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BAE SYSTEMS PENSION SCHEME ANNUAL REVIEW 2015

# JOURNEY

ANNUAL REVIEW FOR IN-SERVICE AND DEFERRED MEMBERS

**BAE SYSTEMS**

INSPIRED WORK

# WELCOME



**I am pleased to welcome you to Journey, the Trustee's 2015 Annual Review of the BAE Systems Pension Scheme ('Scheme'). In the following pages you can read a summary of the 2015 Report and Accounts and obtain an overview of the past year.**

Earlier in the year, you received details about the results of the actuarial valuation as at 31 March 2014. We reported that the funding position of the Scheme had improved since the previous valuation. Since then, however, market conditions have caused the funding level to fall. You can read more about the recent valuation and the funding update on pages 4 to 6.

Following a review across all BAE Systems pension schemes, there has been a change in the actuarial service provider. We are delighted to announce that the actuarial consultancy firm, Hymans Robertson, has been appointed. There is more information on page 4.

David Adam, Chief Investment Officer at BAPFIM, provides an update on how well the Scheme's investments have been performing over the last year. You can read his report on pages 8 and 9.

On pages 12 to 15, we have included the latest pensions news to bring you up to date with what has had an impact on our Scheme.

Please let me know what you think of this Annual Review. If there is anything you would like to see covered in a future issue, please get in touch using the contact details on page 16.

## **Guy Griffiths CBE**

Chairman of the Trustee

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The Scheme's assets were worth

**£12,932m**

at the end of March 2015



The Scheme has

**125,465**

members at the end of March 2015



# FUNDING UPDATE

**Earlier this year, we told you about the results of the actuarial valuation as at 31 March 2014 and reported that there had been an improvement in the funding position compared to the previous valuation.**

Since then, we have completed a review of the providers of our actuarial services. It is good governance practice to carry out periodic reviews of providers. After a thorough evaluation, the Trustee decided to appoint the actuarial consultancy firm, Hymans Robertson, to replace our previous provider, Aon Hewitt. The Trustee of the Scheme has appointed Mike Parker as Scheme Actuary who recently joined Hymans Robertson from Aon Hewitt, and who has extensive knowledge of the Scheme.



I have been the Scheme Actuary for five years now. My role as your Actuary is to carry out the detailed financial calculations of the Scheme's liabilities to enable it to pay pensions to its members and also to advise the Trustee Board on how to manage the Scheme's risks. I work with the Board in seeking to improve the financial security that

the Scheme provides for those benefits. Having recently joined Hymans Robertson – your new actuarial consultancy firm, I very much look forward to continuing that work and to building on the longer-term foundations that have been agreed with BAE Systems.

**Mike Parker**

The Scheme Actuary prepares regular valuations and advises the Trustee on funding matters. The valuations provide an assessment of the funding position of the Scheme and help the Trustee and the Company to reach agreement on the contributions payable to the Scheme.

## RESULTS OF THE LAST ACTUARIAL VALUATION

	31 March 2014 £m	31 March 2011 £m
Assets	11,653	8,912
Amount needed to provide benefits	13,646	11,254
Surplus/(shortfall)	(1,993)	(2,342)
Funding level	85%	79%

*AVCs/DC Retirement Plan and Level 100+ Retirement Accounts are included in the above figures.*

The main factors affecting the funding position since the previous valuation in 2011 were strong asset returns and the Employers' additional contributions towards the deficit, offset by the reduction in government bond yields (which increases the estimated cost of providing future benefits).

Following the latest valuation, the Trustee and the Company have agreed that the Employers will increase their deficit contributions into the Scheme to a lump sum of £75m for the years ending 31 March 2015 until 31 March 2026, along with 8% of contribution earnings. These payments, together with an allowance for investment returns on the Scheme's assets, are expected to be sufficient to remove the deficit

by March 2026. The Employers also pay additional contributions to cover the cost of the ongoing accrual of benefits. There is no change to member contributions or benefits as a result of the actuarial valuation.

## WHAT HAS HAPPENED TO THE FUNDING LEVEL MORE RECENTLY?

	31 March 2015 £m
Assets	12,688
Amount needed to provide benefits	16,423
Surplus/(shortfall)	(3,735)
Funding level	77%

*AVCs/DC Retirement Plan and Level 100+ Retirement Accounts are excluded in the above figures.*

Since 31 March 2014, the funding level has fallen from 85% to 77% as at 31 March 2015. This is largely attributable to a further decrease in government bond yields causing the current value of benefit liabilities to substantially increase. This has been partially offset by a higher than expected return on assets and contributions paid by the Employers. The Trustee continues to monitor the funding position closely.

# FUNDING UPDATE CONTINUED

## WHAT WOULD HAPPEN IF THE SCHEME HAD TO BE WOUND UP?

Whilst there is no intention to wind up the Scheme, it is a requirement to provide members with the information on the Scheme's position if that were to be the case.

The Scheme Actuary estimated the cost of securing all members' benefits with an insurance company as at 31 March 2014 to be around £20,282m, representing a shortfall of £8,629m. This is approximately the amount the Employers would have needed to pay into the Scheme if it had been wound up on 31 March 2014.

In the event of the Scheme having to be wound up because the Employers became insolvent and, if the Scheme then had insufficient assets to provide a certain minimum level of benefits for members, compensation might be provided by the Pension Protection Fund (PPF).

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, Renaissance, 12 Dingwall Road, Croydon, Surrey CR0 2NA.

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



# MONEY IN AND MONEY OUT

The table below is a summary of how the value of the Scheme's assets changed during the year ended 31 March 2015.

INCOME AND EXPENDITURE	YEAR ENDED 31 MARCH 2015 £M
<b>Fund at beginning of the year</b>	<b>11,619</b>
Total income	<b>561</b>
Total outgoings	<b>(603)</b>
Excess of income over outgoings	<b>(42)</b>
Change in the market value of assets	<b>1,355</b>
<b>Fund at end of the year</b>	<b>12,932</b>
Net investments	<b>12,922</b>
Net current assets	<b>10</b>
<b>Net assets of the Scheme at year end</b>	<b>12,932</b>

*These figures exclude the DC Retirement Plan, but include AVCs and Level 100+ Retirement Accounts of £244m.*

**If you would like a copy of the full Annual Report and Accounts, please contact the Pensions Service Centre.**

## TRUSTEE DIRECTORS AND ADVISERS

The Scheme's Trustee Directors:

Guy Griffiths CBE (Chairman)  
 Mike Byfield\*                      Pat Cauldwell\*  
 David Cole                              Andy Dean\*  
 Andreas Drabert                      Andrew Gallagher  
 Trevor King                              Steve Olsson\*  
 Carol Paul\*                              Mark Stewart  
 Louise Wallwork                      Chris Williams\*  
 Andy Wishart\*

\*Member Nominated Director (MND)

The Scheme's Advisers:

### Actuary

Mr M Parker, Aon Hewitt Limited  
 (resigned on 16/03/2015)

Mrs J Curtis, Aon Hewitt Limited (appointed  
 16/03/2015 and resigned on 19/06/2015)

Mr M Parker, Hymans Robertson LLP (appointed  
 on 30/06/15)

### Auditor

KPMG LLP

### Legal Advisers

Travers Smith LLP

# INVESTMENT UPDATE



**David Adam, Chief Investment Officer of BAE Systems Pension Funds Investment Management (BAPFIM), brings members up to date on the Scheme's investments.**

The year to end March 2015 saw strong absolute returns for the Scheme. Financial assets in general were driven higher by global central banks' efforts to stimulate economic growth and keep interest rates low. Of the major asset classes, overseas equities, led by the US and Japanese markets, and UK property rose by almost 20% over the year. Bonds, despite low starting yields, were also strong, rising by almost 15%. UK equities lagged, but still produced single digit returns.

Despite the strong absolute returns, the Scheme's performance over the year lagged the benchmark set by the Trustee. This was due to the short-term performance of the Scheme's property holdings. Whilst the absolute return on the Scheme's property was strong, the relatively lower risk nature of our property portfolio meant that the benchmark was not achieved. The Scheme holds higher yielding, longer leased properties, which have strong covenants and future rental

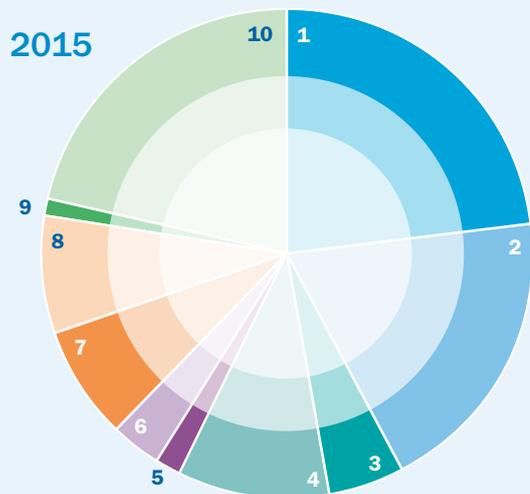
increases linked to inflation. These underperformed when measured on a short term basis.

In the equity portfolio, strong contributions from the UK smaller company managers and Japanese manager were offset by weaker performances from the US, emerging market and European equity managers. The bond portfolio outperformed and the Scheme's longer-term performance continues to compare favourably with its benchmark.

The year ahead should see global economic growth continue to pick up, but the recovery will depend on a robust US economy and continued central bank support in keeping interest rates abnormally low, to stabilise debt and encourage investment and growth. The slowdown in Chinese economic growth is of concern, but the decline in the oil price should help stimulate developed economy growth. The Scheme has started to invest in alternative assets, presenting the opportunity to both diversify and enhance returns. In this area, the Scheme has so far invested in a wide range of assets, from dry cargo ships and onshore wind farms, to providing financing for a variety of small and medium sized companies. Overall, the Scheme is enjoying strong, positive returns from these investments.

## ASSET ALLOCATION

The asset allocation of the Scheme is shown below:



### SPREAD OF INVESTMENTS AT:

	2015	2014
<sup>1</sup> UK Equities	23.1%	24.4%
<sup>2</sup> Overseas Equities	19.2%	18.1%
<sup>3</sup> Government Bonds	5.0%	4.6%
<sup>4</sup> Corporate Bonds	9.9%	10.8%
<sup>5</sup> High Yield Bonds	1.6%	1.0%
<sup>6</sup> Best Ideas Fund <sup>#</sup>	3.5%	3.7%
<sup>7</sup> Unquoted	7.8%	6.7%
<sup>8</sup> Property	7.7%	7.6%
<sup>9</sup> Cash and Other Assets	1.2%	2.2%
<sup>10</sup> Matching Assets <sup>*</sup>	21.0%	20.9%
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>

<sup>#</sup> The Best Ideas Fund is a concentrated portfolio, consisting of UK, North American and European equities, offering a higher return equity vehicle.

<sup>\*</sup> Matching Assets consists of long dated government bonds, index-linked bonds and inflation and interest rate swaps. Matching Assets are designed to generate a return based on future pension payments.

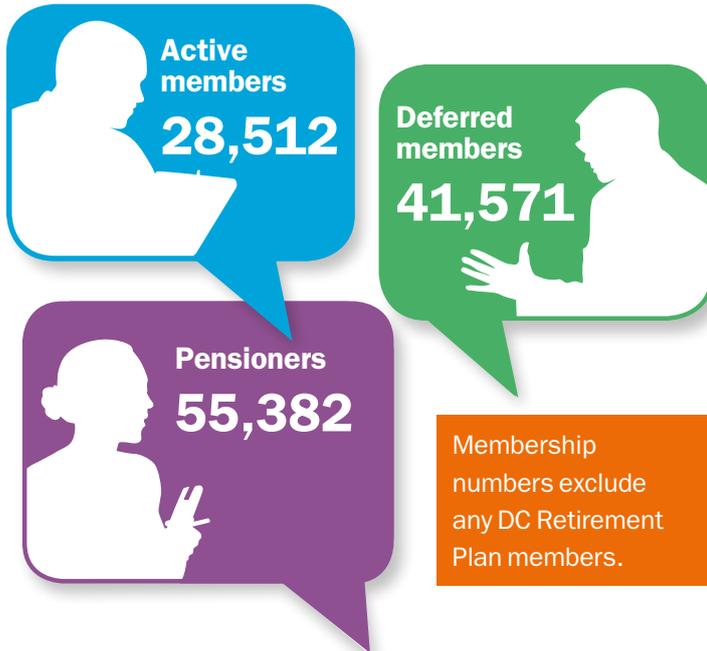
## INVESTMENT PERFORMANCE

	1 year to 31 March 2015 %	3 Years to 31 March 2015 % p.a.	5 years to 31 March 2015 % p.a.	10 Years to 31 March 2015 % p.a.
Scheme (total)	12.1	10.1	9.3	8.7
Scheme Performance (excluding unquoted and matching assets)	11.5	10.8	9.3	8.7
Performance Benchmark <sup>*</sup>	13.5	10.7	9.3	8.2

<sup>\*</sup> The total performance assets exclude unquoted assets and matching assets. This is because unquoted assets are highly illiquid and accordingly do not have an active market against which performance can be assessed. Matching assets are designed to generate a return based on future pension payments. Accordingly, the Scheme's future pension payment profile is specific to the Scheme and there is no benchmark which these assets can be assessed. The Scheme's performance assets should be compared against the performance benchmark shown. The performance for the Scheme includes unquoted and matching assets but there is no relative benchmark against which the total assets can be assessed.

# WHO'S IN THE SCHEME?

At the end of March 2015, the Scheme had a total of 125,465 members. This total was made up as follows:



## AVCs

### HOW CAN I PAY ADDITIONAL VOLUNTARY CONTRIBUTIONS?

**If you are an active member, you can pay additional voluntary contributions (AVCs) to boost your retirement benefits.**

AVCs normally qualify for income tax relief at your highest rate, in the same way as your Scheme contributions. However, when deciding whether or not to pay AVCs, please remember that the Annual Allowance restricts the total annual amount of pension contributions and benefits that can receive tax relief.

Further information on the Annual Allowance can be found on page 13.

Under the Scheme Rules it is now possible to transfer just your AVCs into an alternative pension arrangement. This may be of interest to members who might wish to access the additional flexibilities now available for defined contribution pensions.

# SCHEME CHANGES

The Company, with the consent of the Scheme Trustee, has made a number of improvements to the Scheme Rules and here we provide a summary of these.

## SAME SEX MARRIAGE

New legislation introduced in 2013 gave same sex couples the right to marry from 29 March 2014. The Scheme Rules have been amended so that surviving same sex spouses are entitled to the same benefits as opposite sex spouses and civil partners, within our Scheme.

## LATE RETIREMENT

If you leave service on or after normal retirement date, you will have the option to postpone payment of your pension up to age 75 (at which point it will be paid with actuarial increases).

## SHARED PARENTAL LEAVE

New legislation recently introduced a new form of family leave called Shared Parental Leave which allows parents to share leave rights after the birth of a child. The Scheme Rules have been amended to provide for Shared Parental Leave to be treated in the same way as other family leave.

## TRIVIAL COMMUTATION LUMP SUM

Spouses and dependants will now have the option, subject to certain statutory restrictions, to exchange their pension for a lump sum in the same way as Scheme members.

Scheme members may take a trivial commutation lump sum, if the value of all their defined pension benefits (ignoring any State pension) when added together do not exceed £30,000 in total. Payment is subject to other statutory conditions.

# PENSIONS NEWS

## LONGEVITY ADJUSTMENT FACTOR

We are pleased to report that there has been no change to the Longevity Adjustment Factor (LAF) this year. However, that is not to say it will not change in the future.

Each year, the Scheme Actuary analyses the recent experience of the Scheme to determine how life expectancy has moved since the base year of 2005. When setting the LAF for 2015, life expectancy had not changed significantly since 2014 and therefore it was reasonable to hold the factor steady for this year.

The LAF is applied to pension accrued on or after 6 April 2006. The LAF is based on the best estimate of how life expectancy will change, drawing on the experience of our pensioner population and the predicted future improvements in life expectancy.



## MYPENSION

All Scheme members now have access to MyPension and many of you have accessed MyPension since it was launched in 2014. MyPension allows active and deferred members to obtain pension estimates at selected retirement ages and active members will be able to model the impact of AVCs (additional voluntary contributions) on their overall retirement benefits. Members can also view annual benefit statements and access a range of useful pensions materials. Pensioners can view their payslips, pension increases and P60s on MyPension. Contact details for MyPension are available on page 16.

## IS YOUR EXPRESSION OF WISH FORM UP TO DATE?

The Scheme provides valuable benefits in the event of your death. The Trustee is responsible for deciding who these benefits are paid to, but it takes your wishes into consideration. It is important that you tell us what you would like us to do. You can nominate any person to be your beneficiary (including family, dependants, friends and charities) and you can ask the Trustee to split the benefit between two or more beneficiaries.

It is important to keep your Expression of Wish form up to date if your circumstances change. You can obtain an Expression of Wish form at any time from the Pensions Service Centre or online at [www.baesystemspensions.com](http://www.baesystemspensions.com).

## ANNUAL ALLOWANCE AND LIFETIME ALLOWANCE

The Annual Allowance is the amount by which the value of an individual's pension benefits can increase each year without incurring a tax liability. The Annual Allowance for the tax year 2014/2015 was £40,000. For the 2015/2016 tax year, the Annual Allowance has remained at £40,000. From April 2016, the Annual Allowance will be tapered for those with total incomes over £150,000 and reduces to £10,000 for those earning £210,000 or more.

The Lifetime Allowance is the limit on the total value of pension benefits that an individual can build up over their working life without a tax charge. The Lifetime Allowance for the tax year 2014/2015 was £1.25m. For the 2015/2016 tax year, the Lifetime Allowance has remained at £1.25m but will reduce to £1m in the tax year 2016/2017. From April 2018, the Lifetime Allowance will increase in line with the Consumer Prices Index.

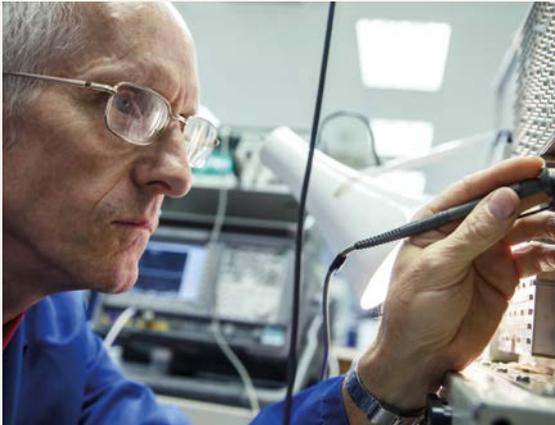
Further information about these limits and transitional protections that may be available is on the pensions website: [www.baesystemspensions.com](http://www.baesystemspensions.com).

## MEMBER NOMINATED DIRECTOR REVIEW

The Trustee needs to satisfy the requirements of the Pensions Act 2004 with regard to Member Nominated Directors (MNDs). The MND procedures for the Scheme were subject to a routine review by the Trustee in 2014, which is undertaken every three years. Following the review, the Trustee proposed no changes to the existing MND procedures.

## NEW SHORT FORM ANNUAL BENEFIT STATEMENT

Active members in the Main Edition of the Scheme will have received a shorter annual benefit statement this year to replace the detailed statement, which they received in previous years. We hope you find the new style statement helpful and easier to read. We would be pleased to hear what you think of it, so please contact the Pensions Service Centre to give your views. Members can still access their detailed benefit statement from MyPension, should they wish to view it.



## PENSION SCAMS: SAFEGUARD YOUR SAVINGS

Pension scams are on the increase and scammers have a variety of tricks to catch you out. They may claim that you can access your pension pot before age 55, approach you out of the blue over the phone, via text message or in person door-to-door, entice you with upfront cash or offer a free 'pension review', or try to lure you in with so-called 'one-off' investment opportunities. The scammers may even pretend that the government has asked them to contact you.

What they won't tell you is that you may incur significant tax charges and you might never see your pension pot again. Please check the facts before you make an irreversible decision. Working with organisations across the financial industry and the government, the Pensions Regulator launched a new campaign in March this year to raise awareness of the danger of pension scams. You can visit: [www.thepensionsregulator.gov.uk/pension-scams](http://www.thepensionsregulator.gov.uk/pension-scams) to find out more and who to contact if you think you have been targeted.

While on the subject of scams, please be aware that 'boiler room' share scams are still extremely active. The term 'boiler room' refers to salesmen operating from an unofficial 'call centre' using unfair, dishonest sales tactics. These fraudsters may purport to represent BAE Systems, the government or another company. Please be vigilant – if you receive any unsolicited calls relating to your BAE Systems shares, it is highly likely to be from a 'boiler room'. This could also be the case for other shares you hold.

For more details on all types of investment scams, please visit the Financial Conduct Authority website: [www.fca.org.uk/consumers/scams](http://www.fca.org.uk/consumers/scams).

## DC CODE OF PRACTICE – TRUSTEES’ DUTIES

In November 2013 the Pensions Regulator issued a Code of Practice (‘the Code’) which deals with the governance and administration of defined contribution (‘DC’) savings under trust based pension schemes. The Code extends to DC/AVC sections of defined benefit schemes, such as this Scheme. The Code and accompanying regulatory guidance set out a number of ‘DC quality features’ that the Pensions Regulator expects to be present in schemes.

In a quality DC scheme, trustees will ensure that members:

- are regularly made aware of their current investment strategy and what this means for them
- receive value for money with all costs and charges borne by members clearly disclosed to them
- have the options available to them at retirement clearly communicated to them (and/or signposted to other sources of support) in a way which supports them in choosing the option most appropriate to their circumstances
- receive scheme communications that are accurate, clear, understandable and engaging and which address the needs of members from joining to retirement.

The Trustee, together with its advisers, undertakes regular reviews of its DC and AVC arrangements to ensure it complies with the Code and regulatory guidance.

## USEFUL DOCUMENTS

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.

**Statement of Investment Principles**, which explains the investment strategy of the Scheme.

**Statement of Funding Principles**, which explains how the Scheme will be funded.

**Schedule of Contributions**, which shows how much money is being paid into the Scheme to cover the cost of the benefits which are accruing.

**Annual Report and Accounts of the Scheme**, which shows the Scheme’s income and expenditure in the year to 31 March 2015.

**Actuarial Valuation Report**, which includes details of the Scheme’s financial situation as at 31 March 2014.

**Annual Funding Update**, which includes an estimate of the Scheme’s financial position as at 31 March 2015.

# GETTING IN TOUCH

**We are here if you need to get in touch with us or if you have any questions. It is important too that we have your up to date contact details. You can contact us using the details below:**

**Freephone:** 0800 917 9568

**If calling from overseas:** +44 121 415 0891

**Email:** [farnborough.pensions@equiniti.com](mailto:farnborough.pensions@equiniti.com)

## **IF YOU WANT TO WRITE TO US, OUR ADDRESS IS:**

### **BAE Systems Pension Scheme**

Pensions Service Centre, PO Box 1193

Crawley, West Sussex RH10 0FY

**There is lots of information on the pensions website:  
[www.baesystemspensions.com](http://www.baesystemspensions.com)**

## **MYPENSION**

You can log into the MyPension service at **[www.baesystemspensions.com/mypension](http://www.baesystemspensions.com/mypension)**. If you cannot access this service, please contact the Member Web services free on 0800 917 9567, or +44 121 415 0816 if calling from overseas (normal mobile phone network charges will apply).

## **NEED HELP?**

We cannot give you financial advice but if you need help with your pension, the Pensions Advisory Service might be a good starting point: **[www.pensionsadvisoryservice.org.uk](http://www.pensionsadvisoryservice.org.uk)**. They can also help with any unresolved complaints, as can the Pensions Ombudsman: **[www.pensions-ombudsman.org.uk](http://www.pensions-ombudsman.org.uk)**.

If you would like to find out more about pensions and how to make the most of your retirement planning, visit the Money Advice Service website: **[www.moneyadviceservice.co.uk](http://www.moneyadviceservice.co.uk)**.

You can also go to Pension Wise, a new free and impartial guidance service set up by the government to help people understand their defined contribution pension options. For more information visit **[www.pensionwise.gov.uk](http://www.pensionwise.gov.uk)**.

If you are not sure what to do, you can speak to an independent financial adviser (IFA). You can find one in your area on this website: **[www.unbiased.co.uk](http://www.unbiased.co.uk)**.

If you want to make a formal complaint about the Scheme, please contact Nigel Tinsley, Pensions Director, at PO Box 87, Farnborough Aerospace Centre, Farnborough GU14 6YU. If your complaint remains unresolved, you can contact the Pensions Ombudsman or the Pensions Advisory Service.