LEONARDO

HELICOPTERS PENSION SCHEME

Actuarial valuation as at 5 April 2017 - Questions and Answers

1. *Why has the valuation position improved?*

Financial conditions have been difficult since the previous valuation. However the Scheme's risk-controlled investment strategy has stood up well and the initiative to manage liabilities through the Pension Increase Exchange (PIE) exercise was successful. During the valuation process the Trustee and the Company have taken actuarial advice and this found that certain financial and demographic assumptions could be eased while still ensuring that the funding basis remains prudent. The Scheme has a deficit of £67m compared to £123m three years ago.

2. *Why has the cost of future accrual got worse?*

It is not possible to control the cost of future benefits in the same way as we can manage risk around past service benefits. The difficult financial conditions (and low interest rates in particular) mean that the cost of each new year of benefits has doubled for the Company (to 18.2%). These conditions pose a threat to the sustainability of the Scheme.

3. *Why is the Company keeping the Scheme open?*

The Scheme was closed to new members in 2007 but the Company is prospectively able to support existing members in earning more pension benefits for a further period. This is being done to provide stability and certainty to members of the Scheme. It is only possible because of the way the improved funding position eases the pressure on the recovery element of Company contributions. However the Company is seeking one change to the benefits in relation to future pension increases to help manage the liabilities consistently.

4. *What does the Company want to change?*

The Company proposes that pension increases from future service will be linked to the Consumer Prices Index (CPI), rather than the Retail Prices Index (RPI). Without this change the future service rate would be 1.4% higher (19.6%)

There is no change in relation to increases on the pension which has been earned before the date of change (unless you choose to give up those pension increases through the new PIE at retirement option described below).

5. *Why does the Company want to make this change?*

The Office for National Statistics considers RPI to be "a flawed measure of inflation with serious shortcomings" and they "do not recommend its use".[1] It may overstate inflation by around 1% per annum and has not been used by the Government for statutory uplifts to benefits since 2011. The replacement index used by the Government is CPI.

[1] Jonathon Athow, Director General of the Office for National Statistics 31 July 2017

6. Is there a maximum increase?

Yes, there is a current maximum increase of 2.5% per annum and this will continue.

7. Why does the Company still use RPI for pension increases?

The Company uses RPI because a specific reference to this index was included in the Pension Scheme Rules by the lawyers when the Scheme was first set up. If, instead, the Rules referred to the 'statutory' rate of increase then the Rules would have switched automatically to CPI in 2011. This problem is often described as the rules 'drafting lottery'.

8. Is the Government going to do something about the 'drafting lottery'?

The Government is aware of the pressure affecting defined benefit schemes and has consulted on changes to support them. This has included the possibility of a 'statutory override' which would allow schemes to make an automatic change to CPI as the measure of inflation even where the Rules have a specific reference to RPI. It is not known how likely this is to reach legislation and by when.

9. What are the current pension increases?

Pensions are split into tranches depending on when they were earned and the statutory requirements then in place. The table below shows the rates of increase and *(in italics)* how this would change as a result of the proposal.

Tranche of benefit	Increase provided by the Rules of the Scheme
Guaranteed Minimum Pension from contracted-out employment prior to 6 April 1988	Nil
Guaranteed Minimum Pension from contracted-out employment between 5 April 1988 and 5 April 1997	CPI up to 3%
Pension accrued prior to 6 April 1997 (in excess of Guaranteed Minimum Pension)	RPI up to 5%
Pension accrued between 6 April 1997 and 5 April 2005	RPI up to 5%
Pension accrued after 6 April 2005 *(between 6 April 2005 and 5 April 2019)*	RPI up to 2.5%
Pension accrued after 6 April 2019	*CPI up to 2.5%*

10. What is PIE?

PIE stands for Pension Increase Exchange. The offer involves exchanging future annual pension increases for a one-off increase (or uplift) in your pension amount. Thereafter, your pension would be increased in line with statutory minimum requirements rather than in line with the higher requirements of the Scheme's current Rules.

11. Why would a member use the PIE option?

Typically someone would use the PIE option because they prefer to have a higher level of pension earlier in their retirement while they are most able to enjoy it. Other reasons include a view that inflation is likely to stay low in the long term or being in poor health with shorter life expectancy.

There are also reasons why PIE may not be appropriate for a member and hence the option is entirely voluntary.

12. Why does the Company offer PIE?

PIE is designed so that the one-off uplift in benefits is worth a proportion of the expected cost of providing future pension increases through the Scheme in excess of the statutory minimum levels. The saving generated from members taking up PIE is retained by the Scheme to help improve funding.

The code of good practice on incentive exercises like PIE provides for a 'Balanced Deal Percentage' to be produced. This percentage is the expected cost of additional benefits to be awarded to members (assuming that everybody accepts them) compared to the expected cost of the benefits being given up. The Balanced Deal Percentage for our PIE exercise is 60%. Therefore, on average, the Trustees expect the cost of providing the uplift to be 60% of the expected cost of future pension increases through the Scheme in excess of the statutory minimum levels. Hence the Trustees expect there to be a reduction in the value of benefits and a saving in the Scheme of 40% of the expected cost. It follows that for those who use the PIE option there is a reduction in the liabilities of the Scheme and a saving in the accounts of the Company.

13. How many pensioners took up the PIE offer?

The rate of take up was 33% for the first exercise and 38% for the second exercise. This was in line with our expectations given the complexity of the decision and the fact that the suitability of PIE depends on individual circumstances.

14. What is an at retirement option?

This is an option you can take when you reach retirement. For example you can take some of your pension as tax free cash under current HMRC rules while the new PIE option would allow you to adjust the starting level of your pension and the rate at which it will increase.

15. When will the new PIE option at retirement be available and do I have to take it up?

The PIE option is voluntary and you will have a choice whether you wish to select it when you reach your retirement. It is intended that the PIE option will be available before April 2019.

16. What rates of increase can I choose through PIE when it is available at retirement?

The increase rates are shown in the table below (assuming that the change proposed by the Company takes effect):

Tranche of benefit	Increase provided by the Rules of the Scheme	Statutory increase if PIE option is selected
Guaranteed Minimum Pension from contracted-out employment prior to 6 April 1988	Nil	Nil
Guaranteed Minimum Pension from contracted-out employment between 5 April 1988 and 5 April 1997	CPI up to 3%	CPI up to 3%
Pension accrued prior to 6 April 1997 (in excess of Guaranteed Minimum Pension)	RPI up to 5%	Nil
Pension accrued between 6 April 1997 and 5 April 2005	RPI up to 5%	CPI up to 5%
Pension accrued (between 6 April 2005 and 5 April 2019)	RPI up to 2.5%	CPI up to 2.5%
Pension accrued after 6 April 2019	CPI up to 2.5%	CPI up to 2.5%

17. How much would the PIE increase be?

The option terms depend on your personal circumstances, and are not guaranteed as they will be updated to reflect prevailing conditions when you retire. However, as an illustration only, the uplift for a particular male member aged 65 last year would have been as follows:

Tranche of benefit	Statutory increase after PIE option	Example % uplift to pension
Guaranteed Minimum Pension from contracted-out employment prior to 6 April 1988	Nil	Nil
Guaranteed Minimum Pension from contracted-out employment between 5 April 1988 and 5 April 1997	CPI up to 3%	Nil
Pension accrued prior to 6 April 1997 (in excess of Guaranteed Minimum Pension)	Nil	34%
Pension accrued between 6 April 1997 and 5 April 2005	CPI up to 5%	8%
Pension accrued after 6 April 2005	CPI up to 2.5%	3%

For the reasons outlined in this document, the PIE option would only apply in relation to pension built up to the effective date of the proposed benefit change.

18. Does PIE mean I can have more tax free cash at retirement?

Yes, under current HMRC rules the amount of tax free cash is derived from the level of your starting pension – so a PIE uplift would allow more tax free cash.

19. Will the Company always use the CPI index?

Given the example of the problems caused by the RPI drafting lottery, the Company proposes to provide within the Rules a power for future update in the event that CPI is no longer the recognised, statutory measure of inflation for pension purposes. Any future change would be made by agreement with the Trustee and the index would always be a suitable statutory measure.

How to contribute to the consultation:

The consultation starts on 12 February 2018 and will conclude on 13 April 2018. It is proposed that the change to pension increases would take effect for benefits accrued from no later than 6 April 2019.

Please note that the Company is making proposals only which will be discussed with the Pensions Council. Please note that we cannot answer individual questions that relate specifically to your situation. Instead a summary will be prepared and made available on the Scheme website.

You can submit your feedback and questions:

- by email to pensions@leonardocompany.com
- in writing to Pensions Department, Leonardo MW Ltd, Box 205, Yeovil, BA20 2YB.

After the Company has considered your feedback, a formal announcement will be made of any changes to the Scheme. Please go to www.lhpensions.co.uk for more information and updates through the consultation period.