intouch

November 2006

AgustaWestland

Westland Pension Scheme

Company Announcement

Early in October the Company issued an Announcement to employees about its proposals for change in the benefits and contributions of the Scheme.

Alan Ladd
Chairman of Trustees

This is part of the ongoing consultations with the Pensions Council and employees as a whole over how the Scheme's deficit is to be recovered.

The Trustees have also been kept informed about the Company's proposals and at this stage we are still evaluating whether the deficit will be recovered in an acceptable period and that benefits from past service are properly protected.

The Company's Announcement also talks about simplification - 6 April 2006 was "A Day" – the start date of the biggest change to the tax treatment of pensions for over 25 years. The Trustees have been reviewing these changes in conjunction with the Company and we have taken the opportunity of this edition of **in**touch to provide you with some more background on how the Company and Trustees are proposing to implement them. In particular you will find some good news about the Scheme's commutation and AVC options.

To avoid any doubt, we can confirm for pensioners and deferred members reading **in**touch that they are not affected by any of the Company's proposals.

also in this issue

There continues to be a huge amount of attention on the world of pensions as the Government, employers and individuals all work through how to make a comfortable retirement affordable.

Inside we provide you with our regular annual update, covering what happened to the fund in the year to 5 April 2006. This time we have provided some extra information on the funding position in response to the Government's initiative to make schemes more open about this. There is now a formal requirement for trustees to send members information about their scheme's funding every year.

While there have been huge changes in pensions law already, the Government has produced a number of further initiatives. We have provided a brief summary of the White Paper and the new age discrimination measures.

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New faces

We are pleased to introduce to you some new Trustees who have recently joined us in looking after the Scheme on your behalf.

As Trustees, we are responsible for the assets of the Scheme and making sure that there is enough money available to pay you the pension you have earned when it falls due.

Our Rules allow for nine trustees. The Company nominates five of these and there is a separate process allowing members to select the remaining four. The duties of Company and member Trustees are identical.

There was a vacancy for a Company Trustee when we issued the last intouch. Two other Company Trustees, David Lee and Nigel Hunter, also decided to end their terms of office during the year. Everybody involved with the Scheme is grateful to them for their hard work and enthusiasm.

To bring the board back up to full strength, the Company has nominated three new Trustees:

Wayne Speake joined AgustaWestland in April 1991 and is Legal Counsel. He has been married to Claire for 19 years and has three children. He keeps very fit, taking part in athletics, tennis, triathlon and helps to coach at a local swimming club and athletic club. He has prior experience of the Pension Scheme through serving on the Pensions Council as a representative of non-procedurally covered staff.

Richard Smith joined AgustaWestland in 1998 and looks after the finances for the AW (UK) Division. Richard has worked for a number of companies before joining AW, several of them within the service sector of the aviation business. Richard has always attempted to use the company's products at least once, British Airways, Heathrow Express (train service)... so a ride in a AW Helicopter beckons!

Richard is currently involved as a Company representative in the Pensions Council discussions on the deficit recovery plan. He will not therefore be acting as a Trustee for the time being because of the potential conflict of interest.

Martin Flavell is currently Vice President, HR and is based at the London office of Finmeccanica. Martin grew up in the West Midlands and spent his early career in the telecommunications industry prior to holding a number of posts in the Defence industry. Martin has taken a close interest in pensions for a number of years and is also a trustee of the SELEX Pension Scheme. Martin is married with 3 children and 3 grown-up step-children. His interests include economic and current affairs, keeping fit, watching football (he has a season ticket at Portsmouth) and motorcycling.

review of the year

in the accounts

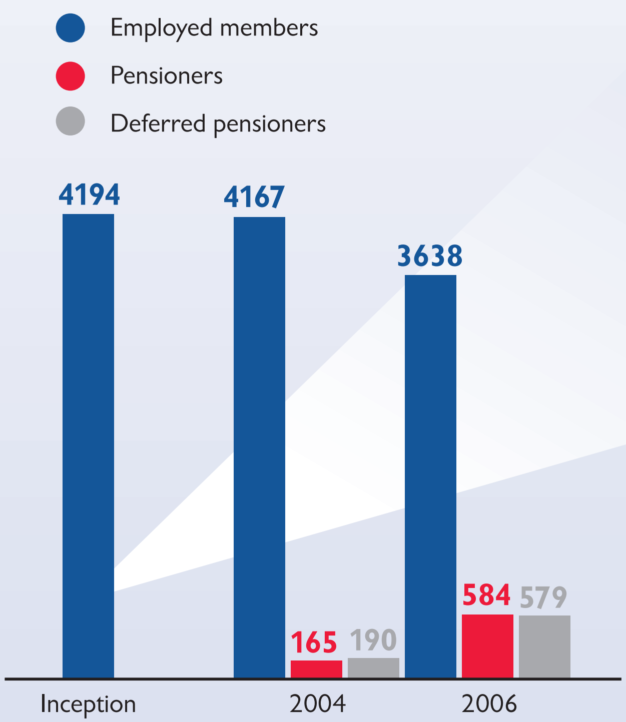
The table below is taken from the Scheme accounts for the year to 5 April 2006, which have been audited by Ernst & Young LLP. If you would like to see a copy of the full annual Report and Accounts please contact the Pensions Department. The contact details are on the back page.

	5-Apr-06	5-Apr-05
Value of Scheme at year start	**£350.4 m**	**£299.8 m**
+ Income		
Company contributions	£15.0 m	£15.0 m
Member contributions	£2.3 m	£6.3 m
smart	£5.2 m	£0.0 m
Other contributions	£6.4 m	£4.3 m
	£28.9 m	**£25.6 m**
− Outgoings		
Pensions	£5.5 m	£2.1 m
Lump sums	£10.3 m	£3.3 m
Other benefits	£0.6 m	£1.0 m
Administration expenses	£0.8 m	£0.9 m
Investment expenses	£1.4 m	£1.1 m
	£18.6 m	**£8.4 m**
+ Return on investments		
Investment income and change in market value	**£101.4 m**	**£33.4 m**
Value of Scheme at year end	**£462.1 m**	**£350.4 m**

member profile

As our Scheme was only launched back in 2002, the majority of our members are employees who are paying contributions and building up benefits. By contrast, final salary schemes in the UK are 'maturing', with most of the benefits belonging to retired members or those who have left service.

This chart shows how the membership has developed since the start of the Scheme below. You can see the impact of the 2005 redundancy exercise in the increase in pensioner and deferred members.



looking after the money

One of the most important things we have to do as Trustees is invest the money that is in the Scheme. If we can get good returns it will help to keep the level of contributions as low as possible, but we need to make sure as well that we don't take too much risk.

We take all the key decisions together but we also have an investment sub-committee to do the detailed investigation and analysis. Most importantly, we rely on our professional investment consultants to provide expert advice and guide us through the more complex investment ideas.

Our thinking begins with the Scheme's aim to provide pension benefits as they fall due. We then assess the level of risk that we can take in discussion with the Company, who ultimately have to pick up the costs of the Scheme. We then draw up a suitable spread of investments. You can find more information about the changes we made last year in 'new ideas' below.

We review our fund managers' performance regularly, checking the returns they have made against the target that has been set each quarter and meeting with them in person at least once a year. While we give them time to get things right, we will not hesitate to change a manager if we think they are not able to perform to the standards we expect.

If you would like to see a more formal summary of how we look after the money you can ask to see a copy of our Statement of Investment Principles. We also produce a document setting how well we believe our arrangements comply with the Myners voluntary code of practice on investments.

new ideas

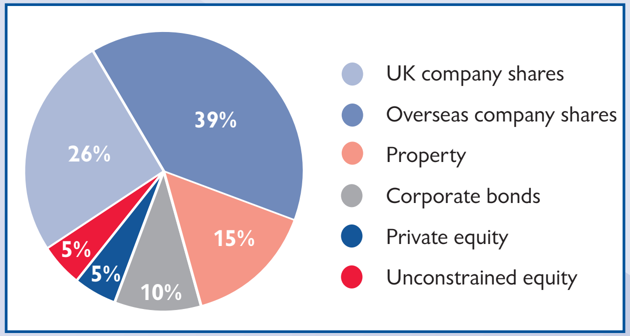
Traditionally pension schemes have tended to invest in a simple mix of company shares and government bonds. The shares are the 'risky' part, aiming to generate extra returns, while the bonds are the more 'stable' part, growing in a similar way to the cost of providing benefits.

Many schemes have experienced difficulties with this kind of allocation because the value of company shares can fluctuate a lot. To reduce the impact of this we have been looking for alternative investments that we still expect to deliver extra returns but which, in combination, should make the ride smoother.

During the year:

- We have topped up our money in property to 15%. Most schemes have no more than 5% of their money in property.
- We made further commitments to private equity. This means investing in companies not listed on the stock exchange who hopefully have potential for growth in the long term.
- We decided to move more money out of the UK because of the way the UK stock market is dominated by a few large companies.
- We decided to give one manager with 5% of the assets more freedom to invest in their best ideas 'unconstrained' by what everyone else is doing.
- We decided to make an allocation to currency. This will reduce the risks associated with investing overseas and add some value from the way the huge currency markets work.

After these changes have been made, our overall assets will be as set out below:



investment line up

We have appointed a number of managers to make the day-to-day investment decisions between different stocks and shares. Below you can see the line up at the end of the Scheme year with the proportion of the fund that they held and a summary of the service they provide. The providers shown as 'manager of managers' select a mix of specialist investment firms on our behalf.

Provider	Size	Type of service	Manager of managers?
Russell	46.0%	Company shares in the UK and overseas on an active basis	yes
Legal & General	27.6%	Company shares in the UK and overseas on a low cost passive basis	no
ING	13.3%	Commercial UK property	yes
Standard Life	1.7%	Commercial UK property	no
Fidelity	9.6%	Company bonds	no
Pantheon and HarbourVest	0.4%	Private equity commitments	yes
In addition, 1.4% of the fund was in cash and AVCs at the year end.			

The new managers we selected who will be joining the line up during this year are:

- **Alliance Bernstein,** managing 10% in global company shares
- **Baillie Gifford,** managing 5% also in global company shares but on an unconstrained basis.
- **Record,** managing our currency risks in a way that may also generate extra returns for the Scheme.

performance

The overall return for the investments over the year to 31 March 2006 was 28.9%. This is 0.5% ahead of the benchmark return for the assets in which we are investing. While we don't compare our performance with other schemes, you may be interested to note that the average (median) return for the same period was 23.1%.

The Scheme has now been in existence long enough to have a three-year track record. Our return has been 22.4% a year over the three years, which is 0.4% behind the benchmark. The median return for pension schemes is 18.8%.

scheme funding

Achieving good returns matters only because they help us to build up the common fund of money for paying members' benefits as they reach retirement.

Unfortunately, the value of the benefits due to members has also grown significantly because they are linked to interest rates, which remain low. Low interest rates are good news for our mortgages but they make the task of funding a final salary pension scheme more difficult. Increasing life expectancy has also put pressure on the cost of providing benefits.

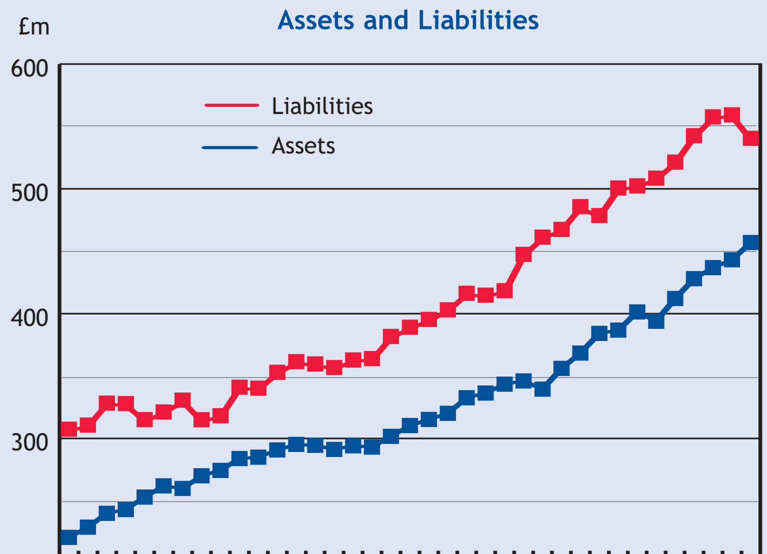
The valuation is the very important process of determining the amount of money that needs to be paid into the Scheme from year to year. Currently the Company sets the contribution rate on the Actuary's advice. We agree the payments with the Company and jointly sign up to a formal Schedule of Contributions.

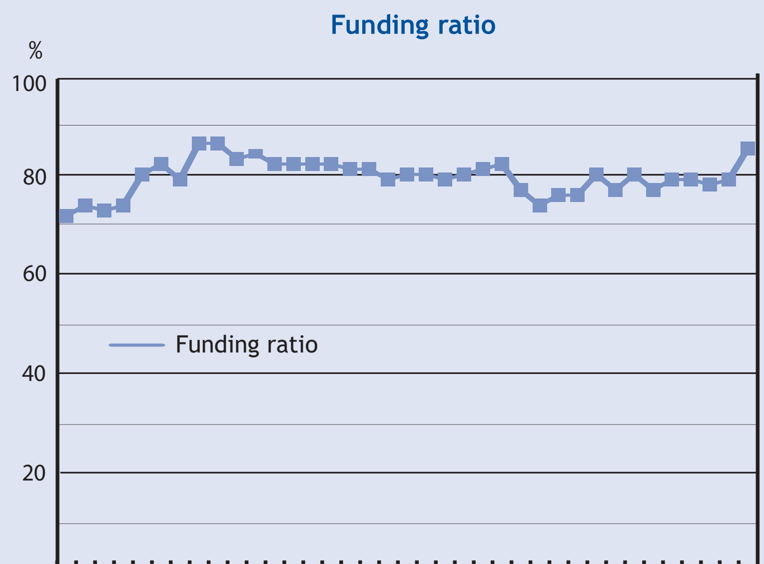
The valuation is done every three years. The first one for the Scheme took place as at 5 April 2003. At that time we had assets of £221m and liabilities of £307m. This means that the shortfall was £87m and the funding ratio was 72%*.

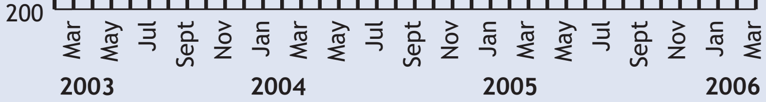
The next formal valuation as at 5 April 2006 is currently in progress. While the report has not yet been signed off, the estimated shortfall is £94m and the funding ratio is 83%. New rules apply to this latest valuation which give us additional powers in setting the contribution rate.

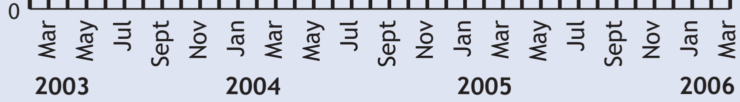
* These numbers have been re-stated to remove the 'smoothing' adjustment. Applying this adjustment encourages a longer term and less volatile assessment of the valuation position but we have since decided that clarifying the position at each point in time would be more helpful.

These charts summarise the position over the past three years:









plans for recovery

Because of the deficit, the Company has been paying extra contributions for some time. At the date of our first valuation, this amounted to 2.2% of pensionable salaries.

As it was clear that the valuation position was worsening we made a number of changes in 2005. Employee contributions increased by 1.5% and we adjusted increases on pension built up from 6 April 2005. Company contributions went up by another 1% and the Company committed to seven further years of contributions towards making up the deficit. We also introduced smart pensions, allowing both employees and the Company to receive National Insurance savings.

This first phase of changes was helpful, but further action is now needed. We mentioned on the first page of **in**touch the Company Announcement on its proposals for a recovery plan on which consultations and discussions in the Pensions Council are currently taking place. We will let you know the outcome once a final decision has been made.

what if?

The funding numbers we have shown you are from the ongoing valuation. It assumes that the Scheme will continue with the support of AgustaWestland. However, we must also look at some more extreme scenarios.

The wind-up position is what might happen if the Scheme stopped and the money was passed to an insurance company. As at 5 April 2003, the funding ratio on this measure stood at 47% (a shortfall of £249m). As at 5 April 2006, the funding ratio is 50% (a shortfall of £462m).

The costs of wind-up are so large because an insurance company would manage the money much more cautiously than we are currently able to do with the ongoing support of AgustaWestland. There is also a margin for the insurance companies' expenses and profit.

More recently, we have also been assessing the closed fund position. This assumes that the Scheme stops but we carry on as Trustees rather than pass the money to an insurance company. Over the year to 5 April 2006, the funding ratio was unchanged at 69% (a shortfall of £205m). The shortfall is greater than the ongoing valuation because we would need to be more cautious in managing the money with no more contributions coming in.

the Covenant

We can manage the Scheme on the ongoing basis because of the continuing support of AgustaWestland. This is crucial because in a defined benefit plan like ours, all of the money is held in a common fund. Ultimately, if there is not enough money to pay the benefits, the Company is required by law to put extra money in. This means that we can carry on paying benefits in full while the funding ratio is below the target.

As part of the research for the valuation, we review AgustaWestland's financial strength. To do this we look at lots of information from different sources. For example the recent long-term contracts signed with the UK Government are good evidence that the Company will be able to pay its contributions. The fact that the Company has the backing of the wider Finmeccancia Group is also helpful.

This year the financial strength of the Company was assessed externally by the rating agency, Dun & Bradstreet, for the purpose of setting the "risk based" element of our levy to the new Pension Protection Fund. It was pleasing to note that the Company's rating was strong, at 97 out of a maximum possible score of 100.

We can confirm that the Company has received no payments out of Scheme funds other than those required for the pension administration services provided by employees of Westland Helicopters Limited.

worst case scenario

Some people are concerned about their pensions because of the much publicised failures of pension schemes where the sponsoring employer has become insolvent. This concern is much less justified now because of the new Pension Protection Fund.

If the Company ever wanted to wind the Scheme up, it is required by law to pay all of the money the Scheme needs to pay out the benefits accrued to date in full. In the unlikely event that it isn't able to do this (because it has become insolvent) a claim could be made to the Pension Protection Fund to pay most of the benefits due.

The Scheme is required to pay levies to the Pension Protection Fund because of this protection.

If you would like more information about the Pension Protection Fund you can visit their website at www.pensionprotectionfund.org.uk or write to them at Knollys House, 17 Adiscombe Road, Croydon, Surrey CR0 6SR.

other information

We have already mentioned several formal documents about our funding and investment plans that are available to members. Please contact the Pensions Department if you would like to see any of them. Other documents we produce that might be of interest are:

- **Schedule of Contributions,** showing how much money is paid into the Scheme.
- **Actuarial Report,** containing the Actuary's review of the Scheme's situation at 5 April 2005.
- **Scheme Booklet,** setting out the benefits provided by the Scheme. You received a copy of this when you joined but we can let you have another copy if you need one.

insight

A-Day

In the past the Revenue has restricted how much money you can put into your pension and the benefits you can receive at retirement. On 6 April 2006 (known as A-Day), these restrictions were lifted and schemes can, if they wish, apply a new, simpler, set of allowances. Schemes have five years to decide exactly how they want to change their Rules.

You may well have heard a lot about these changes from friends or in the press so we felt it might be helpful to give you an insight into the changes that are allowed.
We have also summarised in bold how the Company and the Trustees are proposing to implement them.

Lifetime Allowance

From A-day the Revenue will no longer restrict the maximum amount of pension anyone can have. Instead, everyone will be able to build up pension benefits worth up to £1.5 million (for the 2006/2007 tax year) and still receive tax advantages. This amount is known as the Lifetime Allowance and it will increase broadly in line with inflation. Anyone who builds up benefits worth more than £1.5 million will pay an additional tax equivalent to an extra 15% - that is, it increases the higher rate of tax from 40% to 55%.

your lifetime value

To work out how much your pension is worth, you need to gather the latest pension statements from all of the pension providers you have and then:

- Add up the annual pension amounts you are due from any other defined benefit arrangements (like our Scheme) at the date of the statement and multiply this total by 20.
- Find the latest fund value of any money purchase pensions you have (like AVCs or personal pensions).
- If you are already receiving a pension, multiply the current annual amount by 25.

Add the figures from these three sources together and then add a margin for how your pension has grown between the statement dates and A-Day.

For the vast majority of people, the figure will be well below the £1.5m. Using the standard figure of 20 mentioned above, you can see that your pension amount has to reach £75,000 a year before the Lifetime Allowance affects you. As a result, the new tax regime means that the scope and flexibility for pension saving is much greater.

A-Day

Annual Allowance

After A Day, the limit of 15% of earnings on pension contributions in an occupational scheme can be removed. Instead pension contributions are virtually unlimited - you can now contribute up to your total earnings! Clearly this is far more than most people will want to pay into a pension each year.

There is one word of caution. The amount the value of your pension benefits can increase each year is subject to a new Annual Allowance, which is £215,000 for the 2006/2007 tax year. If you go over the Annual Allowance, you pay 40% tax on the excess.

Because you are in a defined benefit scheme, you can work out your position against the allowance by multiplying the amount of pension you have built up over the year by 10. You should also add any AVCs you have paid, or contributions to a personal policy. However, the Annual Allowance will affect very few people - dividing £215,000 by the standard figure of 10 shows that your pension would have to increase by £21,500 over the year for you to be affected.

voluntary contributions

The 25% cash rule also means that saving for retirement will be more tax efficient. Previously, for almost all forms of voluntary pension saving, you had to convert the amount you built up into a taxable pension at retirement. After A-Day, you are allowed to take 25% of the overall value of your benefits as tax free cash and then convert the balance into taxable pension.

Given that pension saving is easier after A-Day, the Government would now allow us to stop providing voluntary savings if we wanted to avoid the extra work and complexity it causes. **We have decided, however, to continue offering an AVC option.**

The main reason for this is that AVCs will be, by some way, the most tax efficient way of saving. This is because the 25% limit can be applied to everything from the Scheme rather than the AVC and the main benefit separately. So it is possible to take your AVCs first as tax free cash, before you draw any lump sum from your main benefit.

In paying AVCs you will therefore get:

- full tax relief when you pay
- some tax concessions on the investment, and
- full tax relief when you draw them out.

There will still be some limits on the total amount you can save. Most importantly the Company is proposing that the maximum AVC lump sum will be £50,000. This is in place to protect the fund from the impact that might be caused from a significant change in the way the higher paid draw their pension benefits.

There are two more technical limits to bring to your attention. If a member has saved an AVC fund of over £200,000 they would be allowed to take 25% of this, rather than be limited to £50,000. In addition if the total value of the AVCs and main benefit was less than £200,000, then the maximum lump sum would be 25% of that value.

Because of these changes the Trustees anticipate that AVCs will become more popular. Currently the AVC investment choices are fairly limited. Accordingly we have been doing some work on what the AVC investment options should look like so that contributors can have greater choice and flexibility, but hopefully without making things too complicated. We will let you know more about this soon.

cash lump sum at retirement

The new maximum tax-free lump sum is 25% of the value of your benefits. In almost all cases, this is more than the current regime and the Scheme Rules provide for.

It is proposed that this new higher limit will be used for our Scheme and that you will have the option to take more of your pension as tax free cash if you wish.

As part of the formal valuation of the Scheme, the Trustees are also reviewing whether the commutation factors are still appropriate. **We are pleased to confirm that we propose to improve the factors which will mean that you won't have to give up so much pension to receive your tax free cash.**

So in summary:

- more cash will be allowed, and
- you won't have to give up so much pension to receive it.

death in service

The tax treatment of death in service benefits is also changing. Currently a lump sum of four times salary can be paid tax free. In the new regime, all lump sums to your family following your death are tax free up to the £1.5m Lifetime Allowance. Pensions to a spouse or dependant are still subject to income tax.

To take advantage of this the Company is proposing that the death in service lump sum will in future be expressed as a lump sum only. Instead of a spouse's death in service pension being payable, the lump sum will be a higher multiple of salary for those with spouses, long term partners and dependent children.

Clearly it will be a concern to the family to decide how this lump sum should be used and so we will make sure that good quality financial advice is available, including on tax efficient ways of converting the lump sum back into income where that makes sense.

For those who die after retirement, a pension will be paid in exactly the same way as now.

when?

There are a lot of changes needed to our Scheme because of both A-Day and the recovery plan. Given the overall scale the Company has asked that they are all made in one go. Accordingly we don't yet have an implementation date while the consultation with the Pensions Council progress. There will, of course, be a proper announcement once the final decisions have been taken.

Please be assured that, in the meantime, the Scheme and all its provisions continue unchanged.

insight

age discrimination

New employment laws on age discrimination took effect from 1 October 2006. The new rules also affect pensions law, although the implementation date is a little later – 1 December 2006.

Many features of the Scheme are exempt because pensions, by their very nature, must take account of age to be able to work properly. However, some features of the Scheme may not qualify for exemption, which means that those particular benefits would need to change for the future. We are working with our legal advisers to understand what those features may be and we will let you know more in due course. Any changes would not, of course, affect benefits already built up through past service.

white paper

The Government published, early in the summer, a white paper on pensions reform. The proposals are the Government's response to the work done by the Turner Commission into the future of pensions in the UK. While it will be some time before the proposals become law, they will create major change in the pensions landscape.

The main proposal is to create a new National Savings Scheme for people who do not have access to savings. Clearly this will have no impact on AgustaWestland UK employees who have access to our Scheme.

More relevant is the Government proposal to increase State pension age, in line with the increase in life expectancy. In summary, State pension age is increasing:

- from 65 to 66 phased over two years starting in April 2024
- from 66 to 67 over two years starting in April 2034; and
- from 67 to 68 over two years starting in April 2044.

Alongside this the Government proposes that it will become simpler to qualify for a full State pension. It has also said that the State pension increases will be linked to earnings growth in future – currently they are linked to inflation. However this will not happen until around 2012 and will depend on whether the funds are available.

There is a second, complex State pension arrangement (currently known as S2P) that is linked to earnings. The Government intends to make this a flat rate benefit with easier qualification rules from around 2030. Many people, including AgustaWestland UK employees are 'contracted-out' of S2P to save the extra National Insurance it costs. ('Contracting out' is when company schemes provide benefits in place of S2P in return for National Insurance savings for the company and members.) The Government proposes to change the way contracting-out works significantly.

Getting in touch

If you have any comments or queries you can call the Pensions Team on 01935 705353, or write to

Westland Pension Scheme, Box 205, Westland, Lysander Road, Yeovil, Somerset BA20 2YB

If you would like to visit us on site we are in Building 212.

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