Leonardo Helicopters Pension Scheme

Valuation as at 5 April 2017 – Consultation with members

March 2018

LEONARDO

Pension Scheme valuation briefing - agenda

1. Explain the background to the valuation

2. Explain the proposed change from RPI to CPI as the measure of inflation for pension increases from future accrual

3. Example member impact

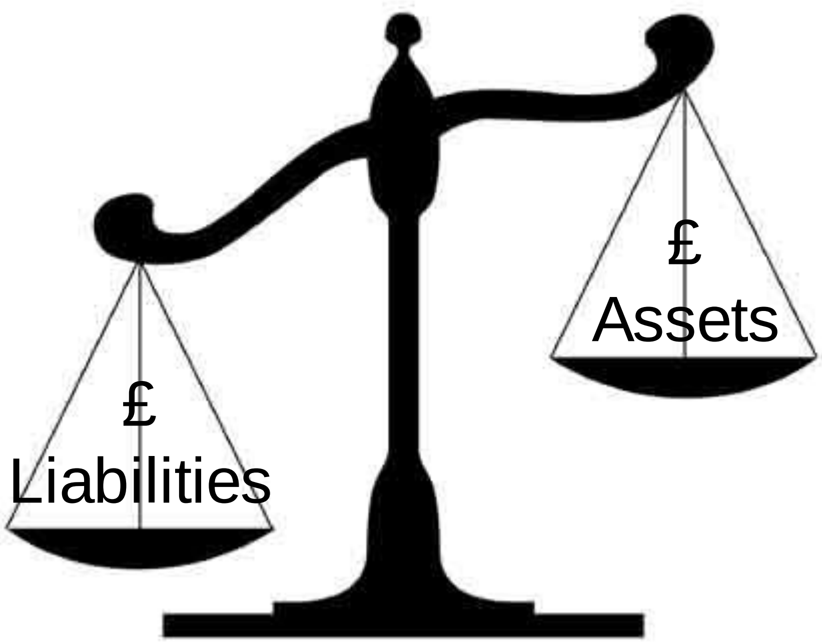
This presentation only applies to members of the main Helicopters Scheme

Members of Leonardo FuturePlanner are not affected (employees after October 2007)

Background to the valuation

Valuation

- The Scheme must be valued every three years to:
  - Compare the money in the fund with the estimated amount needed to pay all of the pensions promised
  - Determine the cost of building up new amounts of pension in the future

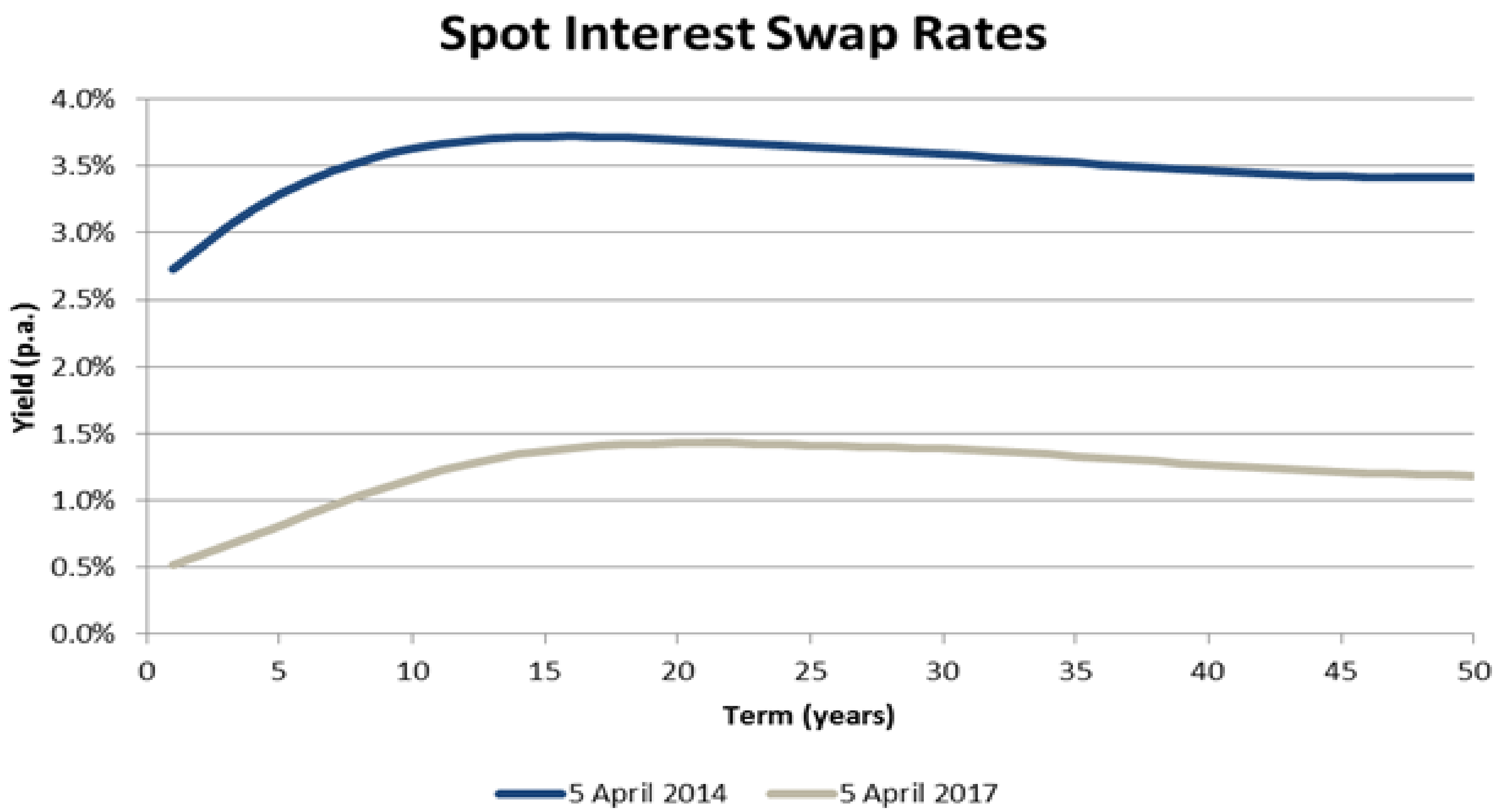


Accrued benefits

Future benefits

Funding conditions

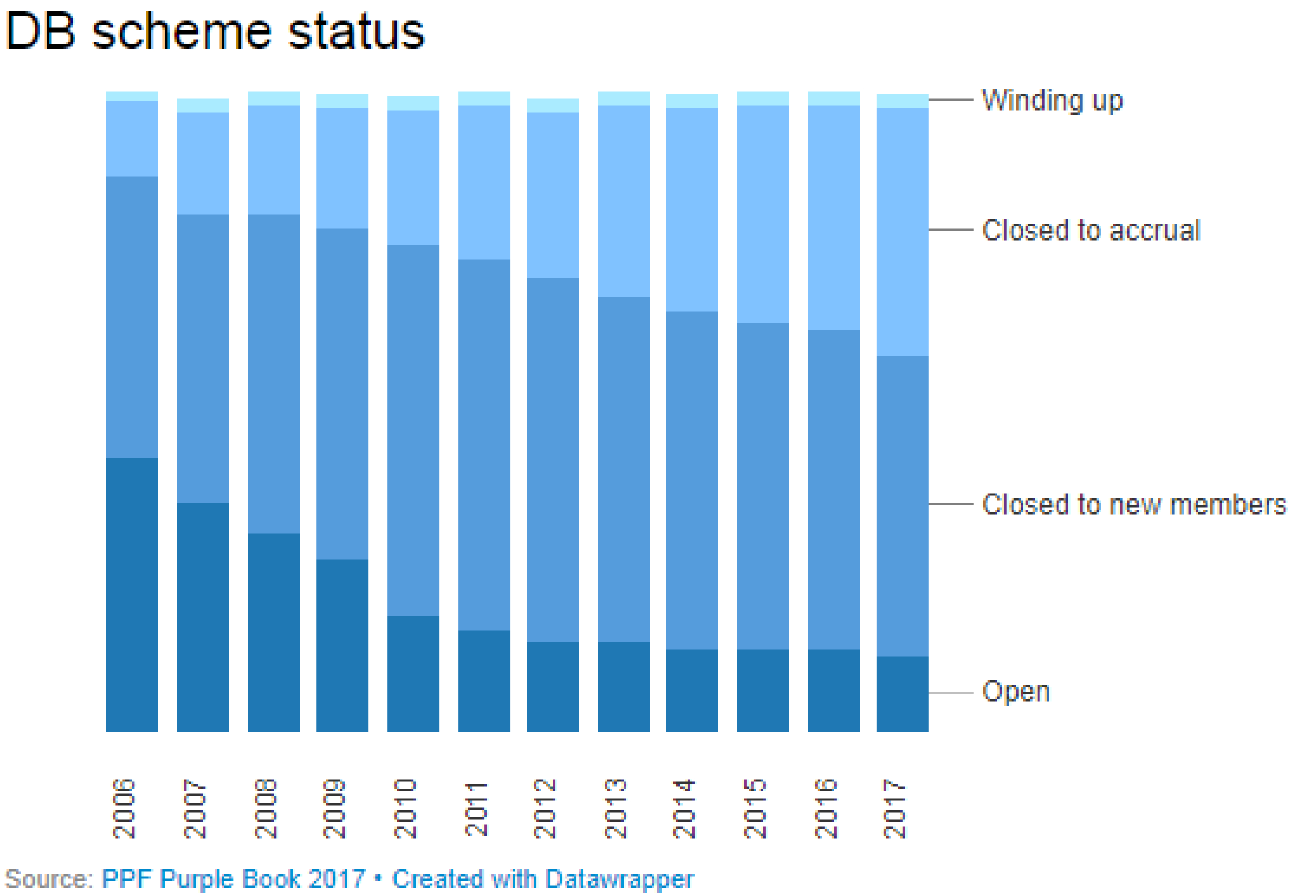
- The valuation period from 2014 to 2017 was difficult
- The main problem was low interest rates



2014 valuation basis	Final results as at 5 April 2014	2014 Basis updated using 5 April 2017 conditions
Deficit	£123m	£227m
Future service cost (after member contributions)	9.05% (+£1.5m)	23.9%

Employer trends

- Given the financial background, many employers are closing their schemes



Some good news…

- The Actuary reviews the membership and assumptions carefully at each valuation
- Helpfully there have been some favourable developments:
  - There is a change in the view of inflation and how volatile it is
  - The rate of improvement in life expectancy has slowed
  - The Company and Trustee believe we can take investment risk for longer while the Scheme is still growing
  - The Pension Increase Exchange (PIE) exercise with the pensioners was successful – **but this needs to be extended to employees**
- In addition there is willingness to be flexible in the allocation of employer contributions between deficit and future service costs through the recovery plan period

2017 valuation basis	Final results as at 5 April 2014	2014 Basis updated using 5 April 2017 conditions	**Prospective results as at 5 April 2017**
Deficit	£123m	£227m	**£67m**
Future service cost (after member contributions)	9.05% (+£1.5m)	23.9%	**9.3% (+£2m)**

- Company deficit contributions are increasing, with 70% of them effectively covering the risk that future service contributions are too low
- The result, otherwise, would be a deficit of **£18m** and future service cost of **18.2%**

Consultation

- The 2017 valuation basis is agreed in principle between the Company and the Trustee
- The final element to complete the valuation is the extension of the PIE exercise to employees
- This involves:
  – A new option at retirement to choose a higher pension with lower increases
  – Stopping further build up of RPI linked pension from new accrual – which accounts for **1.4%** of the reduction in future service cost

Change from RPI to CPI as the measure of inflation for pension increases from future accrual

Measuring inflation

- To protect the ‘real’ value of pensions we must use an inflation index – and those that apply are shown below:

Blocks of pension earned each year for employees:	**CPI**
Uplifting the value of deferred pensions for leavers:	**CPI**
Increases to pensions in payment for retirees:	**RPI**

State pension (within the ‘triple lock’):	**CPI**

- CPI stands for ‘Consumer Prices Index’
- RPI stands for ‘Retail Prices Index’
- The measures are produced by the Office of National Statistics
- Government regulation for pension schemes influences the ones we can use

Development of inflation measures

- RPI was developed in the 1940s and is now considered to be ‘bad maths’ – overstating inflation by about 1% per annum
- The Office for National Statistics says that RPI is *“a flawed measure of inflation with serious shortcomings”* and they *“do not recommend its use”* *
- CPI was developed in the 1990s to an international standard and the Government has transitioned to this measure for most of its needs
- In 2011 it switched pension increases to CPI
- We were not allowed to make this switch for pensioners because our Rules refer specifically to RPI
  - If the Rules referred to the ‘statutory’ rate then we would have switched automatically to CPI in 2011 (the ‘drafting lottery’)

* Jonathon Athow, Director General of the Office for National Statistics 31 July 2017

A statutory override?

- There is pressure on the Government to remove the drafting lottery

  "It would be helpful to have just one public-facing measure of cost of living for consumers."

  Comment of Mark Carney, Governor of the Bank of England, to the House of Lords' economic affairs committee (30 January 2018)

- For the time being the Government are reluctant to provide a statutory override:

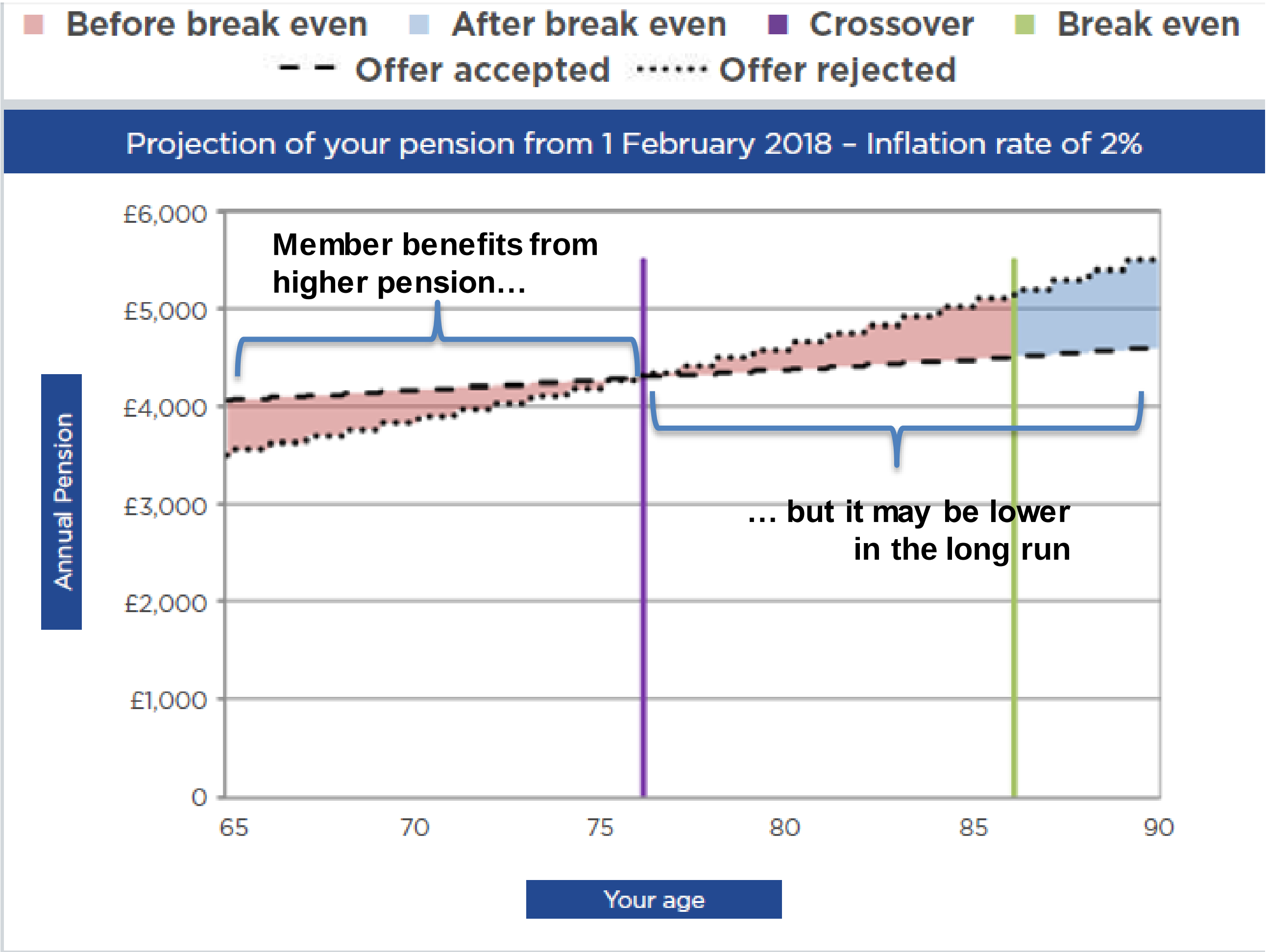
  "… while we will not be providing an override of scheme rules at this time, we will continue to monitor developments in the use of inflation indices across Government, in pensions, and more widely"

  Paragraph 219 DWP White Paper 'Protecting Defined Benefit Pension Schemes (March 2018)

- Accordingly, for our Scheme, generating some of the saving now through PIE and the consultation change helps the Scheme to be sustainable

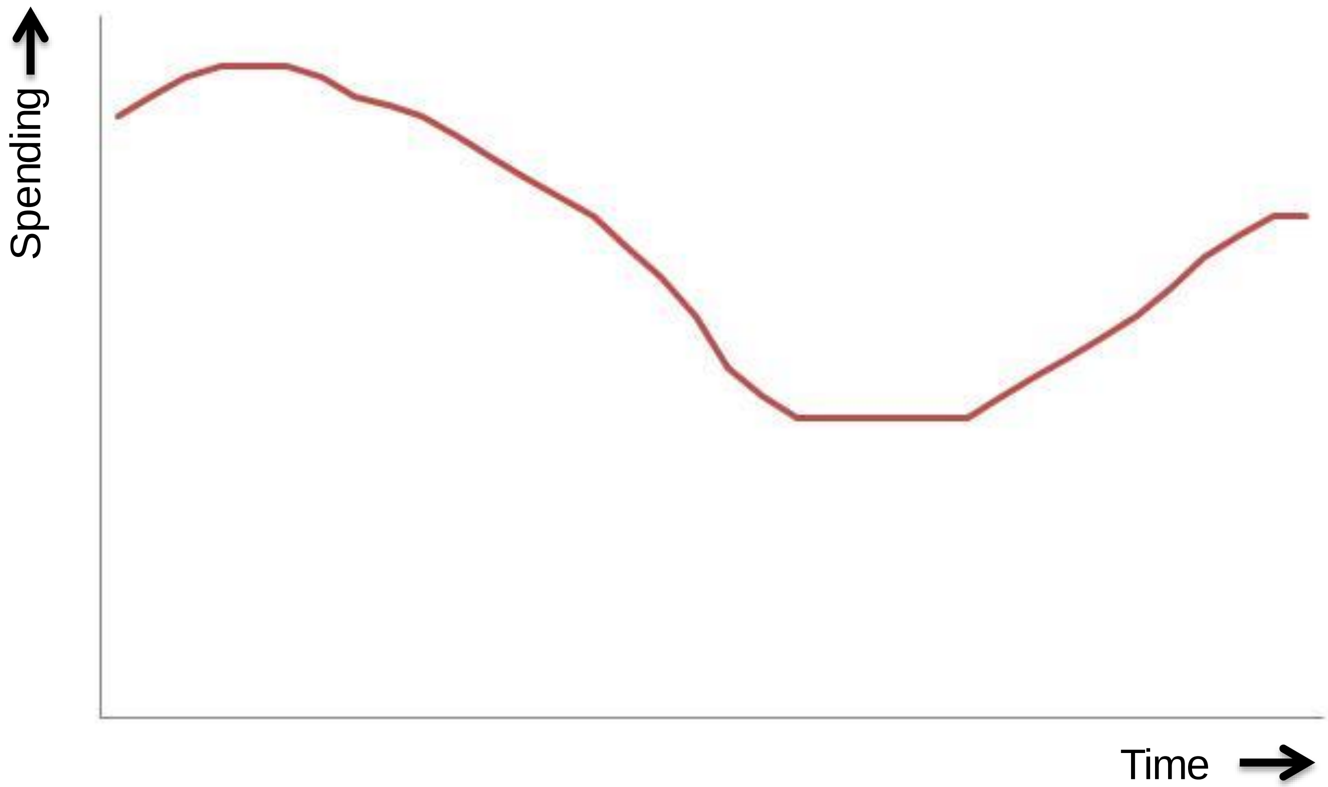
Pension increase exchange

- PIE provides a higher pension in exchange for lower future increases
- It reduces liabilities because the pension is more predictable and a proportion of the value is retained by the Scheme



Benefit to members

- The option is attractive because of the ‘time value’ of money – a higher pension is available when it may be most useful
- It is also influenced by your view of inflation and life expectancy



How much?

- The headline increases can be significant
- There is an additional benefit in that commuted sums are derived from the higher pension amount

THE OFFER

Leonardo MW Ltd (the 'Company') would like to offer you an opportunity to give up future increases in excess of statutory minimum levels in exchange for an uplift to your pension. Note that this offer only applies to some parts of your pension.

You can choose to receive a one-off uplift to your pension in exchange for future increases on your pension in excess of the statutory minimum requirements from 1 February 2018. If you accept this offer, your total pension will increase with effect from 1 February 2018 from **£6,728.64** a year to **£8,187.00** a year as shown in the table below:

	Current pension as at 1 February 2018	Uplifted pension from 1 February 2018	Uplift
Pre-88 GMP	£0.00	£0.00	n/a
Post-88 GMP	£0.00	£0.00	n/a
Pre-97 excess	£4,446.64	£5,770.28	29.80%
97-05 pension	£1,867.19	£1,992.15	6.70%
Post-05 pension	£414.70	£424.48	2.40%
Supplement (Pre-05)	£0.00	£0.00	n/a
Supplement (Post-05)	£0.00	£0.00	n/a
Pension in respect of AVCs	£0.00	£0.00	n/a
TOTAL ANNUAL PENSION	**£6,728.64**	**£8,187.00**	**21.70%**

Please note, figures may not sum due to rounding.

If you accept the offer, the uplift to your pension of **£1,458.36** will use up 0.00% of your Lifetime Allowance.

PENSION THAT IS EXCLUDED FROM THIS OFFER

Any Supplement you receive, which is payable until the later of your State Pension Age or age 65, is unaffected by this offer. In addition, any pension in respect of AVCs which you receive from the Scheme will not be subject to the offer and is unaffected.

Pension increases for future accrual

- As PIE is introduced it would be an anomaly to continue creating RPI linked pension increases to be swapped out at retirement
- This also saves 1.4% in future service cost - which is a significant amount in keeping the Scheme sustainable
- There is no impact on how your pension grows while you are still working
- Once you retire there is:
  - no impact on the pension earned from your pensionable service up to April 2019 - other than the new PIE option
  - a modest impact over time on the pension earned from pensionable service after April 2019, depending on what the future level of inflation is

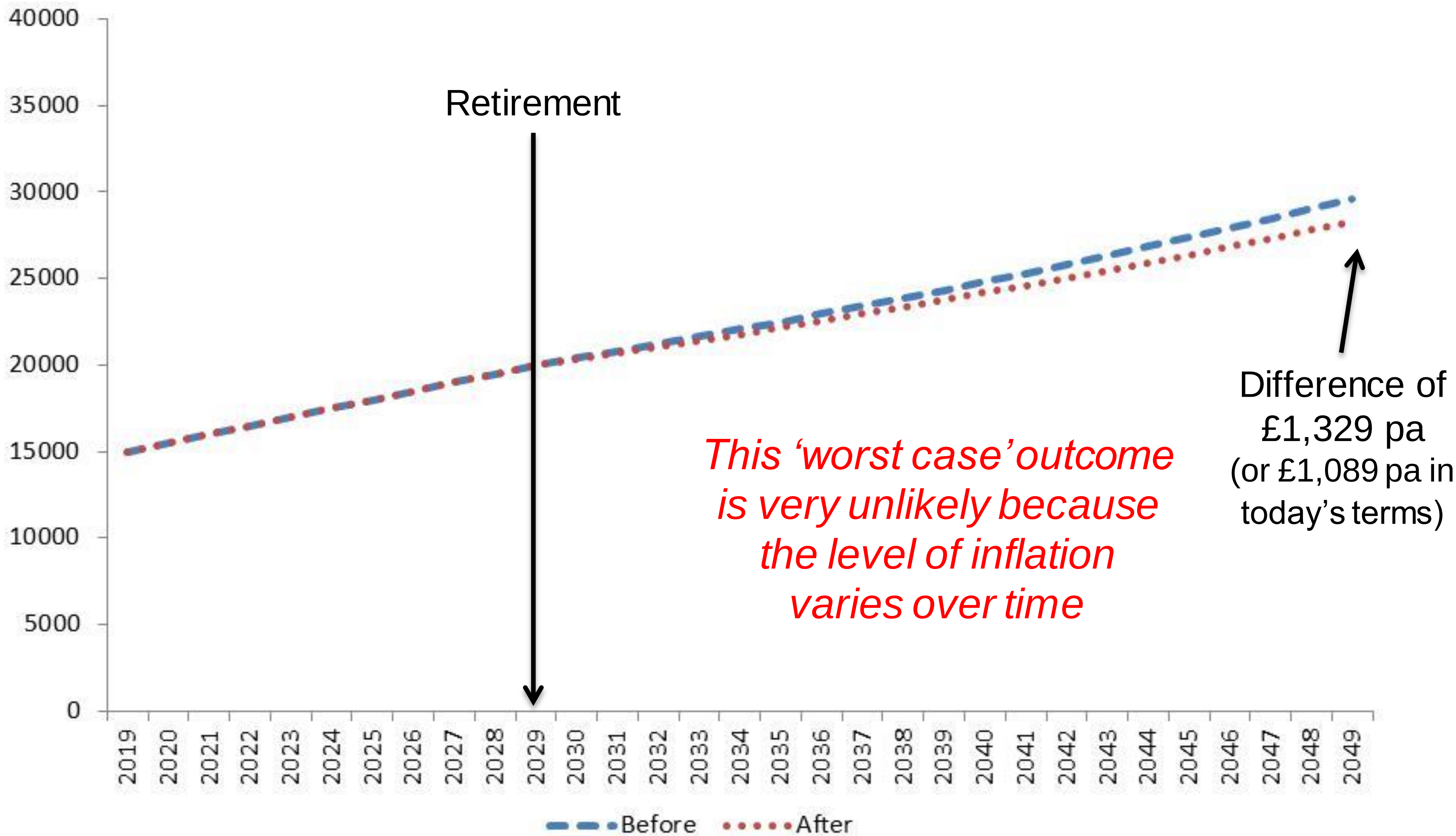
Example member impact

The example member

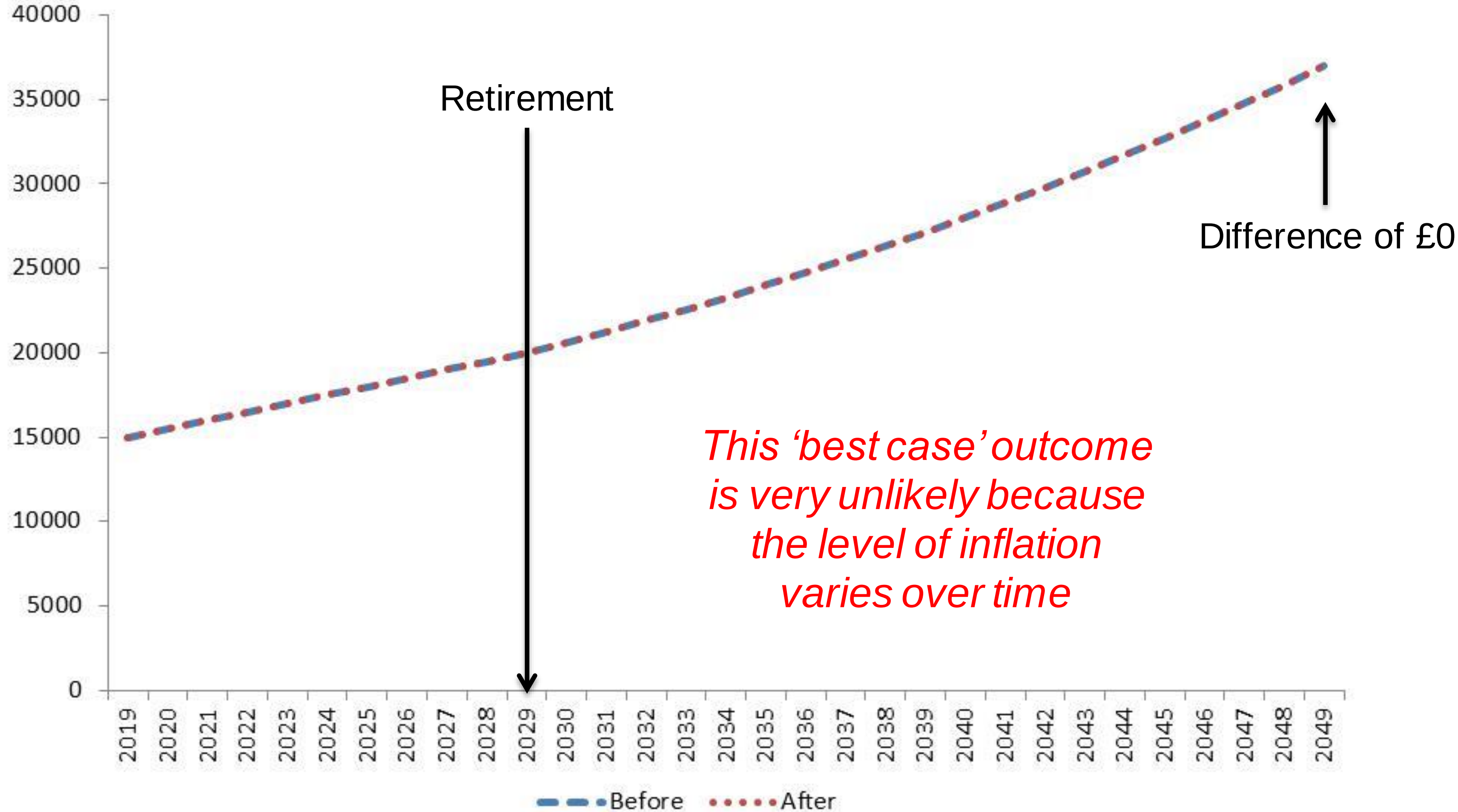
- A member is planning to retire at 65 in ten years time and is looking forward to at least 20 years of retirement
- The pension now is £15,000 and this is forecast to reach £20,000 at retirement
- It is assumed this has been earned evenly over the different periods of employment, as shown below:

Period of employment	Pension	Before PIE	After PIE
Post'88 GMP:	£400	CPI - cap 3%	CPI - cap 3%
Pre'97:	£3,600	RPI - cap 5%	0%
‘97 - '05:	£4,000	RPI - cap 5%	CPI - cap 5%
‘05 - '19:	£7,000	RPI - cap 2.5%	CPI - cap 2.5%
‘19 to '29:	£5,000	CPI - cap 2.5%	CPI - cap 2.5%

Increase path before and after the proposed change RPI 2% CPI 1% each year through retirement

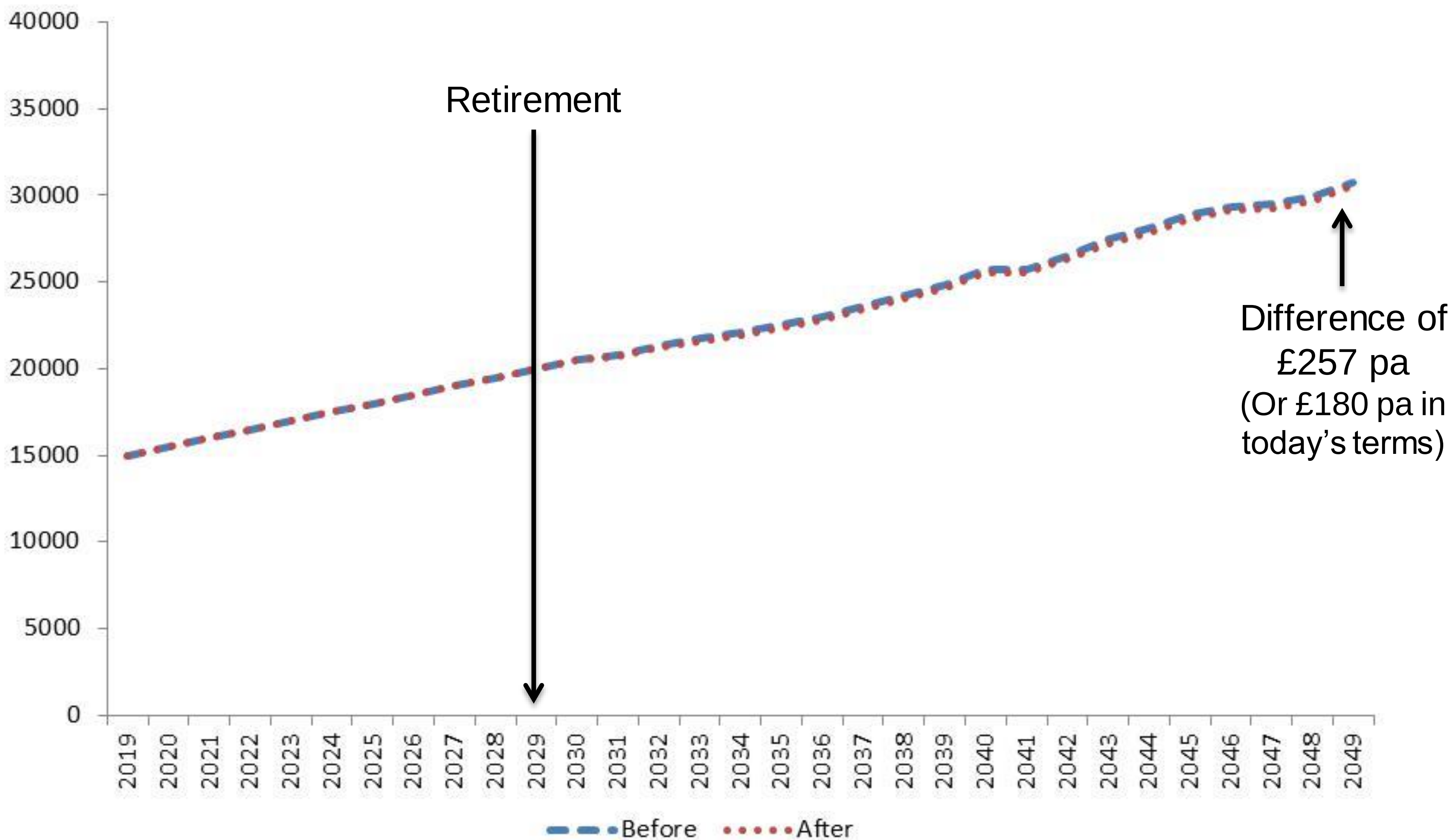


Increase path before and after the proposed change RPI 4% CPI 3% each year through retirement

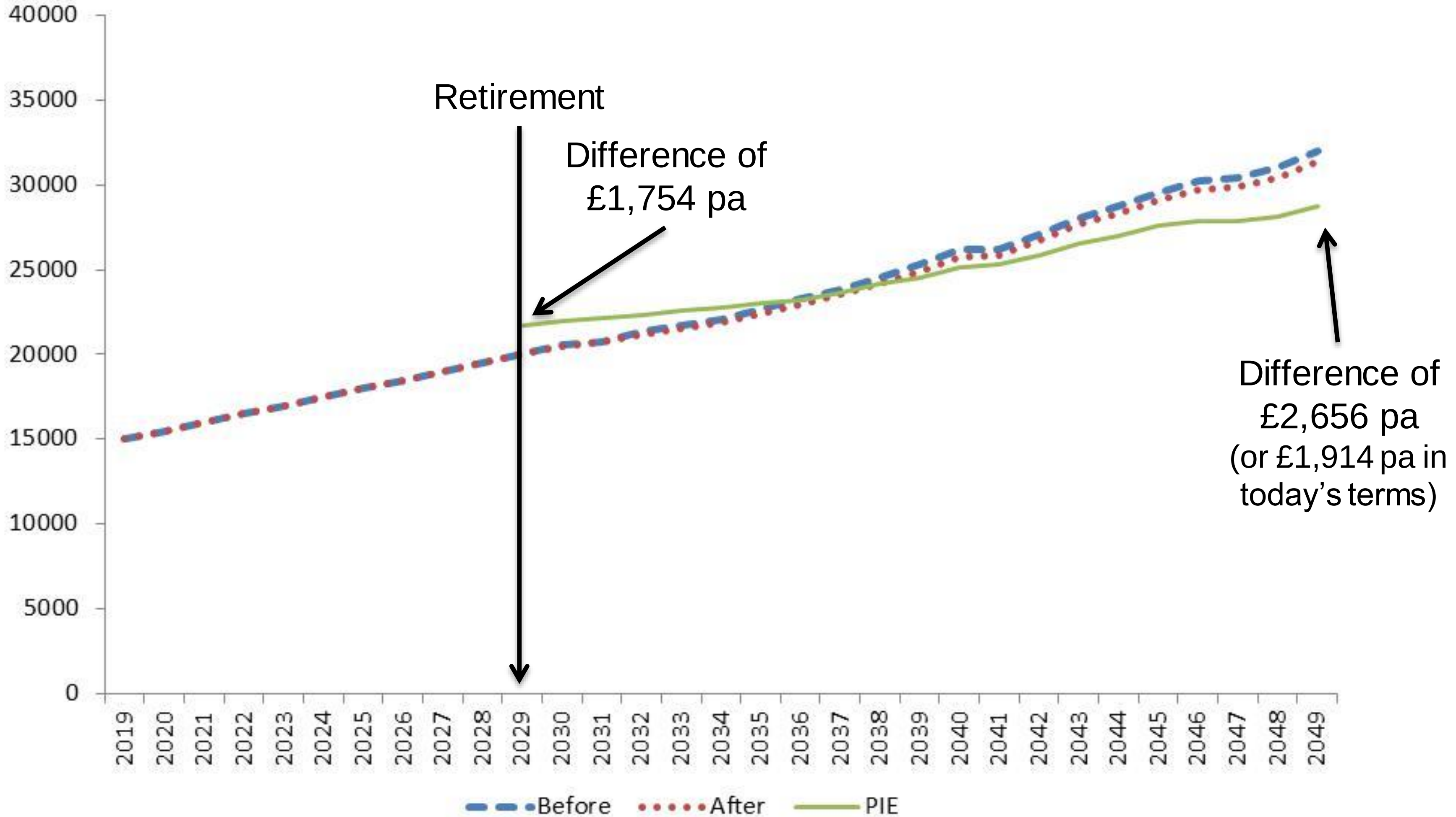


Increase path before and after the proposed change RPI and CPI varying as in the past 20 years

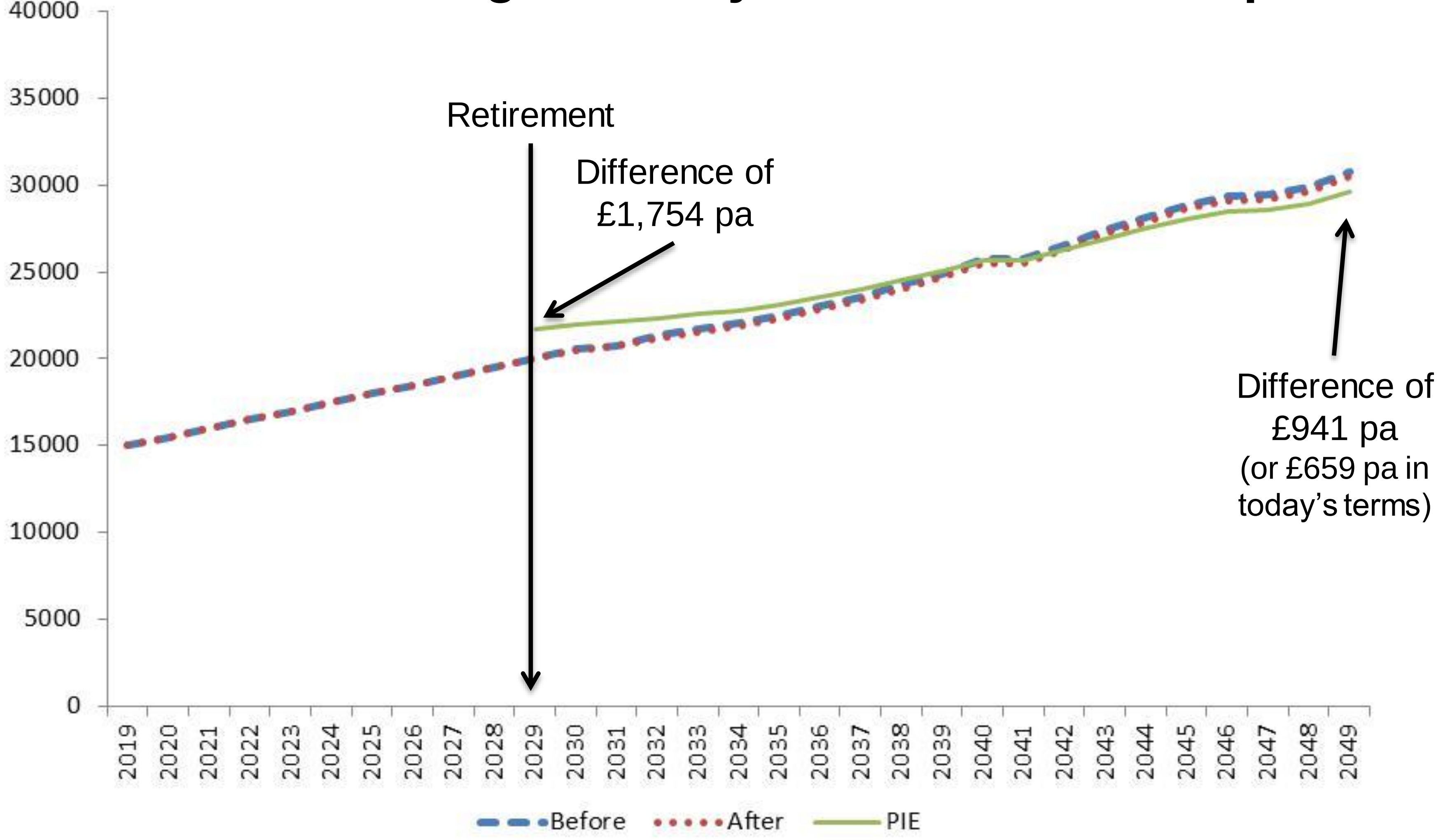
Increase path before and after the proposed change RPI and CPI are merged in 15 years time



Increase path before and after the proposed change RPI and CPI as past 20 years and PIE option



Increase path before and after the proposed change RPI and CPI are merged in 15 years time and PIE option



Summary

Summary

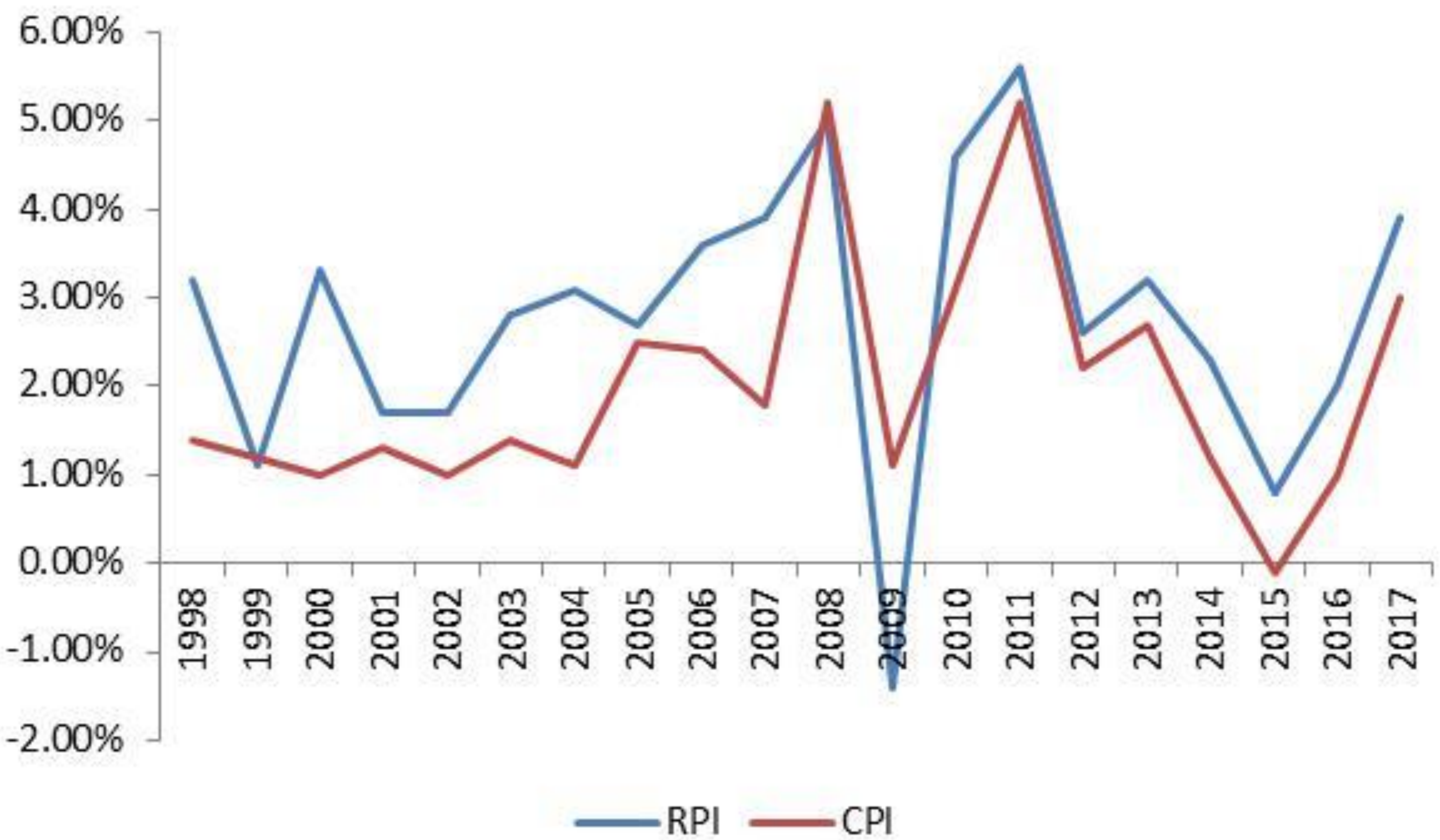
- Despite difficult financial conditions a way forward has been found that is expected to keep the Scheme sustainable over the next valuation cycle (to 5 April 2020)
- The Company will increase its contributions to the Scheme
- There is no change to employee contributions or benefits while you are working for the Company
- When you reach retirement there will be:
  - a new option to select a different rate of pension increase (PIE)
  - your pension in payment remains linked to inflation, but the rate of increase for the portion earned after April 2019 will be linked to CPI (rather than RPI)

Additional materials

Valuation basis – in more detail

	Final results as at 5 April 2014	2014 Basis updated using 5 April 2017 conditions	Prospective results as at 5 April 2017
Value of liabilities	£1,038m	£1,711m	£1,551m
Value of assets	£915m	£1,484m	£1,484m
Deficit	£123m	£227m	£67m
Funding ratio	88%	87%	96%
Company future service cost (and expenses)	9.05% (+£1.5m)	23.9% (+£1.5m)	9.3% (+£2m)

Inflation over past 20 years



Compliance

- This presentation provides information on the Company's proposal to change the measure of inflation from the Retail Prices Index to the Consumer Prices Index for pension increases for benefits accrued after 5 April 2019 – as set out in a letter dated 8 February 2018
- The consultation began on 12 February and will end on 13 April 2018
- Feedback will be reviewed and considered by the Company and discussed with the Pensions Council
- After the Company has considered the feedback a formal announcement will be made of any changes to the Scheme
- The examples provided are based on assumptions about the future which are uncertain and are for information only
- The information is intended to assist you in understanding the Company's proposals for the Scheme and is not financial advice
- If you are uncertain about your pension it is recommended that you take independent professional financial advice