

# JOURNEY

BECAUSE PLANNING IS PART OF THE JOURNEY

# 2011

www.baesystemspensions.com

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

## NEED SOME HELP?

All the contact details  
are on the back page

## VALUATION IN PROGRESS

An update on the current  
actuarial valuation



See page 10

## PENSION INCREASES

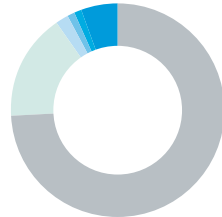
How the move to CPI  
affects the Plan



See page 16

## INVESTMENT UPDATE

from the Plan's  
Investment Officer



Starts on page 18

# WELCOME



**Brian Ierland**  
Chairman of  
the Trustees

Welcome to the 2011 Trustees' Annual Review of the BAE Systems 2000 Pension Plan. 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.

I am delighted to be writing my first introduction since joining the Trustee Board recently. Peter Lynas, Colin Musgrave and Richard Parsons all left the board in recent months and I would like to thank them for their contribution to the Plan over a number of years. Details of the current Trustee Board are on page 7.

## The Trustees' year

Pension plans 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 Plan. The Trustee Board continues to focus on minimising risk to the Plan and to ensure 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 Plan year the value of the investments increased to £3.2bn (from £3.0bn in the previous year) and David provides more detail on the investment performance on page 18. The chart on the left illustrates the trend of Plan assets and the extent to which our long term liabilities are covered by these (the 'funding level').

The funding level shown for the year ended 31 March 2011 is the Plan 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 Plan 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 Company contribution of £25m. The 2010 valuation has been concluded and details on this can be found on page 11. The recovery plan to eliminate the deficit has also been agreed with the Company.

The Trustee Board and the Company agreed that a further full valuation will be undertaken as at 31 March 2011 and work on this is currently under way. Once the outcome of the valuation is known we will make you aware of this. As this work is important in understanding the Plan's longer term funding, we have included an article on page 10 that explains the main stages of the valuation process.

As mentioned in last year's report, Xafinity Paymaster has been appointed to provide pensions administration services to the Plan and I am pleased to report that the transfer of administration to them was successfully made in December 2010. The second phase of the programme is currently under way and this will culminate in the transition to its new administration system in 2012.

### Plan governance

We keep all aspects of the management of the Plan 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 Plan's health independent from the Company, formulating the investment policy and acting in members' interests.

Our governance programme also includes a 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 the externally managed Additional Voluntary Contributions (AVCs). The range of funds and 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 Plan's governance is managed through our Administration and Audit and Investment Committees. In this issue we have included articles that explain how we manage risks that may threaten the well-being of the Plan together with an explanation of the training that is undertaken by Trustees to ensure we remain fully up to date with matters affecting the Plan.

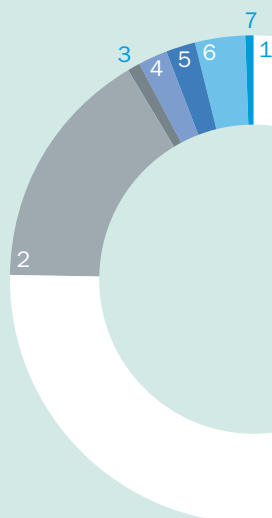
If you would like to comment about any of the contents or to suggest items that we could include in future, please contact me via the Pensions Service Centre, using the details on page 24.

# FINANCIAL SUMMARY



## CONTRIBUTIONS AND OTHER INCOME EXCEEDED £219 MILLION

	<b>2011</b>	2010
	<b>£m</b>	£m
<sup>1</sup> Members' non-SMART ordinary contributions	<b>2.0</b>	2.2
<sup>2</sup> Company contributions	<b>35.1</b>	38.6
<sup>3</sup> Company contributions (deficit funding lump sum)	<b>91.6</b>	26.0
<sup>4</sup> Members' additional contributions	<b>7.5</b>	4.5
<sup>5</sup> Investment income	<b>83.2</b>	86.1
<sup>6</sup> Other income	<b>0.3</b>	0.9
<b>TOTAL</b>	<b>219.7</b>	158.3



## THE PLAN PAID OUT £200 MILLION IN PENSIONS, BENEFITS AND EXPENSES

	<b>2011</b>	2010
	<b>£m</b>	£m
<sup>1</sup> Pensions paid	<b>151.5</b>	146.1
<sup>2</sup> Tax free lump sums at retirement	<b>32.2</b>	19.5
<sup>3</sup> Death benefits	<b>1.5</b>	2.1
<sup>4</sup> Leavers	<b>4.4</b>	1.3
<sup>5</sup> Administration expenses	<b>3.8</b>	4.0
<sup>6</sup> Investment management expenses	<b>6.8</b>	5.1
<sup>7</sup> Other outgoings	<b>0.6</b>	0.4
<b>TOTAL</b>	<b>200.8</b>	178.5

<b>INCOME AND EXPENDITURE</b>	<b>Year ended 31.03.11 £m</b>	Year ended 31.03.10 £m
<b>Fund at the beginning of the year</b>	<b>3,008</b>	2,466
Total income	220	158
Total outgoings	(201)	(178)
Surplus/(shortfall) of income over outgoings	<b>19</b>	(20)
Increase in market value of investments	<b>172</b>	562
<b>Fund at the end of the year</b>	<b>3,199</b>	3,008
Net investments	<b>3,186</b>	2,995
Net current assets	<b>13</b>	13
<b>Net assets of the Plan at the year end</b>	<b>3,199</b>	3,008

The Plan experienced a surplus of income over expenditure in the year of £19m compared with a shortfall of £20m in the previous year. This was largely due to higher contributions received from the employer, offset by an increase in the total amount of tax free lump sum payments to members at retirement.

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

## ACCOUNTS AND AUDIT

**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 Plan, which are independently audited by them.**

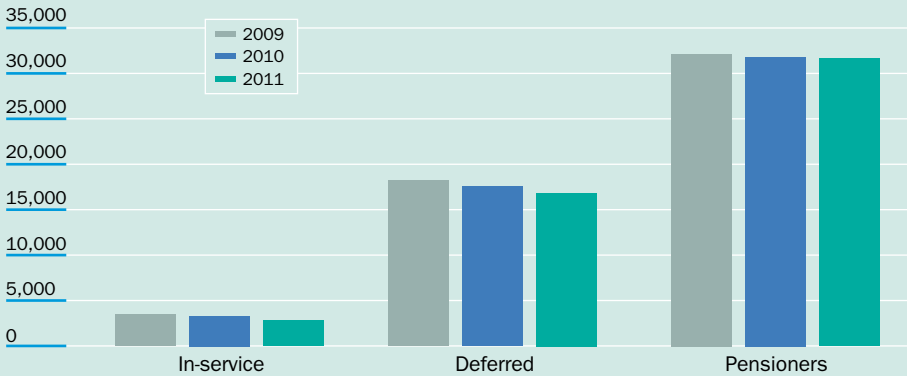
A copy of the full statutory Report and Accounts, which received unqualified audit opinions on the financial accounts and summary of contributions, is available on request from the Pensions Service Centre. The auditor's unqualified opinion means the auditor had no material issues with the accounts or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

The auditors compare the Plan's overall financial controls with those of other large pension schemes. The Trustees are pleased to note that the Plan 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 these guidelines.

# MEMBERSHIP

## SERVING MORE THAN 51,000 MEMBERS



# CONTRIBUTIONS

**Members and the Company pay contributions to the Plan so that the Plan can pay pensions or other benefits to Plan beneficiaries. The money to pay for members' pensions, including the Selected Benefits Scheme, is held by the Trustees in a common fund on behalf of the members. For members who hold AVCs with Standard Life, these 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 required in respect of future service benefits, as well as Company payments to reduce the deficit. Following the actuarial valuation, future contributions have been agreed and details can be found on page 11.

The Plan operates an arrangement for members electing to make a salary sacrifice in return for the employer being responsible for all contributions to the Plan (SMART Pensions).



# YOUR TRUSTEES

Brian Ierland <sup>+</sup>	Chairman	Appointed 16 March 2011
Peter Lynas <sup>+</sup>	Chairman	Resigned 4 March 2011
Derrick Gedge <sup>+</sup>	MND	Appointed 29 June 2011
Duncan McPhee*	MND	
Colin Musgrave*		Resigned 10 October 2011
Ray Newman*	MND	
Bill Newman	MND	
Richard Parsons <sup>+</sup>	MND	Resigned 31 December 2010
John Whelan*		
Mike Wills <sup>+</sup>		
Roger Wiltshire		Appointed 10 October 2011
Secretary: George Bayer		

MND Member Nominated Director    <sup>+</sup> Investment Committee    \* Administration and Audit Committee

## THE PLAN'S ADVISERS

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

### Actuary

Simon Head, Aon Hewitt Ltd

### Auditor

KPMG LLP

### Legal Adviser

Freshfields Bruckhaus Deringer

### Custodian

The Northern Trust Company

### Administrator

Paymaster (1836) Ltd  
(trading as Xafinity Paymaster)

### Investment Managers:

#### Lead Investment Manager

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

### UK equities

Artemis Investment Management Ltd  
Axa Investment Managers UK Ltd  
BlackRock Investment Management  
(UK) Ltd

### Japanese equities

Nomura Asset Management UK Ltd

### European equities

Threadneedle Pensions Ltd

### Property

LaSalle Investment Management Ltd

### Currency Overlay

BlackRock Advisors (UK) Ltd (formerly  
Barclays Global Investors Ltd)

### AVC Provider

Standard Life

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# PLAN GOVERNANCE

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

The Trustee Board delegates certain functions to two standing committees – the Administration and Audit Committee and the Investment Committee. This enables in-depth analysis and review to take place. From time to time ad-hoc committees or 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.

BAE Systems Group Pensions has overall responsibility for management of the Plan 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 Plan and the Trustees?**

A risk is the possibility that an event may happen in the future that adversely affects the Plan 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.

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The Pensions Regulator recommends that trustees should look at the functions and activities carried out by the Plan 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 probability of the risks occurring.

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

The Administration and Audit Committee keeps the risk register and the agreed actions under regular 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 Plan management through appropriate training.

All new Trustees to the Plan 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 plan management.

Every year a 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 Board or Committee meetings, through external courses or at the annual trustee training day.



# VALUATION IN PROGRESS

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**Simon Head**

The appointed Actuary to the Plan has been involved with the Plan 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 Plan's finances and is used to agree the funding arrangements.**

This year's formal actuarial valuation is based on the membership and asset data taken as at 31 March 2011. Normally a formal actuarial valuation is carried out every three years, with interim updates in the years between valuations. This Plan actually completed its last valuation as at 31 March 2010, but the Trustees and the Company agreed to bring the valuation forward to this year, to bring the date in line with the valuation of the BAE Systems Pension Scheme.

The valuation process involves looking at many of the risks facing the Plan but the task that receives most attention is to decide what the funding target should be and then to compare that with the Plan'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 Plan, completed earlier this year, showed that as at 31 March 2010 the funding position was as follows:**

Assets	£3,008 million
Amount needed to provide benefits	£3,695 million
Shortfall	£687 million
Funding level	81%

The funding level of 81% is in line with the Plan Actuary's estimate communicated to you last year. This is materially lower than the funding level of 91% at the 2007 valuation due to the difficult economic conditions over the intervening period. In particular, the positive impact of the shortfall contributions was offset by actual investment returns being lower than expected and changes in

the financial conditions which increased the Plan's liabilities.

As part of the valuation, the Trustees and the Company agreed a recovery plan targeting the removal of the shortfall over a period of 15 years. Under the recovery plan the Company has made lump sum payments of £51.2 million by 31 October 2010 and £15.3 million by 31 March 2011. A further amount of £76.6 million is scheduled to be paid by 31 March 2012 plus 14 payments of £54.1 million each year until 2026. These represent a significant increase on the sums payable under the previous recovery plan.

A further formal actuarial valuation of the Plan as at 31 March 2011 is currently being carried out by the Plan Actuary. When the valuation has been completed and the results are finalised, they will be communicated to you.

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

There is no intention to wind up the Plan but it is a requirement to provide further information if that were to be the case. As at 31 March 2010, 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 £2.0bn at that time. However, even though funding may be temporarily in deficit, the Company is committed and able to support the Plan 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

Plan and pay compensation to members. Further information and guidance is available on the PPF's website at [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 Plan to pay benefits now and in the future. To achieve this, the Trustees have to review the funding position and set 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 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 a copy of 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 Plan
- **Statement of Funding Principles**, which explains how the Trustees work out how much money is needed in the Plan to pay members' benefits
- **Actuarial Valuation Report**, which includes details of the Plan's financial situation as at 31 March 2010
- **2010 Recovery Plan**, which shows how the funding shortfall is being met
- **Schedule of Contributions**, which shows how much money is being paid into the Plan
- **2011 Annual Report and Accounts**, which shows the Plan's income and expenditure in the year to 31 March 2011

# UPDATE ON PLAN MANAGEMENT



**Nigel Tinsley**  
Pensions Director of  
BAE Systems

**“99% OF  
CONTRIBUTIONS  
WERE RECEIVED  
ON TIME”**

**Nigel Tinsley, Pensions Director, leads the team responsible for day to day management of the Plan. Here he brings members up to date on what has been happening within the Plan 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 Plan in line with the Pensions Regulator’s requirements and pensions industry best practice.

We oversee the payment of contributions to the Plan 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 Plan year, 99% of contributions (including the agreed additional funding from the Company) were received on time in accordance with the Schedule of Contributions and the remaining amounts have been subsequently received. Pensions were paid on the due dates.

## Payment of pension by cheque

More and more organisations are no longer accepting cheques and, over time, payment of pensions by cheque will 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 pensioners may wish to consider making a change. If so please contact the Pensions Service Centre.



### New administration service

As Brian Ierland mentioned in his introduction on page 3, the provision of pensions administration moved to Xfinity 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.

### Changes to the Plan Rules

The Rules have been changed to clarify the payment of death benefits in certain circumstances.

### 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

	Strongly agree	Agree	Disagree	Strongly disagree
2008	63%	36%	1%	
2009	63%	35%	2%	
2010	64%	34%	2%	
2011 (YTD)	62%	37%		1%

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 Plan Actuary. He takes into account this new external data as well as the looking at the experience within our own Plan.

### Information about State benefits

[www.direct.gov.uk](http://www.direct.gov.uk)

Directgov 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'll see the middle section of the homepage has the heading 'Straight to . . .'. You will see that 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

For in-service and deferred members, 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 Plan name and contact information.



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# PENSION INCREASES

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## Increases to pensions in payment

In line with the Rules, and reflecting economic conditions, pensions in payment were increased from 1 May 2011 by 5% for any part of the pension in payment attributable to Pensionable Service before 6 April 2006 and 2.5% for any part of the pension in payment attributable to Pensionable Service from 6 April 2006 onwards.

## Changes to pension increase measures

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

## What's 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 pension increases in the public sector pension plans. It may also affect private sector occupational pension plans but the precise impact depends on the rules of the plan as the trustees must award pension increases in accordance with the rules.

## So what does this mean for the Plan?

These changes have no impact on pension increases under the Plan during deferment or while the pension is in payment. Increases will continue to be paid in accordance with the Plan Rules and to reflect RPI where appropriate.

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**“THESE CHANGES HAVE NO IMPACT ON PENSION INCREASES UNDER THE PLAN”**

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# SPECIFIED DEPENDANTS

**It is possible for members to nominate someone to receive a Specified Dependant pension. These pensions are only paid to individuals who meet both the financial test set out in the Plan Rules and who also meet the legal definition of a dependant.**

A Specified Dependant is defined in the Rules as someone who is wholly or mainly dependent on the member of the Plan for the ordinary necessities of life.

Ordinary necessities can include accommodation, food, basic clothing and other essential expenses. A nominee must fulfil this dependency requirement at the time they are nominated and also when the pension becomes payable and financial information will need to be provided as evidence of the dependency.

## How do I make a nomination?

Nominations must be received by the Plan Trustees either before you reach age 65, or, if earlier, before your pension starts. A nomination form can be obtained from the forms section of the pensions website or from the Pensions Service Centre (details are on page 24).

Nominations will need to be accompanied by financial information as evidence of the dependency. Upon receipt, the Trustees will either accept or reject the nomination and you will be notified of their decision.

It is also possible to nominate one or more people to be your Specified Dependant to share any pension payable, but they must all meet the necessary criteria.

## What if my circumstances change?

If you marry or enter into a civil partnership after having a Specified Dependant's

nomination accepted, the nomination will be automatically revoked. Any pension that is payable on your death will then be payable to your spouse or civil partner. You are also able to revoke any accepted nomination by giving written notice to the Plan Trustees.

## Where can I obtain further information?

If you are considering nominating someone as a Specified Dependant and require further clarification, please contact the Pensions Service Centre.

Please remember the Trustees are able to exercise their discretion, where there is no spouse, civil partner or a Specified Dependant, to pay a pension to a person to whom they consider had a relationship with you closely resembling marriage or civil partnership.

## 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 Plan. 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.

An Expression of Wish Form can be obtained from the pensions website or from the Pensions Service Centre. Forms must be returned to the Pensions Service Centre in order to be considered by the Trustees.

# 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

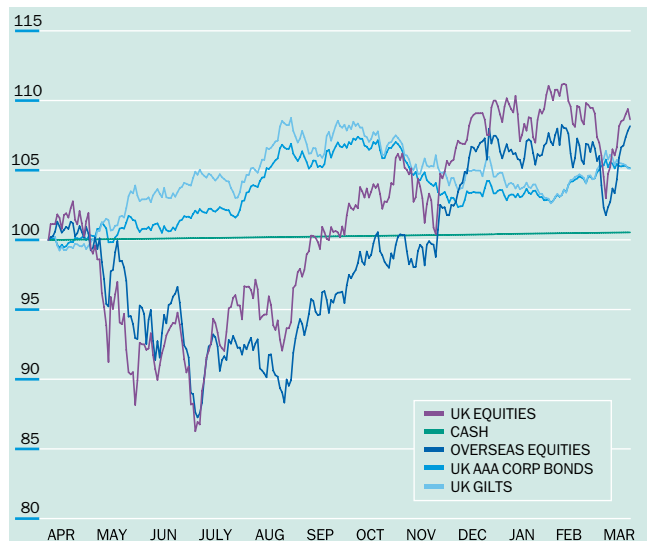
I was appointed as CIO in April on David Brief's retirement and was previously Head of UK Equities at BAPFIM.

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 crises, 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.

The Plan's assets are held under the arrangements shown on page 20.

The in-house team at BAPFIM, the lead investment manager, manages the bulk of the assets, while a number of external specialists manage specific investment portfolios.

### Investment strategy

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

The Trustees decide, in consultation with the Company, how to invest the Plan'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 Plan. This is implemented by the investment managers and the Trustees review their performance on a regular basis.

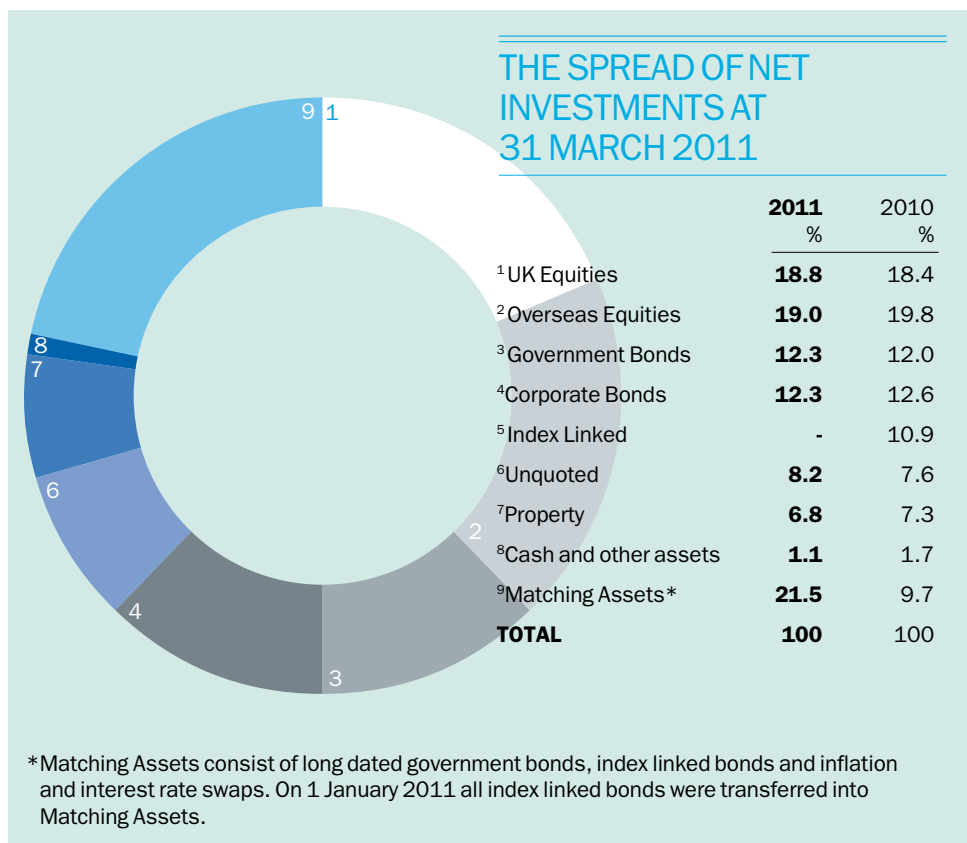
The funding level, ie the extent to which funds' assets meet their liabilities, has been a major focal point in recent years. This resulted in the Plan adopting a risk reduction, or de-risking, strategy in October 2008, directed at moving investments into assets that more closely match the Plan's underlying liabilities.

BAPFIM has put in place a strategy that dampens the volatility of the Plan's funding ratio (assets divided by liabilities) as this 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 Plan's liabilities.

As of 31 March, 43% of the Plan's inflation liabilities and 36.1% of the fixed-rate liabilities have been hedged.

## INVESTMENT UPDATE CONTINUED

### Asset allocation



### Plan assets are held under the following arrangements

	<b>31 March 2011</b>	31 March 2010
	£m	£m
Direct Investments	<b>2,562</b>	2,451
Pooled Investment Vehicles	<b>621</b>	541
AVCs	<b>3</b>	3
<b>TOTAL</b>	<b>3,186</b>	2,995

## Investment performance

The Plan uses HSBC Security Services to provide the fund with an independent performance measurement service.

The performance of the Plan was ahead of the performance benchmark set by the Trustees in the 12 months to 31 March 2011. The Plan produced a return of 9.3% compared with the benchmark of 7.9%. Annual performance is measured excluding the Plan's private equity and infrastructure assets as these are assessed over a much longer timescale. Members' external AVCs are also excluded. The table below shows the performance of the Plan 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 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 Plan's bond portfolio is invested in a mixture of UK Government (gilts) and corporate bonds. The gilts portfolio performed in line with

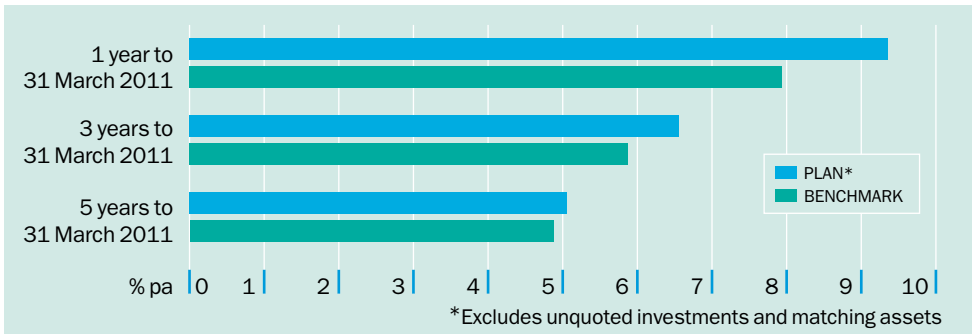
its benchmark and the corporate bond portfolio was ahead.

The Plan'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 Plan 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.



# HOW DID THE AVC FUNDS PERFORM?

If you pay external AVCs, these are invested in the Standard Life fund(s) which you have selected.

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 AVCs to notify them about changes to funds offered. 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 Standard Life Investment Choices guide which can be downloaded from the pensions website: [www.baesystemspensions.com](http://www.baesystemspensions.com).

The performance of the Standard Life funds available to Plan members is shown below.

<b>Funds for current investment</b>	<b>1 year %</b>	<b>3 years % pa</b>	<b>5 years or since launch % pa</b>
SL Blackrock Aquila HP Global Equity 50:50	7.7	6.4	4.2
SL Blackrock Aquila HP Over 15 Year Gilt	7.0	5.0	N/A
SL Blackrock Aquila HP UK Equity	9.6	5.3	3.5
SL HSBC Life Amanah	3.9	8.7	5.3
SL Investments Global Absolute Return Strategies	6.3	N/A	N/A
SL Investments UK Equity High Income	7.1	3.6	N/A
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	N/A
SL Pension Property	9.7	(1.6)	(2.1)

<b>Funds previously offered where members still hold investments</b>	<b>1 year %</b>	<b>3 years % pa</b>	<b>5 years or since launch % pa</b>
SL Pension Sterling	1.4	2.3	3.2
SL With Profits	10.7	(0.3)	5.9
SL With Profits 2006~	13.0	(12.9)	11.4

~ Returns are shown to 31 December 2010

You can find more information about the currently offered funds and the Lifestyle profiles in the Standard Life Investment Choices Guide (downloadable from the 'Investing your contributions' section of the pension 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 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 1403.

### Selected Benefits Scheme

For members holding funds in the Selected Benefits Scheme, the rate of Credited Interest was 3.5% for the 2010/11 Plan year. It was 2.5% in 2009/10 and the rate for 2011/12 will be 10%.



### How and where to get financial advice

Please remember that no-one involved in running the Plan 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 Plan, 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 2000 Pension Plan

Pensions Service Centre, PO BOX 1194, Crawley, West Sussex RH10 0FZ

Telephone:	0845 180 1403
If calling from abroad:	+44 (0)1293 591958
Fax:	01772 705492
Email:	fulwood.pensions@xafinity.com
Website:	www.baesystemspensions.com

## Pensioners:

### BAE Systems 2000 Pension Plan

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:	fulwood.pensions@xafinity.com
Website:	www.baesystemspensions.com

Please also contact the Pensions Service Centre if you have a question or concern with 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 or the Pensions Ombudsman, and contact details can be found on the 'useful links' page of the pensions website.

