% of contributions (including the agreed additional funding from the Company) were received on time in accordance with the Schedule of Contributions and pensions were paid on the due dates.

### New administration service

As Guy Griffiths mentioned in his introduction on page 3, the provision of pensions administration moved to Xafinity Paymaster in December last year and our priority was to ensure delivery of an uninterrupted service in the transition to the new provider. The feedback we have received has confirmed that this was the case.

Members who use the Pensions Service Centre are sent a questionnaire that seeks their feedback on the service they have received. Responses to the statement, 'My overall perception of your service was good', are shown below and currently these are ahead of the required service level. I would encourage all members who are sent a questionnaire to complete and return it as feedback is appreciated and I can assure you that any queries are answered and observations are taken into consideration.

	Strongly agree	agree	disagree	strongly disagree
2008	55%	42%	3%	
2009	65%	35%		
2010	56%	40%	2%	2%



### Changes to the Scheme Rules

There have been no significant changes to the rules of the Scheme since the Annual Review was issued last year.

### Expression of Wish Form – a reminder

It is important to make sure your family and dependants are provided for if you die while an in-service or deferred member of the Scheme. Because lump sum death benefits are paid at the Trustees' discretion, these are not subject to Inheritance Tax.

By making a nomination you can help the Trustees in arriving at their decision as to whom they should award benefits. Your nomination does not legally bind the Trustees, although they will take your wishes into consideration.

It is important that you keep your Expression of Wish Form up to date. An

Expression of Wish Form can be obtained from the pensions website, or from the Pensions Service Centre – the contact details are on page 24. Forms must be returned to the Pensions Service Centre in order to be considered by the Trustees.

### Longevity Adjustment Factors

In April 2006 it was necessary to introduce Longevity Adjustment Factors in order to protect future benefits for all members, given that people are living longer. This year new data is available, compiled from the collected data of company pension schemes in the UK. This data shows that individuals are living longer than previously anticipated.

The Longevity Adjustment Factor is applied to the amount of pension earned by members after 6 April 2006. It reduces the pension to reflect changes in future life expectancy. It is determined on a unisex basis

and is reviewed annually by the Scheme Actuary. He takes into account this new external data as well as looking at the experience within our own Scheme.

### Payment of pension by cheque

More and more organisations are no longer accepting cheques, and over time, payment of pensions by cheque may be phased out.

The advantages of pensions being paid directly to your bank account are that the payment would not be affected by any postal delays, or go missing and, unlike a cheque, which must clear before funds are drawn against it, the money is immediately available as soon as it is credited to a bank account.

For these reasons, you may wish to consider making a change. If so, please contact the Pensions Service Centre – see the back page for contact details.

### **Increases to pensions in payment**

Annual increases for pensioners are awarded from 1 May and these are based on the increase in the Retail Prices Index (RPI) for the previous 12 months. For 2011, pensions were increased by between 2.5% and 4.6%, depending upon the dates of Pensionable Service.

### **Changes to pension increase measures**

The government has changed the inflation measure used to declare its annual pension increase orders from the RPI to the Consumer Prices Index (CPI). This affects future revaluation of deferred pensions where these are linked to the government's annual pension increase orders.

### **What is the difference between RPI and CPI?**

RPI and CPI are based on slightly different selections of goods. In particular, RPI includes housing costs such as mortgage interest costs and council tax but CPI does not. The methods for calculating RPI and CPI also differ.

These factors mean that, historically, CPI has been on average around 0.7% a year lower than RPI, although there have been times since the introduction of CPI in 1996 when CPI has been higher than RPI. The

increase in the RPI in the 12 months to September 2010 was 4.6% and the increase in the CPI was 3.1% over the same period.

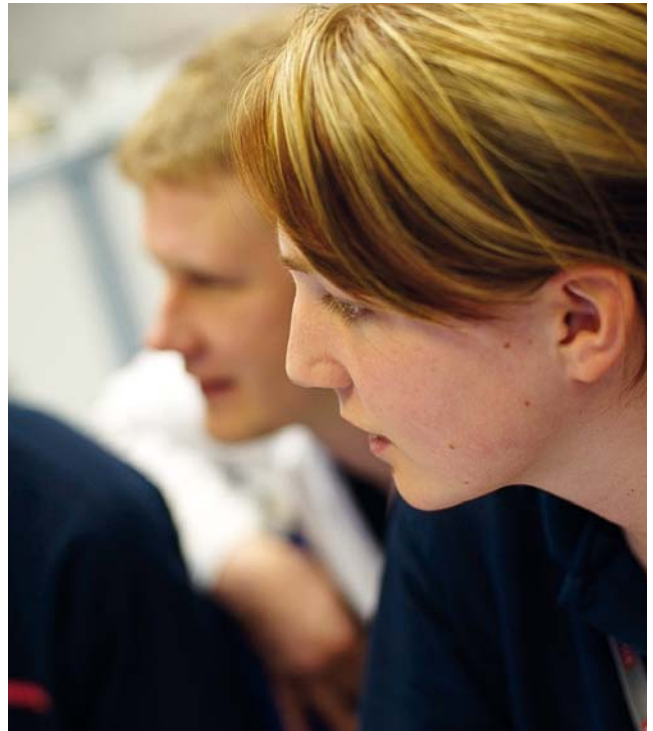
### **Does this apply automatically to all UK pension schemes?**

The change to CPI applies to the revaluation of deferred pensions and pension increases in the public sector pension schemes. It may also affect private sector occupational pension schemes. The precise impact depends on the rules of the scheme, and the Trustees can only award annual pension increases in accordance with the rules.

### **So what does this mean for me?**

If you are a pensioner, most pension increases paid by the Scheme will continue to be based on RPI as before, however that part of your benefit which is guaranteed minimum pension will be based on CPI, rather than RPI. Maximum increases will continue to apply.

If you are a deferred member the rate of annual revaluation to be applied to your pension in the future will be based on CPI, rather than RPI. Again this is subject to maximum increases that will continue to apply.





If you are an in-service member, this has no immediate impact on your benefits.

### Information about State benefits

[www.direct.gov.uk](http://www.direct.gov.uk) is the Government website which draws together all the information available about public services and State benefits into one place. As a result, it replaces the old Pension Service website.

When you first visit Directgov, you will see the middle section of the

homepage has the heading 'Straight to...'. One of the links goes to the 'Pensions and retirement planning' section. Here you will find a section explaining State pensions, along with a wealth of information to help support your financial planning.

The Tracing Service, which may be able to help you find a scheme you have lost touch with since leaving it, has also moved into this section of Directgov from its old home at the Pension Service site.

### Member Representatives

I am pleased to enclose an updated list of Member Representatives following the election earlier this year. Members requiring assistance can get in touch with any of the Member Representatives who will be pleased to help.

### Pensioner ID cards

Pensioners will find enclosed a new ID card which contains their membership number, the Scheme name and contact information.

# INVESTMENT UPDATE



**David Adam**  
Chief Investment Officer  
(CIO), BAE Systems  
Pension Funds Investment  
Management (BAPFIM)

“A REASONABLY  
POSITIVE  
BACKDROP  
FOR FINANCIAL  
ASSETS”

## A new CIO

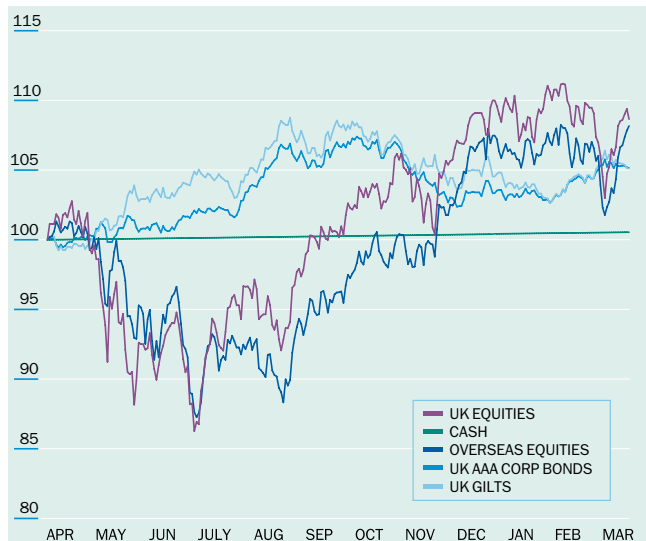
I was appointed as CIO in March on David Brief's retirement, and was previously Head of UK Equities at BAPFIM.

I have worked for BAPFIM for three and a half years. Before joining BAPFIM I was a senior manager for British Steel Pension Fund, a board director at Abbey National Asset Management responsible for UK Fund Management, and a UK and European fund manager for Norwich Union and Scottish Mutual Assurance Society. I have a track record of managing teams of experienced investment professionals achieving a strong record in terms of performance and continuity. I have a solid knowledge base in all asset classes, selecting and monitoring managers as well as expertise in wider strategic and industry matters.

## Market background

After very strong returns in 2009, 2010 also proved to be another positive year for financial assets. UK equities returned over 7%, but lagged the performance of some of the overseas equity markets, most noticeably Asia (excluding Japan) and emerging markets which returned over 15% and 10% respectively. Corporate bonds and Government bonds returned about 5% for the year.

## Market returns April 2010 to March 2011



The main drivers of this performance were a strong pick up in global economic growth, boosted primarily by rapid growth in emerging market economies and continued global government monetary and fiscal stimulation. Corporate profits continued to recover strongly, as listed company profits benefited from a pick up in sales and high margins as a result of cost cutting and efficiency measures undertaken during the financial crisis.

The performance of financial assets in 2011 has been lacklustre, held back by concerns over high government debt levels, rising oil prices as a result of the Middle East and Northern African crisis, the tragic events in Japan and rising inflationary concerns in emerging economies.

Going forward, BAPFIM believes that high debt levels and de-leveraging will hold back developed country economic growth. However, despite this, global economic growth should be fairly robust, boosted by strong emerging market economies and easy fiscal and monetary policies, and should provide a reasonably positive backdrop for financial assets. Solid earnings prospects and strong balance sheets should be supportive for longer term equity performance.

### Investment strategy

The objective of the investment strategy is to generate enough capital gains and income from the Scheme's assets, when combined with Company contributions, to meet the Scheme's liabilities and statutory obligations.

The Trustees decide, in consultation with the Company, how to invest the Scheme's assets with an appropriate balance between seeking higher returns and managing the risk if markets fall. The Statement of



Investment Principles sets out the general investment strategy and objectives for the Scheme. This is implemented by the investment managers and the Trustees review their performance on a regular basis.

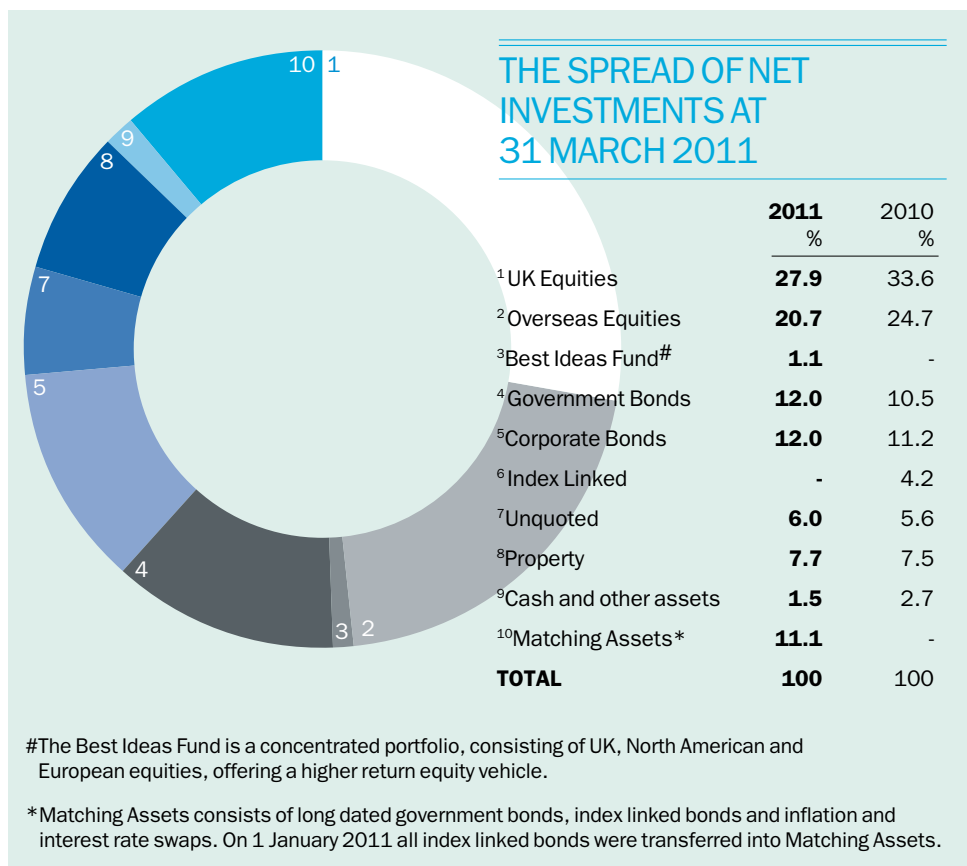
The funding level, ie the extent to which funds' assets meet their liabilities, has been a major focal point in recent years. This has resulted in the Scheme adopting a risk reduction, or de-risking, strategy directed at moving investments into assets that more closely match the Scheme's underlying liabilities.

BAPFIM has put in place a strategy that dampens the volatility of the Scheme's funding ratio (assets divided by liabilities) as the ratio gradually improves, at a price that is affordable. This involves BAPFIM progressively locking in improvements in the funding ratio by transferring assets from equities to conventional bonds, which act as a better hedge for the Scheme's liabilities.

BAPFIM started implementing this strategy for the Scheme in July 2010 and it has led the fund to reduce its weightings in equities to just under 50%, with 24% held in bonds and just over 11% in matching assets (see page 20).

## INVESTMENT UPDATE CONTINUED

### Asset allocation



### Scheme assets are held under the following arrangements

	<b>31 March 2011</b>	31 March 2010
	£m	£m
Common Investment Fund	<b>7,562</b>	6,921
Pooled Investment Vehicles	<b>547</b>	475
Direct Property	<b>650</b>	559
AVCs	<b>59</b>	55
Other investment balances	<b>(7)</b>	(7)
<b>TOTAL</b>	<b>8,811</b>	8,003

**Investment performance**

The Scheme uses HSBC Securities Services to provide the fund with an independent performance measurement service.

The performance of the Scheme was slightly ahead of the performance benchmark set by the Trustees in the 12 months to 31 March 2011. The Scheme produced a return of 9.1% compared with the benchmark of 8.9%. Annual performance is measured excluding the Scheme's private equity and infrastructure assets as these are assessed over a much longer timescale. Members' Retirement Accounts and AVCs are also excluded. The table below shows the performance of the Scheme against the benchmark over one, three and five years to 31 March 2011.

The portfolio is positioned to take advantage of our views on markets (asset allocation) and on individual issuers of shares or bonds (stock selection). In the year to 31 March, stock selection contributed positively to the performance but asset allocation detracted slightly. Within the equity part of the portfolio, UK equities performed better than the benchmark but overseas equities in aggregate underperformed. The Scheme's bond portfolio is invested in a mixture of UK Government (gilts) and corporate bonds.

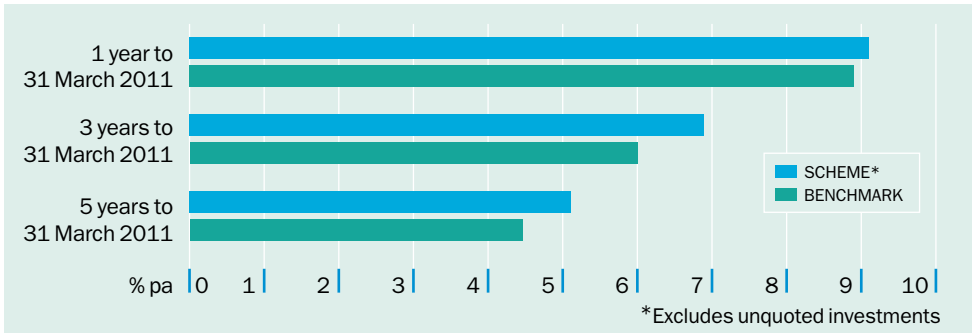
The gilt portfolio performed in line with its benchmark but the corporate bond portfolio was ahead.

The Scheme's property portfolio lagged its benchmark. The property market performed very strongly over the year particularly offices based in central London to which the portfolio has little exposure.

**Investment Stewardship**

Following the Walker Review in 2009 and the Financial Reporting Council report in 2010 all institutional investors are now expected to comply with the Stewardship Code. The code is targeted at improving engagement between institutional investors and the companies they invest in, with a view to improving both returns and governance. It encompasses a statement of activism policy and suggests a systematic process to monitor the performance of companies through engagement and a more active approach to shareholder voting.

Hermes Equity Ownership Services ('Hermes') assists, and acts for BAPFIM to provide the Scheme with high standards of stewardship. Hermes acts collectively on behalf of a number of large financial institutions which enables it to engage far more effectively. Hermes and BAPFIM are committed to complying with the Stewardship Code.



# STANDARD LIFE

All Level 100+ members and any members of the Scheme who hold AVCs can choose to invest in a range of options with Standard Life. The performance of the Standard Life funds offered through the Scheme are shown below. Some members also continue to hold investments made under earlier arrangements with Equitable Life.

The Trustees take regular professional advice regarding, amongst many things, the investment options available to members. During the year the Trustees wrote to all members with Standard Life funds to notify them about these changes. Further information about investment choices with Standard Life is available from the pensions website.

## How the Standard Life funds performed – growth to 31 March 2011

The Trustees have secured lower management fees than the normal rates and a rebate is given which is taken into account in the performance figures quoted below. Members receive the Standard Life rebate through additional units being issued in their funds each month. If you wish to understand what the rebate is for a specific fund please refer to the Retirement Account or AVC guides. These guides can be downloaded from the pensions website at [www.baesystemspensions.com](http://www.baesystemspensions.com).

<b>Funds currently offered</b>	<b>1 year %</b>	<b>3 years % pa</b>	<b>5 years or since launch % pa</b>
BlackRock Aquila HP Global Equity 50:50	7.7	6.4	4.2
BlackRock Aquila HP Over 15 Year Gilt	7.0	5.0	3.4
BlackRock Aquila HP UK Equity	9.6	5.3	3.5
HSBC Life Amanah	3.9	8.7	5.3
Newton Managed	8.5	3.7	4.2
SL Investments Global Absolute Return Strategy	6.3	n/a	8.7
SL Investments UK Equity High Income	7.1	3.6	3.5
SL Pension Ethical	14.0	5.8	4.3
SL Pension Fixed Interest	5.5	7.0	5.2
SL Pension International	8.9	8.4	5.6
SL Pension Managed	7.9	5.8	4.5
SL Pension Managed Cash	0.2	n/a	0.5
SL Pension Property	9.7	(1.6)	(2.1)
SL Pension Protection	6.8	5.8	4.4

**Funds previously offered and in some instances contributions are still permitted**

	<b>1 year %</b>	<b>3 years % pa</b>	<b>5 years or since launch % pa</b>
SL Pension FTSE Tracker	9.5	5.5	3.5
SL Pension Global Equity 50:50 Tracker	10.1	6.4	4.4
SL Pension Sterling	1.4	2.3	3.2
SL Pension UK Equity	9.3	3.4	2.3
SL With Profits Fund*~	10.7	(0.3)	5.9
SL Millennium With Profits / With Profits One / Profits One 2006~	13.0	(12.9)	11.4

\* Applies to ex-AEI members only

~ Returns are shown to 31 December 2010

You can find more information about all the currently offered funds and the Lifestyle Profiles in the Retirement Account and AVC guides (downloadable from the 'Investing your contributions' section of the pensions website at [www.baesystemspensions.com](http://www.baesystemspensions.com)), or more detailed information about the funds is available via the Standard Life website at [www.standardlife.co.uk](http://www.standardlife.co.uk).

You can view your up to date fund value and which funds your Retirement Account contributions or AVCs are invested in by registering for online services – simply call Standard Life's dedicated support team on 0845 271 9501 between 9am and 5pm Monday to Friday (call charges may vary).

If you want to switch to other funds, you can do so at any time. You will need to complete and return the Investment Instruction Form. This is available from the pensions website at [www.baesystemspensions.com](http://www.baesystemspensions.com) or can be obtained from the helpline by calling 0845 180 1401.

Level 100+ members and all members investing in AVCs are reminded that your investment choices can make a real difference to your income when you reach retirement age. You should review your choices to make sure they are still right for you and if in doubt, you should consider taking professional investment advice.

### How and where to get financial advice

Please remember that nobody involved in running the Scheme can give you individual financial advice. Please consider taking advice if you need help with any financial decision.

[www.unbiased.co.uk](http://www.unbiased.co.uk) is the home of IFA Promotions, the organisation that helps put people in touch with an independent financial adviser. It has a 'find an adviser' service which will locate qualified advisers within the user's area.

If you are looking for independent financial advice, enter your postcode in the 'Find your adviser' box on the homepage and select 'Independent financial adviser'.

# GETTING IN TOUCH

If you are an in-service member, please keep your address updated on peopleportal or with HR. If you are a deferred member or a pensioner with the Scheme, please help us to keep in touch with you if you change address by informing us using the following details.

## In-service and deferred members:

### BAE Systems Pensions Scheme

Pensions Service Centre, PO Box 1193, Crawley, West Sussex RH10 0FY

Telephone:	0845 180 1401
If calling from abroad:	+44 (0)1293 591956
Fax:	01252 378660
Email:	farnborough.pensions@xafinity.com
Website:	www.baesystemspensions.com

## Pensioners:

### BAE Systems Pensions Scheme

Pensions Service Centre, Freepost (RSTA-GHHR-EEAK), PO Box 1197, Crawley, West Sussex RH10 0GD

Telephone:	0845 601 4762
If calling from abroad:	+44 (0)1293 591956
Fax:	01293 604559
Email:	farnborough.pensions@xafinity.com
Website:	www.baesystemspensions.com

Please also contact the Pensions Service Centre if you have a question or concern about your pension.

If you wish to make a formal complaint please contact Nigel Tinsley at PO Box 87, York House, Farnborough Aerospace Centre, Farnborough, Hampshire GU14 6YU. It is ultimately open for you to contact the Pensions Advisory Service (TPAS) or the Pensions Ombudsman, and contact details can be found on the 'useful links' page of the pensions website.

