

JOURNEY

BECAUSE PLANNING IS PART OF THE JOURNEY

2011

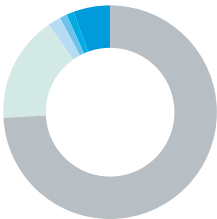
www.baesystemspensions.com

Your annual update
from the Trustees of your
pension scheme

NEED SOME HELP?

All the contact details
are on the back page

FINANCIAL SUMMARY



Starts on page 4

VALUATION IN PROGRESS

an update on the current
actuarial valuation



See page 13

INVESTMENT UPDATE

from the Scheme's
investment adviser



Starts on page 18

WELCOME



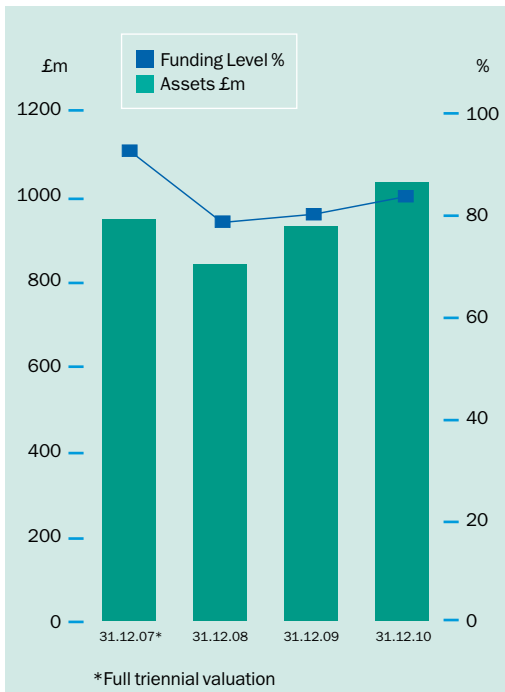
Myles Westcott
Chairman of
the Trustees

Welcome to the 2011 Trustees' Annual Review of the Royal Ordnance Pension Scheme. In the following pages you will find a summary of the 2010 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. I would like to thank Malcolm Green and Keith Hainsworth, who have left the Trustee Board, for their significant contribution over a number of years and welcome Chris Sparkes as a new Trustee. Details of the current Trustee Board are provided on page 7.

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.



At the end of the 2010 Scheme year the value of the investments had increased to £1,031m (from £927m in the previous year) and Tim Giles of Aon Hewitt, the Trustees' investment adviser, provides more detail on the 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 funding level shown for 2010 is the Scheme Actuary's estimate at 30 September 2010 as the formal actuarial valuation as at 31 December 2010 is in progress.

The Trustee Board also continues to monitor the longer term funding levels of the Scheme and we have included information in this Annual Review previously presented as the 'Summary Funding Statement'.

During 2010, contributions were collected in accordance with the Schedule of Contributions which included a recovery plan payment of £11m. In addition, a lump sum contribution of £6.35m was received which was agreed following the BAE Systems share buy-back announcement in 2010. The formal triennial actuarial valuation as at 31 December 2010 is being undertaken by the Scheme Actuary and once the outcome of the valuation is known we will make you aware of this. This work is important in understanding the Scheme's longer term funding and we have included an article by the Scheme Actuary on page 13 that explains the main stages of the valuation process.

We mentioned in last year's Annual Review that Xafinity Paymaster had been appointed to provide pensions administration services to the Scheme 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 their new computer system in 2012.

Scheme governance

We keep every aspect 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' best interests. Our governance programme also includes the review of the performance of key providers, advisers and the Company's pensions team.

In last year's Annual Review we explained that much of the Scheme's governance is managed through our Audit and Discretionary 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.

Trustee election

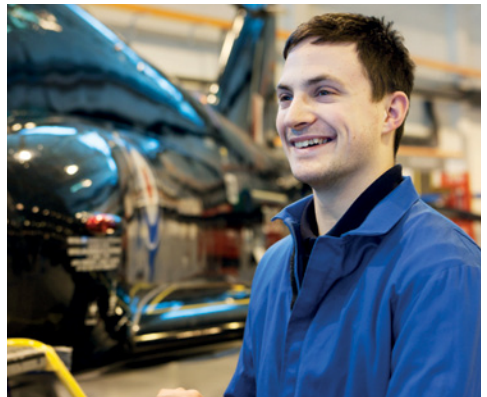
Elections are to be held in 2012 for in-service Member Nominated Trustees. There are three positions available for these interesting and important roles. If you are an in-service member and would like to be considered then please refer to the separate MNT Invitation which contains details about the role and how to obtain a nomination pack.

If you wish to be considered for election, completed applications must be received by 31 January 2012. The positions are for a term of four years commencing on 1 June 2012.

Pension Increases

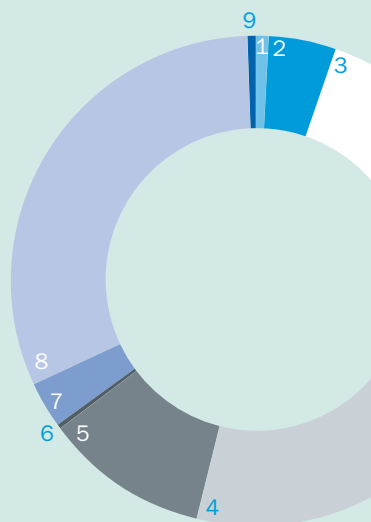
Pension increases in May 2011 were made in line with the change in the Consumer Prices Index following the Government decision to adopt this index for statutory pension increases rather than the previous Retail Prices Index. More details regarding pension increases are included on page 15.

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.



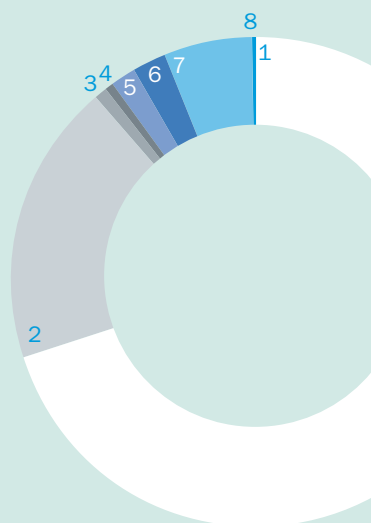
FINANCIAL SUMMARY

INCOME AMOUNTED TO £51 MILLION



	2010	2009
	£m	£m
¹ Members' non-SMART contributions	0.5	0.5
² SMART contributions	2.7	3.0
³ Company contributions	10.5	10.4
⁴ Company contributions (lump sum)	11.0	11.0
⁵ Company contributions (share buy-back)	6.4	-
⁶ Company augmentation contributions	0.1	0.3
⁷ Members' additional voluntary contributions	1.8	0.7
⁸ Investment income	18.0	16.7
⁹ Other income	0.3	0.6
TOTAL	51.3	43.2

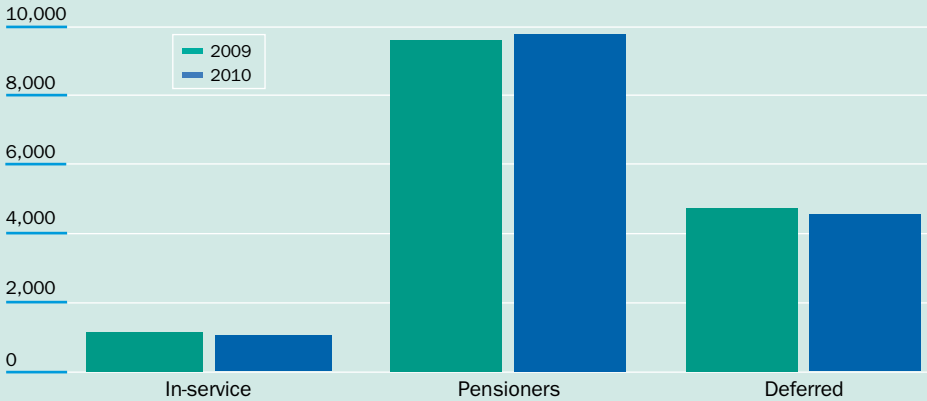
OUTGOINGS WERE £56 MILLION



	2010	2009
	£m	£m
¹ Pensions paid	39.5	38.2
² Tax-free lump sums at retirement	10.5	5.7
³ Death benefits	0.4	0.4
⁴ Leavers	0.4	0.4
⁵ Administration expenses	0.9	0.9
⁶ Pension Protection Fund levy	1.2	1.0
⁷ Investment management expenses	3.3	1.9
⁸ Other outgoings	0.1	0.1
Total	56.3	48.6

MEMBERSHIP

SERVING 15,280 MEMBERS



INCOME AND EXPENDITURE

	Year ended 31.12.10 £m	Year ended 31.12.09 £m
Fund at the beginning of the year	927	838
Total income	51	43
Total outgoings	(56)	(49)
(Shortfall) of income over outgoings	(5)	(6)
Change in the market value of assets	109	95
Fund at the end of the year	1,031	927
Net investments	1,030	923
Net current assets	1	4
Net assets of the Scheme at the year end	1,031	927

The main variation in the year has been the significant increase in the market value of the Scheme's investments. This is more fully explained in the update from the Scheme's investment consultant on page 18.

The Scheme experienced a shortfall of income over expenditure in the year of £5m, which is similar to the amount in the previous year.

ACCOUNTS AND AUDIT

The summary accounts presented in this Annual Review are not the statutory accounts of the Scheme, but a summary of the financial statements included in the full statutory Report and Accounts.

The financial statements were independently audited by PricewaterhouseCoopers LLP who stated that, in their opinion, the accounts show a true and fair view of the financial transactions of the Scheme during the Scheme year ended 31 December 2010. If you would like to see a copy of the full statutory Report and Accounts, please contact the Pensions Service Centre using the revised details on page 24.



CONTRIBUTIONS

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, for members who hold money purchase Additional Voluntary Contributions (AVCs) 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 in respect of

future service benefits as well as Company payments to reduce the funding deficit.

In-service members pay regular contributions at the rate of 9.29% of Contributory Pensionable Pay and regular Company contributions are equal to 26.43% of Contributory Pensionable Pay. Pensionable earnings allow for your individual 2006 Basic Pay Freeze Factor and so the 9.29% of Contributory Pensionable Pay, in most cases, will be slightly less than 9.29% of your current basic salary.

All contribution levels will be reviewed following the actuarial valuation, which is currently being carried out as at 31 December 2010.

YOUR TRUSTEES

Malcolm Green* (Chairman)	(until 29 June 2011)
Myles Westcott* (Chairman)	(from 29 June 2011)
Murray Fullerton~ MND	
Keith Hainsworth~	(until 15 December 2010)
Brian Halliwell*	
Brian Johnson* MND	
Mark Kane~	
Colin Mackenzie~ MND	
Derek Plunkett* MND	
Chris Sparkes~	(from 1 April 2011)
Secretary: Alison Miller	
Pensions Manager: Julie Cook	

MND Member Nominated Trustee

~ Audit Committee

* Discretionary 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:

Scheme Actuary

Alison Blay, Towers Watson Limited

Auditors

PricewaterhouseCoopers LLP

Legal Advisers

Pinsent Masons LLP

Legal Advisers – property transactions

Eversheds LLP

MacRoberts

Banker

Lloyds TSB Group plc

Banker and Custodian

The Northern Trust Company

Investment Managers

BAE Systems Pension Funds Investment Management Limited

BlackRock Investment Management (UK) Limited

CB Richard Ellis Investors Limited

MFS Investment Management

Standard Life Investments Limited

State Street Global Advisors UK Limited

Investment Adviser

Aon Hewitt Limited

SCHEME GOVERNANCE



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

The Trustee Board delegates certain functions to two committees – the Audit Committee and the Discretionary Committee. This enables in-depth analysis and review to take place at the committees.

These committees 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.

The Committees are supported by the BAE Systems Pensions Director, Nigel Tinsley, and his team and by external professional advisers, as appropriate.

The Trustee Board and the Audit Committee 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. The Discretionary Committee meets on an ad-hoc basis as needed. Each year the Trustee Board reviews the effectiveness of its own operation.

BAE Systems 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 they need and the appropriate 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 the scheme and identify the key risks that may prevent these being completed successfully. The Pensions Regulator also recommends that controls are put in place that will reduce the chances of the risks occurring.

The risks are carefully assessed, recorded in a 'risk register' and appropriate mitigating actions agreed to minimise any likely adverse effects.

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 of the risk register 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 attend an external introductory training course which is followed by induction sessions hosted by the BAE Systems Group Pensions team. New Trustees also receive detailed training on topics related to the committee they will sit on. Trustees are also 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.



FUNDING UPDATE

RESULTS OF THE LAST VALUATION

The results of the most recent full actuarial valuation showed that on 31 December 2007 the funding position was as follows:

Assets	£942.0 million
Amount needed to provide benefits	£1,044.5 million
Deficit	£102.5 million
Funding level	90%

payments and a series of annual lump sums as shown in the table below.

Amount of lump sum contribution	Payment dates due by 30 September
£9.95m	2008
£11m	2009 and 2010
£9m	2011 to 2016 inclusive
£7.1m	2017

Following the 2007 valuation, the Trustees and the Company agreed a schedule of additional contributions to address the deficit, which includes additional monthly

If the assumptions underlying the valuation are borne out in practice, the deficit is expected to be removed within 10 years of the valuation date.

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. However, if the Scheme had started winding up at the end of 2007, the additional amount that would have been needed to ensure that all members' benefits could have been paid in full by an insurance company was estimated to be around £361 million at that time. This is the amount that the Company would have had to pay to the Scheme if it had started to wind up on 31 December 2007.

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 at 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. 'Covenant' means a company's ability and willingness to support its pension scheme financially. The monitoring 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.

We are also required to confirm to you that there has been no payment to the Company out of Scheme funds in 2010, except to reimburse administration and investment expenses, and the Pensions Regulator has not had to intervene in the running of the Scheme.

IS THERE MORE UP TO DATE INFORMATION?

The Trustees are also required to obtain an estimate of the financial position of the Scheme as at each 31 December between full actuarial valuations.

The results at each of the recent assessment dates are summarised below.

	2009 update £m	2008 update £m	2007 valuation £m
Expected cost of providing benefits	1,160	1,066	1,045
Market value of assets	927	842	942
Deficit	233	224	103
Funding level	80%	79%	90%

The Scheme Actuary estimated that the funding level had improved from 80% at the end of 2009, to 83% at the end of September 2010, and that the deficit had fallen from £233 million to £208 million. The full actuarial valuation as at 31 December 2010 is currently under way.

Even though funding may be temporarily in deficit, the Scheme continues to be able to pay benefits.



Where can I find out more?

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 Scheme
- **Statement of Funding Principles**, which explains how the Trustees work out how much money is needed in the Scheme to pay members' benefits
- **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
- **Annual Report and Accounts** of the Royal Ordnance Pension Scheme, which shows the Scheme's income and expenditure in the year up to 31 December 2010
- **Actuarial Valuation Report**, which includes details of the Scheme's financial situation as at 31 December 2007
- **Actuarial Reports as at 31 December 2008 and 2009**, which include an estimate of the Scheme's financial position as at each date

VALUATION IN PROGRESS



Alison Blay
Scheme Actuary

Alison Blay is the appointed Actuary to the Scheme and has been involved with the Scheme for a number of years. This year she has been helping the Trustees through the formal actuarial valuation process.

The Actuarial Valuation

The formal valuation of the Scheme is now under way, using information taken at 31 December 2010.

A valuation is a thorough health-check of a pension scheme's finances and is used to agree the funding arrangements. Normally, it is carried out every three years – although there is also a requirement for trustee boards to obtain interim updates in the years between valuations.

I provide advice to the Trustees regarding the valuation. I work with the Trustees to help them decide what the funding target should be – this is normally based on the best estimate of the value of the Scheme's liabilities, plus a safety margin.

When the Trustees set the funding target, they use assumptions about future events, and take into account the investment strategy and the expected covenant from the Company. The covenant is kept under review and from time to time the Trustees ask PricewaterhouseCoopers to help with a covenant evaluation.

The assumptions used in the valuation range from members' life expectancies to possible future rates of inflation, investment return and salary increases. All of these assumptions affect the value of the liabilities and have to be agreed with the Company. The volume and complexity of the calculations involved, together with the need to reach agreement with the Company on all aspects of the funding plan, mean that a valuation takes a long time to carry out; under current rules, the Trustees have 15 months from the valuation date of 31 December 2010 to complete it.

At the end of the process, the final results will show how close the Scheme is to meeting the funding target, based on the value of the Scheme's assets at the valuation date. This percentage is the 'funding level'. If it is less than 100%, there is a shortfall (or 'deficit') and a funding level above 100% would mean the Scheme had a surplus.

In the event that there is a deficit, the Trustees work with the Company to agree a recovery plan to eliminate the deficit over an agreed period. The recovery plan covers the level of ongoing contributions required from the Company and Scheme members and the size and timing of any Company lump sum contributions that are needed.

The Pensions Regulator may wish to review the funding plan, depending upon the size of the deficit and the period over which it is planned to be cleared.

UPDATE ON SCHEME MANAGEMENT



Nigel Tinsley
Pensions Director
of BAE Systems

Nigel Tinsley leads the team responsible to the Trustees 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 2010 Scheme year, 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 Myles Westcott 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.

Changes to the Scheme Rules

During the year there have been some minor changes to the rules of the Scheme. Pensions payable to Civil Partners are now calculated based on the member's full Pensionable Service where previously the pensions were based on Pensionable Service from 5 December 2005 onwards. A minor amendment was also made to make the serious ill-health commutation of pension into lump sum rule consistent with legislation.



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, is reviewed annually

and takes into account new external data .

Changes to pension increase measures

As you will know from the announcement dated January 2011, the government has confirmed that the inflation measure used to declare its annual 'Pension Increase Orders' would be changed from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) with effect from the Order declared for 2011. This will also affect future revaluation of deferred pensions and increases to pensions in payment where these are linked to the government's annual pension increase orders. BMARC members are unaffected by this change.

What's the difference between RPI and CPI?

RPI and CPI are based on slightly different selections of goods and services. 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.

Increases to pensions in payment

Pensions in payment, excluding Guaranteed Minimum Pensions (GMPs), for 1984 and Crown Section pensioners increase in line with the percentage specified in the Pensions Increase Orders (up to a maximum of 5% a year for 1984 members).

As mentioned on page 15, the increase in the CPI in the year to September 2010 was 3.1% and this is the rate that was applied to pensions in payment (excluding GMPs) for 1984 and Crown Section pensions in payment from 1 May 2011.

Pensions in payment (excluding GMPs) for BMARC Section members were, in line with the

Scheme Rules, increased at the fixed rate of 5% with effect from 1 April 2011, subject to individually calculated Scheme limits, which are based on the old Inland Revenue Limits.

The provisional figures to September 2011 are 5.6% for RPI and 5.2% for CPI. Pension increases for 2012 will be confirmed when the government issues its 2012 pension increase order.

Expression of Wish Form – a reminder

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

By completing an Expression of Wish form you can help the Trustees in their decision making as to whom they should award benefits. Your nomination(s) cannot 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 (whose contact details are on page 24). The fully completed and signed form must be received by the Pensions Service Centre in order to be considered by the Trustees.





Information about State benefits

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 also 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 Pensions Tracing Service, which can be found in the Pensions and Retirement Planning section

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

Pensioner ID cards

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

INVESTMENT UPDATE



Tim Giles
Scheme Investment
Adviser

**“THE SCHEME
IS WELL
POSITIONED
TO CONTINUE
THE PROCESS
OF DE-RISKING
WHEN MARKETS
RECOVER”**

Tim Giles of Aon Hewitt, the Scheme’s investment adviser, brings members up to date on the Scheme’s investments during 2010 and on events into 2011.

Investment strategy

As Myles Westcott highlighted in his introduction, the principal objective of the Trustees when they set the investment strategy is to ensure they have sufficient funds to pay benefits when they fall due.

The Trustees decide, in consultation with the Company, how to invest the Scheme assets choosing a balance between seeking higher returns and managing the risk that the assets do not move in line with the amount needed to meet the cost of the benefits. The Statement of Investment Principles sets out the Trustees’ chosen investment strategy and the investment objectives for the Scheme. Specialist investment managers are chosen to run different parts of the investment strategy on a day-to-day basis and the Trustees review and hold them to account for their performance.

Over time the Trustees are looking to rely less on return-seeking assets such as equities (shares in company profits) to provide investment returns and invest more in low risk assets such as bonds (effectively loans to governments and companies) that move in line with the expected cost of the benefits. This gradual ‘de-risking’ strategy which the Trustees have elected to follow is designed to switch assets in a controlled manner from return-seeking assets to bonds over a period of time. The de-risking is gradual because the Trustees and the Company still want to benefit from some investment returns to meet the cost of benefits, but will switch to lower risk assets when this is no longer required.

The Trustees have recently appointed BlackRock to purchase lower risk assets when market conditions are favourable. BlackRock purchase assets that mirror the movement in the amount needed to meet the cost of the benefits. The assets increase in value when the cost of benefits rises and decrease in value when the cost falls. This approach is called ‘Liability Driven Investment’. Effectively, it is similar to buying insurance against the Scheme’s investment risks. However, the cost of this insurance varies with market conditions so the Trustees are looking to buy gradually when prices are favourable. BlackRock manages this process for them, but the Trustees monitor its progress.

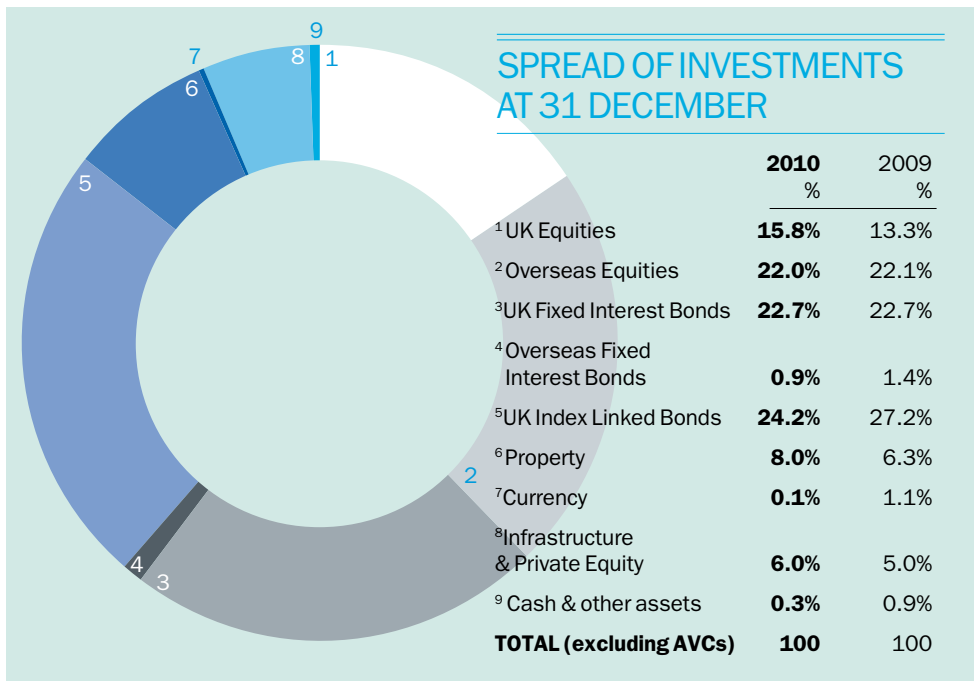
Asset allocation and performance

The Trustees invest the Scheme assets in a range of traditional assets, including equities (both publicly-traded companies like BAE Systems, and privately owned companies), bonds and property. The Scheme does not invest directly in the shares of BAE Systems. The Trustees also invest in less traditional assets such as infrastructure (this is providing private financing for projects such as roads, railways or public utilities). Each investment manager is chosen as a specialist in the asset involved and has a performance objective against which they are measured.

In early 2010, the Trustees decided to amend the Scheme's overseas equity mandate with State Street Global Advisors in order to broaden the range of investments and gain greater exposure to emerging markets (such as Brazil, Russia, India and China). In July 2010, the Trustees replaced one of their equity managers, BankInvest,

as a number of its senior investment professionals had resigned. The Trustees were, as a consequence, unsure that the manager would perform well in the future so it was replaced with MFS. The Trustees also decided to sell the currency portfolio managed by Record Currency Management Limited in September 2010.

The Scheme's investments performed well as equity markets rose in 2010 on the back of continued activity from central banks and governments boosting investor confidence. The Scheme returned 13.9% in absolute terms over the 12 months to 31 December 2010. The main contributors to strong performance over the year were the Scheme's equity and property investments. The Scheme's best performing manager in 2010 was Standard Life Investments who manages a portfolio of UK equities. Standard Life substantially outperformed general markets as a result of picking the right UK companies to invest in.



INVESTMENT UPDATE CONTINUED

Scheme assets are held as a mixture of 'direct investments' where the Trustees own the specific company shares, bonds or property or 'pooled investment vehicles' where the Trustees own a share in a fund which then owns specific company shares, bonds or properties as follows:

	31 December 2010	31 December 2009
	£m	£m
Direct Investments	324	375
Pooled Investment Vehicles	704	547
AVCs	2	1
TOTAL	1,030	923

Market update

In 2010, governments and central banks continued to employ expansionary monetary and fiscal policies to stimulate economic growth and prevent economies from slipping back into recession.

Most equity markets enjoyed a strong rally over 2010 with the MSCI World (a measure of global equities) and the FTSE All-Share Index (a measure of UK equities) returning 15.9% and 14.5% respectively. The cyclically sensitive basic materials sector posted a very strong return of 31% during the year. The best performing sector was technology (up 34.7%) though this sector constitutes only around 1% of the FTSE All-Share index.

Unsurprisingly, given the strong market returns, the less volatile healthcare sector was the worst performing sector rising only 3.7%. Overseas, emerging market equities were the strongest performing after allowing for the impact of currency movements (up 22.9%) and US equities were the strongest performing before the impact of currency movements (up 15.1%).

The uncertainty over the European sovereign debt crisis led to poor performance from European equities, which was the worst performing region after allowing for currency movements, but still delivered a positive return of 5.8%.

The price of UK fixed interest government bonds reached what were then historic highs on the back of investor concerns over the economic recovery however, in the latter part of 2010, prices fell as positive economic data emerged. Inflation was persistently higher than expected which contributed to UK inflation-linked government bonds outperforming UK fixed interest government bonds over the year as a whole.

The price of the typical UK company bond moved broadly in line with the equivalent UK government bond over the year. Commercial property enjoyed a very strong year (up 14.5%) as measured by the IPD Property Index (an independent property index commonly used as an indicator of market performance).

So far in 2011, concerns over financial turmoil in the Eurozone, the size and management of the US government deficit and a deteriorating outlook for economic growth have seen the value of most return-seeking assets fall at the same time as bond prices have risen to new historical highs pushing up the expected cost of providing benefits.

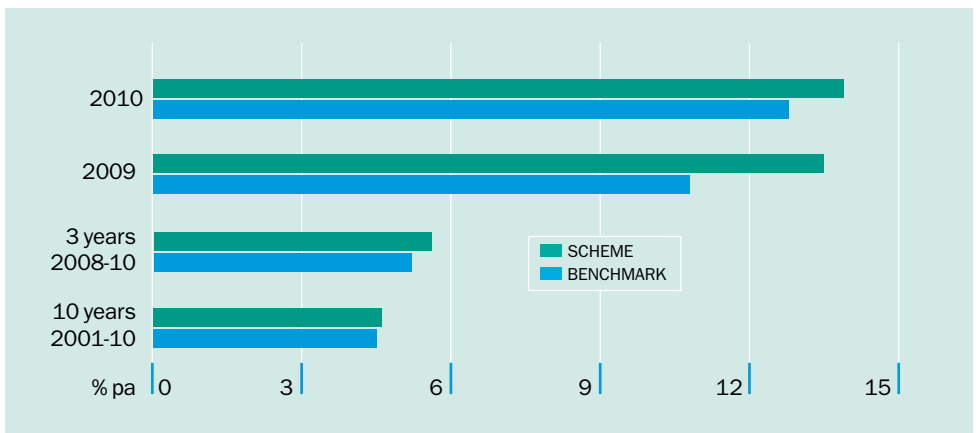
However, the Trustees have put in place the detailed arrangements to manage their de-risking plan. As a result the Scheme is well positioned to continue the process of de-risking when markets recover. I look forward to providing more detail on progress in 2012.



Investment performance

The Scheme subscribes to Mellon Analytical Solutions for independent performance measurement on a quarterly and annual basis, and to IPD specifically for the property investments.

The table below shows the performance of the Fund against its benchmark for 2009, 2010, the last three years and the last ten years. All figures are for the period ending 31 December.



The Trustees regularly monitor the value of the Scheme's assets and the performance of the investment managers, on at least a quarterly basis, with the aim of achieving good investment returns relative to the market.

ADDITIONAL VOLUNTARY CONTRIBUTIONS

If you are an in-service member, you may pay Additional Voluntary Contributions (AVCs) with the aim of increasing retirement benefits.

AVCs normally qualify for income tax relief at your highest rate, in the same way as your normal Scheme contributions.

When considering whether or not to pay AVCs, please remember that the Annual Allowance, which restricts the amount of pension contributions and benefits that can receive tax relief, reduced from £255,000 to £50,000 from April 2011. Therefore, you should bear this in mind if the value of your Scheme benefits plus the amount of AVCs and payments made into other personal pensions paid in any tax year is close to this amount.

AVCs might be of particular interest to those in-service members who joined the Scheme later in their working life, or who are considering the possibility of early retirement.

In-service members can start, increase, decrease or stop paying money purchase AVCs at any time, although if you currently pay 'added years' AVCs and stop them, you cannot start paying them again at a future date and any future AVCs would be invested with Standard Life.

Further information on the Annual Allowance and AVCs is available from the Pensions Service Centre or via the pensions website www.baesystemspensions.com.

Standard Life

The Trustees take regular professional advice regarding, amongst many things, the money purchase AVC investment options available to members. As mentioned in last year's Annual Review, some changes have been made to the funds on offer. Further information about investment choices with Standard Life is available from the pensions website www.baesystemspensions.com.

Your target retirement age with Standard Life is stated on annual benefit statements for in-service members with Standard Life funds. You are urged to ensure that this remains appropriate if you are in the Lifestyle investment option, as your target retirement age affects the time when your investments start to move within the Lifestyle Profiles. We will continue to print your target retirement age on future benefit statements to allow you to keep it under review. If you would like to change your target retirement age, please contact the Pensions Service Centre.

How did the Standard Life AVC funds perform?

The Trustees have secured lower management fees than the normal Standard Life rates and a rebate is given which is taken into account in the performance figures quoted on page 23. Members receive the Standard Life rebate through additional units being applied to their funds each month. If you wish to understand what the rebate is for a specific fund please refer to the 'Standard Life Choices Guide', which can be downloaded from the pensions website www.baesystemspensions.com.

The following table shows how the Standard Life funds performed to 31 December 2010.

Funds currently offered	1 year %	3 years % pa	5 years or since launch % pa
SL Pension Cautious Managed	6.6	6.5	4.9
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 Managed	7.9	5.8	4.5
SL Pension Managed Cash	0.2	n/a	0.5
SL Pension Protection	6.8	5.8	4.4
SL Pension Sterling	1.4	2.3	3.2
SL With Profits*	13.0	(12.9)	11.4

*Fund was previously offered and in some instances contributions are still permitted.

You can find more information about all the funds in the 'Standard Life Choices Guide', which can be downloaded from the 'Investing your Contributions' section of the pensions website www.baesystemspensions.com. Alternatively, more detailed information about each of the AVC funds is available via the Standard Life website www.standardlife.co.uk.

Remember, you can view your up to date fund value and see which funds your AVCs are invested in by registering for Standard Life's online service. 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 your AVCs to other funds, you can do so at any time. You will need to complete and return an AVC form. This is available from the pensions website at www.baesystemspensions.com or can be obtained from the Pensions Service Centre (contact details are on page 24).



How and where to get financial advice

Please remember that no-one 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 is the website 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.

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. Revised contact details are below.

In-service and deferred members:

Royal Ordnance Pension Scheme

Pension Service Centre, PO Box 1194, Crawley, West Sussex RH10 0FZ

Telephone: 0845 180 1403

If calling from abroad: +44 1293 591958

Fax: 01772 705492

Email: fulwood.pensions@xafinity.com

Website: www.baesystemspensions.com

Pensioners:

Royal Ordnance Pension Scheme

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

Low-cost telephone number: 0845 601 4762

If calling from abroad: +44 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 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.

