



# **LEONARDO ELECTRONICS PENSION SCHEME**

**(formerly known as Selex Pension  
Scheme)**

## **REPORT AND FINANCIAL STATEMENTS**

for the year ended 5 April 2017

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## LEONARDO ELECTRONICS PENSION SCHEME

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## LEONARDO ELECTRONICS PENSION SCHEME

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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#### Chairman's Review

I am pleased to present the Report and Financial Statements for the Leonardo Electronics Pension Scheme (the "Scheme") for the year ended 5 April 2017.

The major projects for the Trustee during the year have been the implementation of the career salary benefit structure from 6 April 2016, and the 'Leonardo in the UK' project which saw the consolidation of the UK group companies into Leonardo MW Ltd, to create one Leonardo UK company.

Following the changes to the Scheme Rules in March 2016, to implement a new Career Salary benefit basis, the Scheme Administrator calculated and notified each active member of the value of their Scheme benefits as at 5 April 2016, known as their 'Block 1' pension. The Block 1 statements were issued in September 2016, alongside the relaunch of the pension modeller within Aon Hewitt's interactive pension facility, Pensionline. Aon Hewitt have subsequently announced changes to their pensions administration service and the Trustee will consequently be appointing a new administrator, Punter Southall Administration Limited, who will be taking over during 2018.

The Trustee, with support from its professional advisers, considered the pensions implications of the Leonardo group business reorganisation which took place during 2016, completing on 1 January 2017 with the transfer of a number of UK legal entities into Leonardo MW Ltd. Leonardo MW Ltd assumed responsibility for the pension liabilities and obligations of each of the companies which had been transferred. The Trustee obtained detailed financial covenant advice on the implications of the reorganisation to ensure there were no material implications on the financial support available to the Scheme.

Following the business reorganisation, there was a rebranding exercise, which saw changes to the name of the Principal Employer, the Scheme and the Trustee. A communications exercise was undertaken to inform members of the changes, and to notify them of the new website address and Scheme contact details.

It has been a positive year for the Scheme's return seeking investment portfolio which has outperformed its return objective by 12.84% over the year. The Scheme's liability hedging portfolio has performed as intended by matching the movements in the Scheme's liabilities. The Scheme's total investment strategy (including return seeking assets and the liability hedge) has produced a positive return of 27.18% over the year, which was ahead of the overall objective.

There has been a change to the Trustee Board during the year, with Geoff Munday standing down as a Trustee, and Chairman of the Trustee Board, after 11 years in the role. We thank Geoff for his longstanding support to the Scheme. Bernard Walsh was nominated Chairman of the Trustee Board with effect from 5 September 2016. We welcome Lynda McVay, HR Director UK for Leonardo MW Ltd, who has been appointed to the Trustee Board.

The forthcoming year will include consideration of the actuarial valuation, which is due as at the date of this Report, and the Trustee looks forward to working with the Company with a view to ensuring that the costs of the Scheme are sustainable.

I would like to express my thanks to all the Trustee Directors and our advisers for their significant contribution to the Scheme and I look forward to working with them over the coming year.

Bernard Walsh  
Chairman, Leonardo Electronics Pension Scheme (Trustee) Ltd

Date: 10/10/2017

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

#### Trustee and Advisers

<b>Scheme</b>	Leonardo Electronics Pension Scheme Registered Number: 10273555		
<b>Trustee</b>	Leonardo Electronics Pension Scheme (Trustee) Ltd		
<b>Board of Directors</b>	Geoff Munday (Chairman until 4 September 2016))	employer nominated	Resigned 11/10/16
	James Cull	member nominated	Appointed 12/04/05
	Martin Flavell	employer nominated	Appointed 19/12/05
	Martin Johnson	member nominated	Appointed 29/04/05
	Lynda McVay	employer nominated	Appointed 11/10/16
	Craig Porter	employer nominated	Appointed 23/09/15
	Stuart Rushworth	member nominated	Appointed 19/12/05
	Scott Wallace	member nominated	Appointed 01/01/14
	Bernard Walsh (Chairman from 5 September 2016)	employer nominated	Appointed 13/05/08
<b>Company Secretary</b>	Geoff Phillips		Appointed 14/05/13
<b>Scheme address</b>	Sigma House, Christopher Martin Road, Basildon, Essex, SS14 3EL		
<b>Actuary</b>	Danny Vassiliades of Punter Southall Limited		
<b>Auditor</b>	RSM UK Audit LLP		
<b>Solicitors</b>	Burgess Salmon LLP		
<b>Bankers</b>	Bank of Scotland		
<b>Investment adviser</b>	P-Solve Asset Solutions		
<b>Investment managers</b>	P-Solve Investments Limited		
<b>AVC provider</b>	Old Mutual Wealth Life Assurance Limited		
<b>Administration services</b>	Aon Hewitt Limited		
<b>Administration address</b>	Leonardo Electronics Pension Scheme, Aon Hewitt, PO Box 196, Huddersfield, HD8 1EG  Telephone 0345 6035660 / Email <a href="mailto:leonardoelectronicspensions@aonhewitt.com">leonardoelectronicspensions@aonhewitt.com</a>		
<b>Principal Employer</b>	Leonardo MW Ltd (formerly Selex ES Ltd)		
<b>Participating Employers</b>	Finmeccanica UK Limited (ceased participation on 1 November 2016)		

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#### Introduction

Leonardo Electronics Pension Scheme (Trustee) Ltd (formerly named Selex Pension Scheme (Trustee) Limited), the Trustee of the Leonardo Electronics Pension Scheme (the 'Scheme') (formerly Selex Pension Scheme) presents its report for the year ended 5 April 2017, which together with the audited financial statements and the actuarial statement and certificate, comprise the Annual Report and Financial Statements.

This report gives information about the Scheme and how it is managed, its financial development and any significant developments during the year.

#### Background

The Scheme was established by a trust deed dated 24 March 2005 to provide pension and life assurance benefits to specified employees of the Principal Employer (Leonardo MW Ltd (formerly Selex ES Ltd)) and other participating employers (all of whom have subsequently been transferred into Leonardo MW Ltd as part of a UK business consolidation exercise completed on 1 January 2017).

The Scheme has four different sections, each with a different historic benefit structure. The design of the Scheme was driven initially by a need to replicate a number of schemes run by BAE Systems plc (referred to in this report as the "BAE Legacy Schemes"). From 6 April 2016, the benefits provided by each section of the Scheme remain defined benefit in nature, however there has been some harmonisation between sections and a move from a final salary structure to a career salary structure. The 100+ Section of the Scheme provides both defined benefit and money purchase benefits to members.

The Scheme was closed to new entrants on 27 April 2009.

#### Management of the Scheme

The Trustee of the Scheme is Leonardo Electronics Pension Scheme (Trustee) Ltd, formerly named Selex Pension Scheme (Trustee) Limited.

The names of the present Trustee Directors and the dates they were appointed are shown on page 2.

The Member Nominated Directors are selected by the Pensions Consultative Committee from the members on the committee. Elections took place in October 2016, with two Member Nominated Directors being re-appointed for a period of six years. The next election for the remaining two Member Nominated Directors will take place in October 2019. This staggered appointment process is designed to maintain continuity within the Trustee board. Once the Trustee Directors have been selected, they are appointed as Directors of Leonardo Electronics Pension Scheme (Trustee) Ltd.

For valid decisions to be taken, a minimum of two Trustee Directors must be present at Trustee meetings. Decisions require the support of a majority of the Trustee Directors present and the Chairman has a casting vote.

During the year, the Trustee Directors met frequently to deal with various matters relating to the management of the Scheme including monitoring funding and investing the Scheme assets.

The investment sub-committee and administration sub-committee also met regularly during the year in advance of each full Trustee meeting.

In total there were seven Trustee meetings and nine sub committee meetings during the year, with Trustee Director attendance at 92% for the year (2016: 95%).

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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In addition, there is a Joint DC Investment Committee, which is a joint committee for the Leonardo Electronics Pension Scheme, Leonardo FuturePlanner and the Leonardo Helicopters Pension Scheme. The purpose of the DC Committee is to review the AVC and 100+ Retirement Account Plan investment strategy of the Leonardo Electronics Pension Scheme (together with the investment strategy of Leonardo FuturePlanner and the defined contribution elements of the Leonardo Helicopters Pension Scheme). The committee consists of five trustees of Leonardo FuturePlanner, two Trustee Directors of the Leonardo Helicopters Pension Scheme and two Trustee Directors of the Leonardo Electronics Pension Scheme. The Scheme's representatives on this committee are Martin Flavell (chair) and Martin Johnson.

#### Scheme Advisers

A list of advisers can be found on page 2 of this report. There have been no changes to advisers during the year.

#### Sponsoring Employers

The Principal Employer of the Scheme is Leonardo MW Ltd (formerly named Selex ES Ltd prior to a change of name on 9 September 2016). Its address is Sigma House, Christopher Martin Road, Basildon, Essex, SS14 3EL. Finmeccanica UK Limited was also a participating employer in the Scheme during part of the Scheme Year. Its participation ceased on 1 November 2016, following the transfer of its employees into Leonardo MW Ltd, and its Section 75 debt liability to the Scheme was apportioned to Leonardo MW Ltd.

The Trustee Directors recognise that the ability of the Principal Employer to meet its ongoing contribution requirement is important to the funding of the Scheme and hence the security of members' benefits. As a way of increasing the security of the Scheme, the Trustee has entered into an agreement with the Leonardo Group's parent company, Leonardo SpA, in which Leonardo confirms it will provide support for the Scheme. Leonardo has agreed that it will be responsible for the liabilities of the participating employers and has undertaken to pay any outstanding Scheme contributions and pay any Scheme deficit if the Scheme were to wind up with insufficient assets.

The Trustee regularly monitors the financial status of the Principal Employer and has engaged Ernst & Young LLP to carry out regular 6 monthly independent reviews of the financial strength of the employers, or more frequently if the Trustee considers this appropriate.

A UK business reorganisation took place during 2016, completing on 1 January 2017, with the transfer of a number of UK legal entities (including AgustaWestland Limited) into Leonardo MW Ltd to create one Leonardo UK company. Leonardo became the sponsoring employer for all the Leonardo pension arrangements in the UK. The Section 75 Pensions Act 1995 debt attributable to each of the transferring employers was apportioned to Leonardo MW Ltd, and the apportionment arrangements were notified to the Pensions Regulator, in accordance with the 'notifiable events' requirements. The Trustee took additional covenant advice on the implications of the UK business reorganisation to ensure there were no material implications on the financial support available to the Scheme.

As part of the 5 April 2014 actuarial valuation, an additional detailed review of the employer covenant was commissioned, with Ernst & Young reporting on a range of areas (including cash resources, profitability and credit strength of the Principal Employer and its ultimate parent company). Overall, the employer covenant was rated as strong which assisted the Trustee in its discussions with the Company on the appropriate assumptions and contribution rates to set as part of the actuarial valuation. A similar covenant review process is currently being undertaken in relation to the 5 April 2017 valuation. The actuarial valuation is discussed in further detail on page 5 of this report.

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#### Financial Development

The format of the financial statements follows guidance given in the Statement Of Recommended Practice for pension schemes with multiple benefits as revised 2015. Defined Benefits ("DB") comprise all the sections of the Scheme except for the money purchase element of the 100+ Section which is separately analysed as the Retirement Account ("RA").

The value of the Scheme's assets at 5 April 2017 totalled £961 million (2016: £747 million). This represents an increase of £214 million (2016: £51 million) over the value at the start of the year.

Total contributions received for the year were £29.1 million (2016: £31.3 million). This consisted of £17.0 million (2016: £18.7 million) paid by the employers, £9.4 million (2016: £10 million) paid by the employers on behalf of members through SMART, £2.7 million (2016: £2.6 million) paid by members (including additional voluntary contributions). All contributions were paid within statutory timeframes.

Outgoings from the Scheme were £15.5 million (2016: £12.1 million). Of this sum £13.4 million (2016: £10.5 million) was for benefits payments, £0.4 million (2016: £0.4 million) for life insurance premiums and £1.7 million (2016: £1.2 million) for administrative expenses.

The Scheme's comprehensive investment strategy was developed further and monitored throughout the current Scheme year. From 6 April 2016 to 5 April 2017, the net movement of the investments was an increase of £201 million (2016: £31.0 million). More information about the investments is contained in the Investment Report on pages 11 to 15.

Further information on the financial development of the Scheme is contained in the audited financial statements set out on pages 23 to 50 of the Annual Report and Financial Statements. The financial statements have been prepared and audited in accordance with sections 41(1) and (6) of the Pensions Act 1995.

#### Report on Actuarial Liabilities

Under Section 222 of the Pensions Act 2004, pension schemes are subject to the Statutory Funding Objective, which is to have sufficient and appropriate assets to cover its technical provisions. The technical provisions represent the present value of the benefits members are entitled to, based on pensionable service to the valuation date. This is assessed at least every 3 years using the assumptions agreed between the Trustee and the Employer and set out in the Statement of Funding Principles, a copy of which is available to Scheme members on request by contacting Aon Hewitt at the Administration address set out on page 2.

The most recent full actuarial valuation of the Scheme was carried out as at 5 April 2014. This showed that on that date:

- The value of the technical provisions was £440.7 million
- The value of the assets was £519.9 million

The Scheme therefore had an ongoing funding surplus of £79.2 million with a funding level of 118%.

Whilst the actuarial valuation identified a past service surplus, it also showed a significant increase in the future service contribution rate. The cost of future benefit accrual had increased by 5.9% of earnings per annum between the 2011 and 2014 valuations. To address this, along with some Scheme design issues, and to reduce risk, benefit changes have taken place with the Scheme moving to a career salary structure from 6 April 2016.

See the following page for further information on the method and significant actuarial assumptions used to determine the technical provisions for the 5 April 2014 actuarial valuation. The 5 April 2017 actuarial valuation is currently being undertaken, and will be concluded by 5 July 2018.

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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In addition to the ongoing funding valuation, the actuary also carries out a discontinuance valuation, known as a solvency valuation, and a Pension Protection Fund valuation.

1. The solvency valuation basis differs from the ongoing funding basis in that it assumes that the Scheme had discontinued and all contributions ceased with effect from the valuation date. As at 5 April 2014, the surplus on a solvency valuation basis was £0.8 million and the Scheme's assets would have been sufficient to cover 100% of the total estimated winding up liabilities. It is a legal requirement that these solvency valuation numbers are produced and it does not mean that there is any intention to wind up the Scheme in the foreseeable future.

2. The Pension Protection Fund (PPF) valuation compares the assets of the Scheme to the value of the benefits that would be provided by the PPF. As at 5 April 2014, the surplus on a PPF valuation basis was £94 million and the Scheme's assets would have been sufficient to cover 123% of the PPF benefits.

The Trustee receives regular approximate funding updates from the Scheme actuary. These help the Trustee Directors understand the impact of changes in the funding position and to assess whether any action is needed. The next formal actuarial valuation of the Scheme is due as at 5 April 2017.

Further detail is provided on page 12 regarding how the change in the Scheme's liabilities interacts with the Scheme's swaps portfolio.

The method and significant actuarial assumptions used to determine the technical provisions for the 5 April 2014 actuarial valuation are as follows (all assumptions adopted are set out in the Statement of Funding Principles prepared on 18 June 2015):

#### Method

The actuarial method used in the calculation of the technical provisions was the Projected Unit Method.

#### Significant actuarial assumptions

**Pre retirement discount interest rate:** term dependent rates set by reference to the yield curve derived from interest rate swap contracts at the valuation date, with an addition of 1.8% per annum.

**Post retirement discount interest rate:** term dependent rates set by reference to the yield curve derived from interest rate swap contracts at the valuation date, with an addition of 0.3% per annum.

**Future Retail Prices Index ("RPI") inflation:** term dependent rates set by reference to the yield curve derived from RPI inflation swap contracts at the valuation date.

**Future Consumer Prices Index ("CPI") inflation:** set as future RPI inflation less a deduction equal to 1% per annum.

**Future salary increases:** general salary increases of 1.5% per annum above the term dependent rates for the future RPI inflation assumption.

**Future pension increases in payment:** pensions in payment accrued after 5 April 2006 increase in line with RPI inflation subject to a cap of 2.5% per annum. Pensions in payment accrued before this date increase in line with RPI inflation subject to a cap of 5% per annum.

**Future pension increases in deferment:** set as future CPI inflation, capped at 5% per annum for pension accrued before 6 April 2009 and 2.5% per annum for pension accrued after that date.

**Future mortality in retirement:** 97% for males and 96% for females of the mortality rates in the standard SAPS (S2PA) base tables, with an allowance for future improvements in line with the CMI 2013 projection model using a long term annual improvement rate of 1%.



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#### Significant changes to the Scheme

The following changes have been made to the Scheme during the year.

##### *Career Salary benefit changes*

New Scheme Rules were signed on 31 March 2016 to bring into effect the change to the Scheme benefit structure from a final salary basis to a career salary basis, effective from 6 April 2016.

The continuing earnings link on benefits within the BAE Legacy Schemes came to an end on 5 April 2016. A Block 1 pension calculation is undertaken at 5 April 2016 to calculate members' benefits under the previous final salary structure. A 'transitional uplift' value is calculated as part of the Block 1 calculation which provides the majority of members with an increased Block 1 value by virtue of an assumed future salary uplift to their accrued final salary benefit. The Block 1 value then forms the first 'block' of career salary pension, with additional 'blocks' being earned for Pensionable Service on and after 6 April 2016.

As part of the changes, a number of benefit harmonisations were made between the different sections of the Scheme. A new Buy Up option was also launched enabling members to pay a higher contribution in return for a higher career salary accrual rate.

To ensure that members' accrued pensions at 5 April 2016 are protected, as required by law, a Deferred Pension Underpin was incorporated into the benefit structure which provides for a minimum level of benefit.

##### *Scheme Rebranding*

A rebranding exercise took place during the year, including changes of name for the Principal Employer, the Scheme and the Trustee to reflect the new 'Leonardo' corporate identity:

- The Principal Employer name changed from Selex ES Ltd to Leonardo MW Ltd on 9 September 2016.
- The Trustee name changed from Selex Pension Scheme (Trustee) Limited to Leonardo Electronics Pension Scheme (Trustee) Ltd on 28 December 2016.
- The Scheme name changed from Selex Pension Scheme to Leonardo Electronics Pension Scheme on 1 January 2017.

##### *Deed of Amendment and Apportionment*

A Deed of Amendment and Apportionment was signed on 28 October 2016, which effected the change of Scheme name and documented the 'flexible apportionment arrangement' which apportioned the Section 75 Pensions Act 1995 debt liability attributable to Finmeccanica UK Limited to Leonardo MW Ltd. The flexible apportionment arrangement was notified to the Pensions Regulator in accordance with the 'notifiable events' requirements. Further information on the Leonardo business reorganisation is provided above in the 'Sponsoring Employers' section on page 4.

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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#### Communication

"InFocus", a newsletter for Scheme members is issued by the Trustee twice a year. The Trustee also uses an e mail alert function to communicate pensions information to members. In addition members can access information from the Scheme website, [www.leonardoelectronicspensions.co.uk](http://www.leonardoelectronicspensions.co.uk).

#### Trustee knowledge

There is a requirement on the Trustee Directors to have knowledge and understanding of the law relating to pensions and the principles relating to the funding of the Scheme and the investment of the Scheme's assets. The Trustee Directors are also required to be conversant with the Scheme's documents.

In order to fulfil these requirements:

- the Trustee Directors have adopted a trustee training policy;
- the Trustee Directors maintain a training log of all training attended;
- the Trustee Directors annually review their knowledge against the requirement checklist;
- Trustee meetings regularly contain updates on changes in the law or regulatory guidance;
- an annual training day is held; and
- the Trustee Directors also attend conferences on issues of particular relevance to the Scheme.

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#### Voluntary contributions

The Additional Voluntary Contribution (AVC) option provides members with an opportunity to make further provision for their retirement in addition to the benefits provided by the Scheme. The investment choices available to members with AVC funds are the same as those available to members with 100+ Retirement Accounts, as set out in the Investment Report.

In addition to AVCs, members are able to contribute under the new Buy Up option which provides for a higher career salary accrual rate, in return for an additional member contribution.

As an alternative to AVCs and Buy Up, a closed group of members of the 2000 Section are paying extra contributions towards retirement benefits through the Selected Benefits Scheme (SBS). This option closed to new contributors in 2009 and is only available to members who are currently making SBS contributions towards retirement benefits at a fixed contribution percentage rate.

#### Risk management

There is a requirement on the Trustee Directors to put in place adequate arrangements and procedures to administer the Scheme and to monitor those procedures to ensure the safe custody and security of the assets of the Scheme.

The Trustee Directors have put in place steps to monitor areas of potential risk to the Scheme. They regularly monitor, amongst other aspects of the Scheme, investments, the funding of the Scheme and the administration of the Scheme.

The administration sub-committee have taken steps to identify any areas of potential risk and have reviewed whether any action needs to be taken. The risk register is reviewed on a quarterly basis by the Trustee and updated as necessary.

Name:

Trustee Director, Leonardo Electronics Pension Scheme (Trustee) Ltd

Date:

10/10/2017

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## LEONARDO ELECTRONICS PENSION SCHEME

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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#### SCHEME MEMBERSHIP

Total membership at 5 April 2016		4,730
Active members at 5 April 2016	2,623	
Less:		
Retirements	(87)	
Members becoming deferred members	(106)	
Transfers	(5)	
Trivial Commutation	(1)	
Death in service	(1)	
	<u>(200)</u>	
Active members at 5 April 2017 (includes 779 DC members)	<u>2,423</u>	
Pensioners at 5 April 2016	1,023	
Plus:		
New Retirees	107	
New pensions to widows/dependants	<u>4</u>	
	<u>111</u>	
Less:		
Deaths	<u>(9)</u>	
	<u>(9)</u>	
Pensioners at 5 April 2017	<u>1,125</u>	
Deferred members at 5 April 2016	1,084	
Plus:		
Early leavers with deferred pension	<u>106</u>	
	<u>106</u>	
Less:		
Retirements	(20)	
Deaths	(1)	
Trivial Commutation	(1)	
Transfers	<u>(9)</u>	
	<u>(31)</u>	
Deferred members at 5 April 2017 (includes 466 DC members)	<u>1,159</u>	
Total membership at 5 April 2017 (includes 1,245 DC members)		<u><u>4,707</u></u>

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## LEONARDO ELECTRONICS PENSION SCHEME

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#### Investment Report

#### Defined Benefit

#### Background

At the Scheme year end, 5 April 2017, the net investments of the Defined Benefit section of the Scheme were valued at £943 million, compared to £729 million at the start of the Scheme year.

The majority of the assets of the Scheme continue to be invested in the Total Investment Governance Solution (TIGS) provided by P-Solve Investments Limited.

In addition, to reduce the impact to the Scheme of movements in long-term interest rate and inflation expectations, the Trustee continues to hold swap contracts and gilts as a hedging portfolio. The hedging portfolio is updated periodically to reflect the ongoing benefit accrual.

#### Investment Principles

The Trustee has produced a Statement of Investment Principles, in accordance with the Pensions Act 1995, showing how it decided to invest the assets of the Scheme. The Statement of Investment Principles is regularly reviewed by the Trustee and was updated in November 2016. Copies of this document are available to members upon request.

The Scheme's primary objective, as set out by the statutory funding objective, is to maintain sufficient and appropriate assets to cover its Technical Provisions. In order to meet this objective, and taking into consideration the funding level from the actuarial valuation as at 5 April 2014, the investment strategy will need to achieve returns at least in line with the following:

- Assets backing the non-pensioner liabilities need to achieve at least the return on interest rate swaps +1.8% per annum; and
- Assets backing pensioner liabilities need to achieve at least the return on interest rate swaps +0.3% per annum.

The strategy has been implemented by:

- Implementing interest rate swaps and inflation swaps to decrease the variability of the Scheme's funding position due to movements in both long term interest rates and inflation; and
- Investing the assets to seek to achieve the investment objective.

Following the finalisation of the 5 April 2014 actuarial valuation, and to reflect the career salary benefit changes from April 2016, the Trustee reviewed the investment strategy with its advisers which resulted in changes being made to the Scheme's liability hedging strategy. The level of the liability hedge has been increased to help protect the proportion of the funding surplus which is being used to support the future service contribution rate. Further detail on how the hedging portfolio operates is set out below.

#### Investment Manager

The Trustee has delegated responsibility for the day to day management of the assets to the Scheme's Investment Manager, P-Solve Investments Limited ("P-Solve"). An Investment Management Agreement between the Trustee and P-Solve Investments Limited governs this relationship.

The Investment Manager has been appointed in two capacities:

- To implement the swaps strategy; and
- To actively manage assets through its Total Investment Governance Solution (TIGS) investment product that covers a wide range of asset classes and investment managers.

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#### Market Commentary

The year ended 5 April 2017 saw strong performance for the Scheme's total portfolio return (which includes the performance of the swaps). Performance of the Scheme's return seeking portfolio was also strong over the year.

The financial markets were subject to high levels of uncertainty over the 12 months to 31 March 2017, buffeted by geopolitical and macroeconomic events, but there were steady signs of a generally improving global economy, and the value of most return-seeking assets increased substantially over the year.

The market recovery staged from the beginning of March 2016 slowed on the approach to the UK referendum on continued membership of the European Union. The referendum result, announced on Friday 24 June 2016, surprised the financial markets. Sterling weakened against all major currencies, gilt yields dropped, and all major equity markets fell heavily. Meanwhile economic reports showed more improvement, albeit modest. Notably the oil price staged a significant recovery, largely because producers were disciplined in cutting production but also because of increased demand.

The strongest and most consistent signs of economic growth were in the US, but here the equity markets were held back over the autumn by uncertainty around the US presidential election. When the result was the victory of Donald Trump, with his plans to cut taxes, raise infrastructure spending and loosen financial regulation, US and other equity markets rallied strongly. The rally continued through to March, but paused with Trump's failure to push through the repeal of Obamacare, which was judged at the time to make it less likely that other changes would be pushed through.

#### Investment performance

##### Hedging Portfolio (gilts and swaps)

The liability hedge is designed to protect the Scheme from adverse movements in long term interest rates and inflation which directly impact the value of the Scheme's liabilities. The value of the gilts that are part of the hedging portfolio tends to move in line with the Scheme's liabilities when interest rates and inflation rates change. Similarly the swaps in the hedging portfolio are such that, if interest rates fall significantly (and so the liabilities rise in value), the swap counterparty pays the Scheme to cover the rise in the value of the liabilities. Conversely, if the value of the liabilities falls due to interest rate and inflation changes, the Scheme pays the counterparty under the swap contracts an amount that is in line with this fall in the liabilities.

Importantly, the purpose of the liability hedge is to offset (or hedge) the changes in the value of the liabilities whether there is a rise or fall.

The mark to market valuation of the swaps represented an unrealised gain/loss, as at 5 April, for the following years:

	2017	2016	2015	2014	2013	2012
	£000	£000	£000	£000	£000	£000
Interest rate swaps	23,827	44,787	45,378	(4,248)	8,484	13,770
Swaptions	3,518	n/a	n/a	n/a	n/a	n/a
Inflation swaps	9,907	(9,412)	(5,038)	6,622	9,808	12,769
Proceed Asset Swap	(34,713)	(21,270)	(17,170)	(3,639)	(6,502)	(1,730)
<b>Total Gain/(Loss)</b>	<b>2,539</b>	<b>14,848</b>	<b>23,170</b>	<b>(1,265)</b>	<b>11,790</b>	<b>24,809</b>

A positive mark-to-market value of the swaps represents a rise in the value of the swaps from the Scheme's perspective and vice versa. However, this rise will have been necessary to offset the rise in the value of the Scheme's liabilities and so the impact of the rate changes on the Scheme's finances will (as intended) have been broadly neutral.

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**Hedge/Equity Derivative Overlay Strategy (EDOS) amendments over the 12 month period to 5 April 2017**

**19 April 2016** - One new RPI swap and one new IRS swap

**9 June 2016** – Swap unwinds (IRS and TRS)

**13 July 2016** – Re-coupled swaps (two unwinds and a new par swap)

**14 July 2016** – Package of unwinds and new swaps traded

**19 July 2016** – Re-coupon IRS swaps traded with Barclays

**7 October 2016** – One new RPI swap and one new par (IRS) swap

**14 February 2017** – EDOS4 with Barclays was terminated

**28 February 2017** – New par swaps and an inflation swap was traded with HSBC

#### **Collateral**

The gills can be used to meet collateral calls from the Scheme's counterparties: Barclays Bank plc, Credit Suisse International, Citigroup Inc., Royal Bank of Scotland plc and Morgan Stanley & CO. International plc. The Scheme would be obliged to post collateral to the counterparties as and when the swap mark-to-market is negative to the Scheme (i.e. in the counterparties' favour). Once the collateral is transferred to the respective counterparty it is held by the counterparty but in the name of the Trustee.

#### **TIGS**

TIGS is a fully delegated service designed to deliver performance in excess of a client specific target through exposure to diversified investment arrangements. P Solve invests and manages the Scheme's assets on behalf of the Trustee.

The service reduces the risks and costs of decision delay and provides access to a broad range of asset allocation and increased investment specialisation, such as commodities, high yield bonds, leveraged loans and other alternative asset classes as well as currency hedging. As well as the delegated responsibility for dynamic asset allocation, P Solve are also responsible for selecting, combining and replacing fund managers.

## LEONARDO ELECTRONICS PENSION SCHEME

### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

The table below shows the value and proportion of TIGS assets (including the Equity Derivative Overlay Strategy (EDOS) but excluding the liability hedge) in each asset class as at the current and prior year end:

Asset Class	Allocation at 5 April 2017		Allocation at 5 April 2016	
	£000	%	£000	%
UK Equity	36,537	5.9	31,045	5.9
Overseas Equity	242,828	39.4	219,545	41.8
Alternative	113,221	18.4	107,835	20.6
BroadBonds	170,809	27.7	145,753	27.8
Property	26,240	4.3	6,842	1.3
Cash	29,130	4.7	19,967	3.8
Currency Hedge	(2,731)	(0.4)	(6,311)	(1.2)
<b>Total assets</b>	<b>616,034</b>	<b>100.0</b>	<b>524,676</b>	<b>100.0</b>

The core strength of the TIGS proposition lies in the delegation to the manager of the flexibility to dynamically allocate across all asset classes in accordance with medium to long term views on global markets, and to 'defend' by increasing the allocation to cash when the risk/return attributes of multiple asset classes are poor. This is demonstrated in the table above showing the variation in the Scheme's asset allocation at the current and prior year end.

The investment objective for TIGS is a return of LIBOR + 3% per annum, after the deduction of fees, over rolling three year periods. Performance of the TIGS assets (including the EDOS) against objective is as follows:

TIGS including EDOS	1 Year	3 Years p.a.	5 Years p.a.
Investment return	16.31%	6.32%	6.49%
Objective	3.47%	3.53%	3.57%
Investment return relative to target	12.84%	2.79%	2.92%

Performance is shown to 5 April 2017 after the deduction of fees to the extent that fees are paid from assets.

The Trustee monitors the performance of TIGS on a quarterly basis and is provided with a valuation of all of the Scheme's assets on a monthly basis.

#### Total Portfolio Investment Performance

The Scheme's total investment strategy, as at 5 April 2017, has returned:

Total Portfolio	1 Year	3 years p.a	5 years p.a
Investment return	27.18%	18.66%	13.75%



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## LEONARDO ELECTRONICS PENSION SCHEME

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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#### **Custody of Investments**

The swap contracts entered into with Barclays, Credit Suisse, Citigroup, Morgan Stanley and RBS are held directly in the Trustee's name. These direct principal to principal contracts do not themselves require safe custody. However, the collateral provided to the counterparties to secure their value when their mark-to-market is positive is held by KAS Bank N.V., as custodian for the Scheme, in the name of its nominee company, KAS Nominees Limited.

The pooled fund units and shares comprising the assets managed through TIGS are held by KAS Bank N.V. in the name of its nominee company, KAS Nominees Limited.

#### **Social Responsibility**

The Trustee is seeking to maximise overall investment returns subject to an acceptable level of risk. Social, environmental or ethical considerations are not directly taken into account by the Trustee in the selection, retention and realisation of investments. The Investment Manager may take into account such factors if there will be a positive effect on the expected financial return on investment.

#### **Corporate Governance**

The Scheme's investments are made via pooled investment funds, in which the Scheme's investments are pooled with those of other investors. As such, direct control of the process of engaging with the companies that issue these securities, whether for corporate governance purposes or social, ethical or environmental factors, is delegated to the manager of the pooled investment fund. The extent to which these factors are taken into account in the selection, retention and realisation of investments is considered by the Investment Manager as part of the process of selecting organisations with which to invest.

Following on from this, although the implementation of the principles of the UK Stewardship Code has been delegated to the Investment Manager, the Trustee monitors this by requesting reporting from the Investment Manager on the positions of each of their underlying managers.

The Trustee supports the Myners Principles and the UK Stewardship Code and has implemented comply or explain documents in respect of both of these Corporate Governance tools.

#### **Defined Contribution**

##### **Retirement Account**

Members of the 100+ Section have contributions equal to 2% of their Pensionable Salary put into their Retirement Account by their employer.

The members' Retirement Accounts are held with Old Mutual Wealth Life Assurance Limited and members have the choice of investing their account in one or more of eight funds: Leonardo Electronics Long Term Growth, Leonardo Electronics Stable Growth, Leonardo Electronics Cautious Growth, Leonardo Electronics Global Equity Fund, Leonardo Electronics Corporate Bond Fund, Leonardo Electronics Fixed Interest Gift Fund, Leonardo Electronics Index Linked Gift Fund and Leonardo Electronics Cash Fund. In addition, there is a default Lifestyle Strategy, used by the majority of members, which incorporates four P-Solve 'blend funds' with different 'inflation plus' targets. If a member chooses the default Lifestyle Strategy, they must place the whole of their Retirement Account in this fund.

The performance of the funds can be obtained from reports published on the Old Mutual Wealth microsite, <https://ip.oldmutualwealth.co.uk/selex/fundinformation.asp>.

Further details on the governance of our defined contribution funds are given below, in the Chairman's Statement on DC Governance.

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## LEONARDO ELECTRONICS PENSION SCHEME

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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#### Chairman's Statement on DC governance

This is the Chairman's Statement on defined contribution ("DC") governance for the year ended 5 April 2017.

#### Investment strategy – DC investments

The DC investments within the Scheme include both the Additional Voluntary Contribution arrangement and the 100+ Section Retirement Account Plan. The Trustee has in place a DC Statement of Investment Principles ("SIP") which governs decisions about investments and sets out the aims and objectives of the Scheme's DC investment strategy, including full information about the Scheme's default investment strategy. In particular the SIP covers:

- the Trustee's investment policy, including policies on risk, balancing and realising assets, return and ethical investing; and
- how the default investment strategy is intended to ensure that assets are invested in the best interests of members and beneficiaries.

Generally, the Trustee reviews the default strategy on an ongoing basis, particularly in response to any significant changes in investment market conditions, member demographics or the regulatory framework. The most recent change to the default strategy was made from 1 April 2015. The performance of the funds underlying the default investment strategy is formally reviewed quarterly.

Copies of the SIP can be requested from the Scheme Administrator, Aon Hewitt, using the contact details on page 2.

#### Value for members review

The Trustee is committed to ensuring that members get value for money (i.e. the costs and charges deducted from members' DC pots provide good value in relation to the benefits and services provided) and keep value for members generally in mind on an on-going basis, including as an item on the Scheme's risk register. The Trustee undertakes an annual value for members assessment with support from its advisers.

For the purpose of this assessment, the Trustee looked at whether the total cost of DC fund membership represented value for money, whether the investment risk profile is tailored to the needs of members, the level of contributions in the light of the membership profile, the degree of flexibility available and the transaction costs incurred by members.

The sources of fees can be categorised between investment management charges, additional expenses and investment platform charges. The Trustee considered, among other items, the absolute level of charges, the competitiveness of charges relative to the marketplace and the level of service provided to members. The Trustees also note that the costs of administering the Scheme's DC benefits are met by the Employer.

In accordance with the Pensions Regulator's guidance for DC schemes in this area, it was concluded that, with an average fee of 0.57% for the default funds, the Scheme's DC funds represent value for its members, due to:

- A bespoke investment strategy that takes account of membership needs and controls risk based on the time to retirement and the need for protection to increase.
- Good investment performance, with the funds on average performing broadly in line with the fund objectives as advised to members.
- Risk management within the 'blend funds' based on delegation of day to day decisions and asset allocation to a fiduciary manager and investment managers.
- Robust internal controls and operations covering business continuity plans, internal and external audit of the funds and a wide range of investment operations.

The average fee compares favourably to the charge cap set by the Government of 0.75%.

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## LEONARDO ELECTRONICS PENSION SCHEME

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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The Trustee also considers that value for members is demonstrated through:

- Flexibility to change AVC contributions up or down in any month and to make unlimited online switches with no administration charge.
- Achievement of the Pension Quality Mark Plus external standard by Leonardo FuturePlanner, the Scheme's sister arrangement, which shares its DC investment strategy.

#### Charges

The total expense ratios (TER, defined as the annual management charge plus any additional fees for fund management expenses) for the funds available for selection by members of the Scheme are:

Fund	TER
Long Term Growth	0.54%
Stable Growth	0.60%
Cautious Growth	0.51%
Retirement Protection	0.39%
Global Equity Fund	0.27%
Corporate Bond Fund	0.22%
Fixed Annuity Protection Fund	0.25%
Index-Linked Annuity Protection Fund	0.25%
Cash Fund	0.25%

The default investment strategy is constructed using the top four funds in the list above. The average TER a member would pay across each year in the default investment strategy is 0.55% (assuming a 40 year working lifetime). The average charge for members selecting their own funds (using the 'pick and mix' range) is 0.26%.

#### Transaction costs

The Trustee considers the impact of transaction costs on investment and support industry efforts to improve disclosure of these costs in a cost-effective, scalable manner, using automated processes.

Transaction costs are complex and are incurred when investments are bought and sold. They are an essential part of generating investment returns and managing risk. They are associated with actions of members as well as the Trustees, the fiduciary manager and investment managers.

Transaction costs arise from the 'lifestyle' switching between blend funds within the default investment strategy. The worst case scenario would be that this costs 0.48% over the full cycle, or on average 0.01% per annum. This is considered reasonable in the context of the risk management received through the default strategy. The actual cost is likely to be less than this because the figure does not take account of netting trades (units being switched between investors in and out of the fund at the time of the trade).

Transaction costs are incurred within the blend funds as allocations are varied by the fiduciary manager between underlying managers and securities. Frictional costs occur within the underlying funds themselves due to the buying and selling of assets by the investment managers. In both cases it is not yet possible to disclose the costs but the managers are working to accommodate this in future.

There were no changes made by the Trustee to the fund range in the year and therefore no transaction costs arising from this.

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## LEONARDO ELECTRONICS PENSION SCHEME

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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#### Financial transactions

Core financial transactions are processed by the various service providers to the Trustee. These providers are appointed under agreements with specific service standards. The providers issue quarterly reports against these standards which are reviewed at the joint DC committee Trustee meetings to confirm that transactions have been processed promptly and accurately.

#### Knowledge and understanding

The Pensions Act 2004 requires the Trustee Directors to be conversant with key documents and to have knowledge and understanding of areas of importance in pensions. The Trustee Directors have spent time reviewing the contents of the various constitutional documents in order to satisfy the legislative requirements and a section covering Trustee knowledge is contained on page 8 above.

Joint DC committee Trustee meetings include updates on changes in the law or regulatory guidance which is of relevance to the Scheme from the internal Pensions Management team, the administrator, the investment consultant, the investment platform provider, the auditor and other service providers as appropriate. Trustee Directors participate in external training events depending on the assessment of their training needs and a formal trustee training day is held each year jointly with the sister UK pension schemes in the Leonardo group.

Bernard Walsh  
Chairman, Leonardo Electronics Pension Scheme (Trustee) Ltd  
Date: 10/10/2017

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## LEONARDO ELECTRONICS PENSION SCHEME

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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#### Compliance Statement

#### Constitution of the Scheme

The Leonardo Electronics Pension Scheme is a pension and life assurance benefits scheme constituted and administered in accordance with the Rules. It was established by a trust deed dated 24 March 2005 and has a number of different benefit structures, including defined benefits, money purchase benefits and hybrid benefits.

Copies of the rules which govern the Scheme are available for inspection on request to the Pension Administrator, Aon Hewitt, at the address on page 2.

#### Taxation

The Scheme is a Registered Pension Scheme for the purposes of the Finance Act 2004.

#### Contracting Out

Members of the Scheme who participate in the Main Section were in contracted-out employment for the purposes of the State Second Pension (previously the State Earnings Related Pension Scheme) under a certificate issued by the National Insurance Contributions Office, until 6 April 2016 when the ability to contract-out ceased. No members are in contracted-out employment with effect from 6 April 2016.

#### Pensions in payment

Increases to pensions in payment during the year are applied as at 1 May. Broadly, pensions in payment are increased in line with the rise in the Retail Prices Index capped at 5% for pension earned prior to 6 April 2006 and in line with the rise in the Retail Prices Index capped at 2.5% for pension earned on and after 6 April 2006.

No discretionary increases were payable.

#### Transfer Values

All cash equivalents (transfer values) paid during the year were calculated and verified in the manner required by the Regulations issued under section 97 of the Pension Schemes Act 1993. None of the cash equivalents was less than the amount provided by section 94(1) of the Pension Schemes Act 1993. The Trustee makes no allowance in the calculation of transfer values for discretionary benefits.

#### Employer-related investments

Employer-related investments held by the Scheme at any time during the year are negligible. The Trustee is satisfied that the level of employer-related investments will continue to be negligible due to P-Solve's investment process which is highly diversified.

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## LEONARDO ELECTRONICS PENSION SCHEME

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### TRUSTEE'S REPORT YEAR ENDED 5 APRIL 2017

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#### Queries relating to Scheme benefits

Enquiries about the Scheme generally, about individual entitlement to benefits or requests for Scheme documentation should be directed to:

Leonardo Electronics Pension Scheme  
Aon Hewitt Limited  
PO Box 196  
Huddersfield  
HD8 1EG

Telephone: 0345 603 5660 / Email: [leonardoelectronicspension@aonhewitt.com](mailto:leonardoelectronicspension@aonhewitt.com)

The Trustee has adopted a dispute resolution procedure in line with the requirements of the Pensions Act 1995. Details of this procedure are available from the Pension Administrator at the above address.

If a member has a complaint against the Scheme which has not been resolved to their satisfaction through the Scheme's internal dispute resolution procedure, the Pensions Advisory Service (TPAS), an independent voluntary organisation, may be able to offer advice.

#### TPAS

11 Belgrave Road  
London SW1V 1RB

Telephone: 0300 123 1047

Website: [www.pensionsadvisoryservice.org.uk](http://www.pensionsadvisoryservice.org.uk)

For problems that cannot be settled through TPAS, the Pensions Ombudsman has power to investigate and determine complaints or disputes of fact or law in relation to occupational pension schemes. The Pensions Ombudsman will normally only investigate cases where the internal dispute resolution procedure has been exhausted and TPAS have been unable to resolve the complaint. The Pensions Ombudsman can be contacted at 11 Belgrave Road, London, SW1V 1RB.

The Pensions Regulator can intervene if it considers that a Scheme's trustee, advisers, or the employer are not carrying out their duties correctly. The address for the Pensions Regulator is Napier House, Trafalgar Place, Brighton, BN1 4DW. Full details about the Pensions Regulator's role are available on its website: [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk).

#### Pensions Tracing

A pensions tracing service is carried out by the Department for Work and Pensions. This service can be contacted at:

Pension Tracing Service  
The Pension Service 9  
Mail Handling Site A  
Wolverhampton  
WV98 1LU

Telephone: 0345 6002 537

Website: [www.gov.uk/find-lost-pension](http://www.gov.uk/find-lost-pension)

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## LEONARDO ELECTRONICS PENSION SCHEME

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### STATEMENT OF TRUSTEE'S RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

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The Scheme's Trustee is responsible for obtaining audited financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) and for making available certain other information about the Scheme in the form of an Annual Report.

The financial statements are the responsibility of the Trustee. Pension Scheme regulations require the Trustee to make available to Scheme members, beneficiaries and certain other parties, audited financial statements for each Scheme year which:

- show a true and fair view of the financial transactions of the Scheme during the Scheme year and of the amount and disposition at the end of the Scheme year of the assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year, in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), and
- contain the information specified in the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including a statement whether the financial statements have been prepared in accordance with the Statement of Recommended Practice, "Financial Reports of Pension Schemes" (Revised 2015).

The Trustee has supervised the preparation of the financial statements and has agreed suitable accounting policies, to be applied consistently, making any estimates and judgements on a prudent and reasonable basis.

The Trustee is responsible under pensions legislation for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions showing the rates of contributions payable to the Scheme by or on behalf of the employer and the active members of the Scheme and the dates on or before which such contributions are to be paid.

The Trustee is also responsible for keeping records in respect of contributions received in respect of any active member of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the schedule of contributions. Where breaches of the schedule occur, the Trustee is required by the Pensions Act 1995 and 2004 to consider making reports to the Pensions Regulator and the members.

The Trustee also has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to them to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities, including the maintenance of an appropriate system of internal control.

Name:

Trustee Director, Leonardo Electronics Pension Scheme (Trustee) Ltd

Date: 10/10/2017

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## LEONARDO ELECTRONICS PENSION SCHEME

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### INDEPENDENT AUDITOR'S REPORT TO THE TRUSTEE OF THE LEONARDO ELECTRONICS PENSION SCHEME

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#### Opinion on financial statements

We have audited the financial statements of the Leonardo Electronics Pension Scheme for the year ended 5 April 2017 on pages 23 to 50 which comprise the fund account, the statement of net assets (available for benefits) and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including FRS102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

In our opinion the financial statements:

- show a true and fair view of the financial transactions of the Scheme during the year ended 5 April 2017, and of the amount and disposition at that date of its assets and liabilities, other than the liabilities to pay pensions and benefits after the end of the year;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and,
- contain the information specified in Regulation 3 of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995.

#### Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at [www.frc.org.uk/auditscopeukprivate](http://www.frc.org.uk/auditscopeukprivate).

#### Respective responsibilities of Trustee and Auditor

As explained more fully in the Statement of Trustee's Responsibilities, the Scheme's Trustee is responsible for the preparation of financial statements which show a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's ("APB's") Ethical Standards for Auditors.

This report is made solely to the Scheme's Trustee as a body, in accordance with the Pensions Act 1995. Our audit work has been undertaken so that we might state to the Scheme's Trustee those matters we are required to state to them in an Auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme and the Scheme's Trustees as a body, for our audit work, for this report, or for the opinions we have formed.

RSM UK Audit LLP  
Statutory Auditor  
Chartered Accountants  
25 Farringdon Street  
London  
EC4A 4AB

Date: 10/10/2017



## LEONARDO ELECTRONICS PENSION SCHEME

### FUND ACCOUNT FOR THE YEAR ENDED 5 APRIL 2017

	Notes	Defined benefits section £000	Defined contributions section £000	For the year ended 5 April 2017 £000	For the year ended 5 April 2016 £000
<b>Contributions and Benefits</b>					
Employee Contributions	3	2,677	-	2,677	2,600
Employer Contributions	4	25,982	458	26,440	28,655
		28,659	458	29,117	31,255
Other income	6	464	-	464	585
		29,123	458	29,581	31,840
Benefits paid or payable	7	(7,129)	-	(7,129)	(8,830)
Payments to and on account of leavers	8	(6,250)	-	(6,250)	(1,699)
Other payments	9	(437)	-	(437)	(404)
Administrative expenses	10	(1,656)	-	(1,656)	(1,182)
		(15,472)	-	(15,472)	(12,115)
<b>Net additions from dealings with members</b>		13,651	458	14,109	19,725
<b>Returns on investments</b>					
Investment income	11	8,600	-	8,600	7,957
Change in market value of investments	12	191,488	2,774	194,262	24,829
Investment management expenses	17	(2,307)	-	(2,307)	(1,767)
<b>Net returns on investments</b>		197,781	2,774	200,555	31,019
<b>Net increase in the fund during the year</b>		211,432	3,232	214,664	50,744
Transfers between sections		(843)	843	-	-
<b>Net assets of the Scheme At 6 April 2016</b>		730,756	15,870	746,626	695,882
<b>Net assets of the Scheme At 5 April 2017</b>		941,345	19,945	961,290	746,626

## LEONARDO ELECTRONICS PENSION SCHEME

### STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AS AT 5 APRIL 2017

	Note	5 April 2017 £000	5 April 2016 £000
<b>Defined benefit section</b>			
<b>Investment assets</b>			
Bonds	12	439,897	256,643
Pooled investment vehicles	12,14	479,946	437,759
Derivatives	15	161,744	140,857
Cash deposits	12,16	14,759	20,190
Dividends and withholding tax	12	1,076	779
Unsettled items	12	6,749	-
<b>Total investments</b>		<u>1,104,171</u>	<u>856,228</u>
<b>Investment liabilities</b>			
Derivatives	15	(158,080)	(127,228)
Unsettled items	12	(2,988)	-
<b>Total net investments</b>		<u>943,103</u>	<u>729,000</u>
<b>Current assets</b>	20	1,719	3,019
<b>Current liabilities</b>	20	(3,477)	(1,263)
		<u>941,345</u>	<u>730,756</u>

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## LEONARDO ELECTRONICS PENSION SCHEME

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### STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AS AT 5 APRIL 2017

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	Note	5 April 2017 £000	5 April 2016 £000
<b>Defined contribution section</b>			
Investment assets			
Pooled investment vehicles	12	19,764	15,870
Total investments		19,764	15,870
Current assets	20	181	-
		19,945	15,870
<b>NET ASSETS AVAILABLE FOR BENEFITS</b>		961,290	746,626

The financial statements summarise the transactions of the Scheme and deal with the net assets at the disposal of the Trustee. They do not take account of obligations to pay pensions and benefits which fall due after the end of the Scheme year. The actuarial position of the Scheme, which does take account of such obligations, is dealt with in the Report on Actuarial Liabilities on pages 5 and 6 and the Summary Funding Statement which is issued to members each year and these financial statements should be read in conjunction with them.

The notes on pages 26 to 50 form an integral part of these financial statements.

These financial statements were approved by Leonardo Electronics Pension Scheme (Trustee) Ltd and were signed on its behalf by

Name:   
Trustee Director, Leonardo Electronics Pension Scheme (Trustee) Ltd

Date: 10/10/2017

Name:   
Trustee Director, Leonardo Electronics Pension Scheme (Trustee) Ltd  
Date: 

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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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#### 1. BASIS OF PREPARATION

The financial statements have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, Financial Reporting Standard 102 (FRS 102) - The Financial Reporting Standard applicable in the UK and Republic of Ireland, issued by the Financial Reporting Council, and with the guidelines set out in the Statement of Recommended Practice (SORP)(2015) - Financial Reports of Pension Schemes.

The Trustee has elected to adopt early the amendments to FRS 102 fair value hierarchy disclosures issued in March 2016.

The Scheme is a registered hybrid pension scheme under the Chapter 2, Part 4 of the Finance Act 2004. This means that contributions by the employer and employees are normally eligible for tax relief, and income and capital gains earned by the Scheme receive preferential tax treatment. The Scheme is administered by the Trustee in accordance with the Trust Deed and Rules, solely for the benefit of its members and other beneficiaries.

#### 2. ACCOUNTING POLICIES

The following principal accounting policies have been adopted in the preparation of the financial statements.

##### 2.1 Accruals Concept

The financial statements have been prepared on an accruals basis.

##### 2.2 Contributions and benefits

Employers' contributions, members' contributions, including those paid under the SMART option, are accounted for on an accruals basis in accordance with the schedule of contributions.

AVCs are accounted for on an accruals basis, and the resulting investments are included within the net assets statement on the basis of values provided by the AVC investment managers.

Augmentation contributions are accounted for in accordance with the agreement under which they are payable, or, in the absence of an agreement, on a receipt basis.

Benefits are accounted for in the period in which the member notifies the Trustee of his decision on the type or amount of benefit to be taken or, if there is no member choice, on the date of retirement or leaving. Pensions are accounted for in the period to which they relate. For members with whom contact has been lost, benefits are accounted for on the later of the date that contact is re-established and the date that the relevant benefit payable has been identified.

Individual transfers in or out are accounted for when the transfer has been agreed by both parties and the receiving scheme has accepted liability for the transfer.

##### 2.3 Investment Income

Income from bonds and cash is taken into account on an accruals basis.

Income arising from the underlying investments of the pooled investment vehicles that is reinvested within the pooled investment vehicles is reflected in the unit price. Such income is reported within the change in market value. Where income from pooled investment vehicles is distributed, this income is accounted for on an accruals basis.

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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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#### 2. ACCOUNTING POLICIES (continued)

##### 2.4 Valuation of investments

Investment assets and liabilities are included at market value at the end of the Scheme year as follows:

- (i) Investments in pooled investment vehicles (unit trusts/managed funds) are valued at the bid price ruling at the year end. Where no bid price is available they are valued using the available single price.
- (ii) Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the year end.
- (iii) Additional voluntary contribution and defined contribution with-profits policies are valued at the year end values provided by the AVC provider.
- (iv) Bonds are valued on a clean basis which excludes the value of the interest accruing from the previous interest payment date and the valuation date. Index-linked contracts are valued on an adjusted clean basis using indexation.

##### (v) Derivatives

Derivatives are investment assets and investment liabilities that derive their value from the price or rate of some underlying item.

Derivatives with an initial purchase price are reported as purchases. Those that do not have an initial purchase price but require a deposit, such as an initial margin to be placed with the broker, are recorded at nil cost on purchase.

Derivative contracts are included in the net assets statement at fair value. Fair value for over the counter contracts is calculated using pricing models such as Black-Scholes. Exchange traded derivatives with positive values are included in the net assets statement as assets at bid price, and those with negative values as liabilities at offer price.

Collateral payments and receipts are reported within cash, and do not form realised gains or losses reported within change in market value.

Interest rate and inflation swaps are the present value of the difference between the actual fixed payments and the expected floating payment. The amount included in change in market value is the realised gains or losses on closed contracts and the unrealised gains or losses on open contracts.

Forward foreign exchange contracts outstanding at the year end are stated at fair value which is determined as the gain or loss that would arise if the outstanding contract was matched at the year end with an equal and opposite contract.

Traded options are valued at the fair value as determined by the exchange price for closing out the option as at the year end. Options which are over the counter contracts are valued at fair value using a pricing model such as Black-Scholes, where inputs are based on market data at the year end date.

Changes in the value of the option are reported within change in market value.

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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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#### 2. ACCOUNTING POLICIES (continued)

Swaps are revalued monthly. The fair value is calculated using pricing models such as Bloomberg's, where inputs are based on market data at the year end date. Interest is accrued monthly on a basis consistent with the terms of each contract. The amounts included in change in market value are the realised gains or losses on closed contracts and the unrealised gains or losses on open contracts. Net receipts or payments on swap contracts are either (a) reported within investment income or (b) reported within change in market value.

##### 2.5 Expenses

Expenses are accounted for on an accruals basis.

##### 2.6 Currency

The Scheme's functional currency and presentational currency is pounds sterling (GBP).

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 3. EMPLOYEES CONTRIBUTIONS

	Defined benefits section	Defined contributions section	For the year ended 5 April 2017 £000
	£000	£000	£000
Normal	137	-	137
Additional voluntary contributions*	1,676	-	1,676
SBS contributions **	864	-	864
SBS DIS contributions**	-	-	-
Total	2,677	-	2,677

	Defined benefits section	Defined contributions section	For the year ended 5 April 2016 £000
	£000	£000	£000
Normal	155	-	155
Additional voluntary contributions*	1,634	-	1,634
SBS contributions **	783	-	783
SBS DIS contributions**	28	-	28
Total	2,600	-	2,600

\* Members of all sections can pay additional voluntary contributions (AVCs) to Old Mutual Wealth Life Assurance Limited, which are invested separately from the Scheme's other assets. The proceeds of each member's AVC account is used to provide additional benefits for, or in respect of, the member. The majority of the AVCs are paid through the salary sacrifice arrangement.

\*\* Members of the 2000 Section of the Scheme can pay additional voluntary contributions to the Selected Benefit Scheme (SBS) in order to increase their retirement benefits and/or death in service benefits (the ability to pay additional contributions for death in service benefits ceased in April 2016). SBS contributions are invested in the same way as the Scheme's other assets. The majority of the SBS contributions are paid through the salary sacrifice arrangement.

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 4. EMPLOYERS CONTRIBUTIONS

	Defined benefits section	Defined contributions section	For the year ended 5 April 2017
	£000	£000	£000
Normal contributions	16,560	458	17,018
SMART contributions	9,422	-	9,422
	<u>25,982</u>	<u>458</u>	<u>26,440</u>

  

	Defined benefits section	Defined contributions section	For the year ended 5 April 2016
	£000	£000	£000
Normal contributions	18,227	476	18,703
SMART contributions	9,952	-	9,952
	<u>28,179</u>	<u>476</u>	<u>28,655</u>

Employer contributions include contributions in respect of salary sacrifice arrangements made available to certain members by the Employer.

#### 5. TRANSFERS BETWEEN SECTIONS

	Defined benefits section	Defined contributions section	For the year ended 5 April 2017
	£000	£000	£000
Transfers between sections	(843)	843	-

  

	Defined benefits section	Defined contributions section	For the year ended 5 April 2016
	£000	£000	£000
Transfers between sections	(2,660)	2,660	-

Transfers between sections represents the transfers for the contributions invested from the DB section in respect of the DC section. Also included are members benefits received from asset holdings in the DC section for settlement with DB member's benefits.



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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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#### 6. OTHER INCOME

	Defined benefits section £000	Defined contributions section £000	For the year ended 5 April 2017 £000
Claims on term insurance policies	464	-	464
	<u>464</u>	<u>-</u>	<u>464</u>
	<i>Defined benefits section £000</i>	<i>Defined contributions section £000</i>	<i>For the year ended 5 April 2016 £000</i>
Claims on term insurance policies	585	-	585
	<u>585</u>	<u>-</u>	<u>585</u>

# LEONARDO ELECTRONICS PENSION SCHEME

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

### 7. BENEFITS

	Defined benefits section	Defined contributions section	For the year ended 5 April 2017 £000
	£000	£000	£000
Pensions	3,486	-	3,486
Commutations and lump sum retirement benefits	2,877	-	2,877
Annuities	202	-	202
Lump sum death benefits	533	-	533
Taxation	31	-	31
	<u>7,129</u>	<u>-</u>	<u>7,129</u>
	<i>Defined benefits section</i>	<i>Defined contributions section</i>	<i>For the year ended 5 April 2016 £000</i>
	£000	£000	£000
Pensions	3,045	-	3,045
Commutations and lump sum retirement benefits	4,352	-	4,352
Annuities	239	-	239
Lump sum death benefits	616	-	616
Taxation	578	-	578
	<u>8,830</u>	<u>-</u>	<u>8,830</u>

Taxation arising on benefits paid or payable is in respect of members whose benefits exceeded the lifetime or annual allowance and who elected to take lower benefits from the Scheme in exchange for the Scheme settling their tax liability.

### 8. PAYMENTS TO AND ON ACCOUNT OF LEAVERS

	Defined benefits section	Defined contributions section	For the year ended 5 April 2017 £000
	£000	£000	£000
Transfers out to other schemes	<u>6,250</u>	<u>-</u>	<u>6,250</u>
	<i>Defined benefits section</i>	<i>Defined contributions section</i>	<i>For the year ended 5 April 2016 £000</i>
	£000	£000	£000
Transfers out to other schemes	<u>1,699</u>	<u>-</u>	<u>1,699</u>

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 9. OTHER PAYMENTS

	Defined benefits section	Defined contributions section	For the year ended 5 April 2017
	£000	£000	£000
Scheme's death in service premiums	437	-	437

Other payments represent premiums paid to Aviva Life & Pensions UK Limited who have underwritten the Scheme's death in service benefits during the year.

	Defined benefits section	Defined contributions section	For the year ended 5 April 2016
	£000	£000	£000
Scheme's death in service premiums	404	-	404

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 10. ADMINISTRATIVE EXPENSES

	Defined benefits section	Defined contributions section	For the year ended 5 April 2017 £000
	£000	£000	£000
Administration, management and processing	991	-	991
Actuarial fees	366	-	366
Audit fee	26	-	26
Legal and other professional fees	172	-	172
PPF levy	35	-	35
Accountancy and covenant review fees	37	-	37
Bank charges	2	-	2
Communications and other costs	25	-	25
Sundry expenses	2	-	2
	<u>1,656</u>	<u>-</u>	<u>1,656</u>

General administration expenses of the Scheme, which are in respect of each section of the Scheme, are borne by the Scheme as a whole. A charge to cover administration expenses for the Retirement Accounts is deducted from each Retirement Account before allocation to members' individual accounts and therefore the Scheme does not bear this cost.

	Defined benefits section	Defined contributions section	For the year ended 5 April 2016 £000
	£000	£000	£000
Administration, management and processing	575	-	575
Actuarial fees	372	-	372
Audit fee	13	-	13
Legal and other professional fees	137	-	137
PPF levy	26	-	26
Accountancy and covenant review fees	25	-	25
Bank charges	2	-	2
Communications and other costs	28	-	28
Sundry expenses	4	-	4
	<u>1,182</u>	<u>-</u>	<u>1,182</u>

# LEONARDO ELECTRONICS PENSION SCHEME

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

### 11. INVESTMENT INCOME

	Defined benefits section	Defined contributions section	For the year ended 5 April 2017
	£000	£000	£000
Income from bonds	3,547	-	3,547
Income from pooled investment vehicles	4,281	-	4,281
Interest on cash deposits	24	-	24
Net swaps inflows	748	-	748
	<u>8,600</u>	<u>-</u>	<u>8,600</u>
	Defined benefits section	Defined contributions section	For the year ended 5 April 2016
	£000	£000	£000
Income from bonds	4,107	-	4,107
Income from pooled investment vehicles	3,790	-	3,790
Interest on cash deposits	(52)	-	(52)
Net swaps inflows	112	-	112
	<u>7,957</u>	<u>-</u>	<u>7,957</u>

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 12. INVESTMENTS

##### MOVEMENTS IN INVESTMENTS

##### Defined benefit section

	Value at 06/04/2016	Purchases at cost and derivative payments	Sales proceeds and derivative receipts	Change in market value	Value at 05/04/2017
	£000	£000	£000	£000	£000
Bonds	256,643	334,311	(229,549)	78,492	439,897
Pooled investment vehicles	437,759	399,036	(453,597)	96,748	479,946
Derivative contracts	13,629	36,481	(62,694)	16,248	3,664
	<u>708,031</u>	<u>769,828</u>	<u>(745,840)</u>	<u>191,488</u>	<u>923,507</u>
Cash deposits	20,190				14,759
Dividends and withholding tax	779				1,076
Unsettled items	-				3,761
	<u>729,000</u>				<u>943,103</u>

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### Defined contribution section

	2017 £000	2016 £000
<b>Market value at 6 April 2016</b>	<b>15,870</b>	<b>12,807</b>
Purchases at cost	2,207	4,339
Disposals	(1,087)	(1,203)
Change in market value of investments	2,774	(73)
<b>Market value at 5 April 2017</b>	<b>19,764</b>	<b>15,870</b>

The DC investment assets shown above are pooled investment vehicles which are held with Old Mutual Wealth in a unitised arrangement.

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

There are no unallocated units.

The DB AVCs are not significant to the Scheme assets and therefore have not been disclosed separately.

### 13. TRANSACTION COSTS

The direct transaction costs for the DB section are shown in the table below:

	Fees	Commissions	2017 Taxes and Duties	Levies	Total	2016 Total
Pooled Investment Vehicles	1,707	2,054	-	-	3,761	3,274
	1,707	2,054	-	-	3,761	3,274
2016	3,274	-	-	-		

In addition to the transaction costs disclosed above, indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles and charges made within those vehicles.

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 14. POOLED INVESTMENT VEHICLES

	Defined benefits section £000	Defined contributions section £000	5 April 2017 £000
Bonds	87,092	166	87,258
Cash	10,563	326	10,889
Equity	242,829	1,081	243,910
Property	26,240	-	26,240
Alternatives	113,222	-	113,222
Growth	-	15,442	15,442
Retirement Protection	-	2,257	2,257
Annuity Protection	-	492	492
Total	479,946	19,764	499,710

	Defined benefits section £000	Defined contributions section £000	5 April 2016 £000
Bonds	127,782	558	128,340
Cash	2	327	329
Equity	229,379	817	230,196
Property	6,843	-	6,843
Alternatives	73,753	-	73,753
Growth	-	12,629	12,629
Retirement Protection	-	1,539	1,539
Total	437,759	15,870	453,629

#### 15. DERIVATIVES OBJECTIVES AND POLICIES

	2017		2016	
	Assets £000	Liabilities £000	Assets £000	Liabilities £000
Defined Benefits Section				
Swaps	135,944	(133,405)	123,963	(106,115)
Options	25,268	(21,412)	16,278	(14,186)
Forward Foreign Exchange	532	(3,263)	616	(6,927)
	161,744	(158,080)	140,857	(127,228)



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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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The liability hedging strategy is implemented via interest rate and inflation swaps (contracts between the Scheme and a counterparty bank) and aims to reduce the Scheme's sensitivity to changes in long-dated interest rates and expectations of inflation and hence reduce the impact of movements in these on the Scheme's funding level. The collateral for the liability hedge comprised of index-linked gilts, as well as an amount of cash held in the Matching Fund. At 5 April 2017 collateral of £10.8 million was posted by the counterparties, Citigroup, Morgan Stanley and RBS, and held by the custodian on behalf of the Scheme. Barclays posted £3,144,029 of gilts as collateral. There was also £7,545,921 of gilts delivered by the Scheme to Credit Suisse, and £107,636 delivered by the Scheme to HSBC.

The cash flows are accumulated over the term of the swap. For the interest rate swaps the accumulated liability is compared to the fixed amounts shown above. If the accumulated liability is higher than the fixed amount the Scheme has a liability, conversely if the accumulated liability is lower than the fixed amount then the Scheme has an asset. The cash flows for the inflation swaps are also accumulated.

Included in the market value is an allowance for initial charges on the swaps. The initial charges are payable on closure of the contract. The charge reflected in the market value at 5 April 2017 is £4,300,885 (2016: £1,899,000).

Equity Derivative Overlay Strategy (V) – formed of a portfolio of equity options (on a global equity index) and gilts, designed as a diversifying asset that will protect capital in down markets and give the greatest return when other equity based assets are stationary.

A summary of the Scheme's outstanding derivative contracts at the Year end aggregated by key characteristics is set out on the following page:

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

Swaps	Notional amounts £000	Expires	Asset value £000	Liability value £000
Interest rate swap (OTC)	20,620	2017-2021	1,311	-
Interest rate swap (OTC)	79,392	2022-2026	1,274	(4,471)
Interest rate swap (OTC)	121,414	2027-2031	16,536	(1,117)
Interest rate swap (OTC)	200,025	2032-2036	-	(21,747)
Interest rate swap (OTC)	89,922	2037-2041	9,302	(21,363)
Interest rate swap (OTC)	100,000	2042-2046	24,313	(3,383)
Interest rate swap (OTC)	68,784	2047-2051	27,421	(20,098)
Interest rate swap (OTC)	59,831	2052-2056	9,878	(14,265)
Interest rate swap (OTC)	20,723	2057-2061	17,704	(10,555)
Interest rate swap (OTC)	12,888	2062-2066	13,087	-
Inflation rate swap (OTC)	122,806	2017-2021	2,018	(720)
Inflation rate swap (OTC)	124,904	2022-2026	2,762	(801)
Inflation rate swap (OTC)	91,792	2027-2031	1,916	-
Inflation rate swap (OTC)	24,294	2032-2036	1,318	-
Inflation rate swap (OTC)	9,388	2037-2041	-	(172)
Inflation rate swap (OTC)	21,122	2042-2046	1,452	-
Inflation rate swap (OTC)	11,770	2057-2061	2,134	-
Total Return Swaps	10,000	2017-2021	3,518	-
Proceed Asset Swap (OTC)	25,528	2052-2056	-	(34,713)
Total 2017			135,944	(133,405)
Total 2016			123,963	(106,115)
Options	Notional amounts £000	Expires	Asset value £000	Liability value £000
Equity derived index option - underlying investment FTSE 100	34,000	June 2018	25,268	(21,412)
Total 2017			25,268	(21,412)
Total 2016			16,278	(14,186)

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

Forward Foreign Exchange	Currency bought	Currency sold	Asset value £000	Liability value £000
Forward (OTC) - expiration 13 April 2017	\$33,903,500	£27,088,603	104	-
Forward (OTC) - expiration 13 April 2017	£3,944,433	\$4,869,600	39	-
Forward (OTC) - expiration 13 April 2017	£170,259,883	\$211,940,200	272	-
Forward (OTC) - expiration 13 April 2017	£29,201,082	4,182,030,000 YEN	-	(937)
Forward (OTC) - expiration 13 April 2017	£2,394,961	339,390,000 YEN	-	(51)
Forward (OTC) - expiration 13 April 2017	£23,711,090	27,720,500 EUR	41	-
Forward (OTC) - expiration 13 July 2017	2,022,250,000 YEN	£14,606,778	-	(33)
Forward (OTC) - expiration 13 July 2017	£8,076,869	\$9,983,600	69	-
Forward (OTC) - expiration 13 July 2017	£151,149,571	£190,366,400	-	(1,534)
Forward (OTC) - expiration 13 July 2017	£1,545,085	216,020,000 YEN	-	(12)
Forward (OTC) - expiration 13 July 2017	£32,519,717	4,581,820,000 YEN	-	(500)
Forward (OTC) - expiration 13 July 2017	£23,269,420	27,480,700 EUR	-	(196)
Forward (OTC) - expiration 13 July 2017	£1,089,692	1,267,600 EUR	7	-
Total 2017			532	(3,263)
Total 2016			616	(6,927)

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 16 CASH DEPOSITS

	Defined benefits section £000	Defined contributions section £000	For the year ended 5 April 2017 £000
Sterling cash deposits	14,101	-	14,101
Foreign currency cash deposits	644	-	644
Futures and options - margin monies	14	-	14
	<u>14,759</u>	<u>-</u>	<u>14,759</u>
	<u>14,759</u>	<u>-</u>	<u>14,759</u>
	Defined benefits section £000	Defined contributions section £000	For the year ended 5 April 2016 £000
Sterling cash deposits	18,870	-	18,870
Foreign currency cash deposits	1,056	-	1,056
Futures and options - margin monies	264	-	264
	<u>20,190</u>	<u>-</u>	<u>20,190</u>
	<u>20,190</u>	<u>-</u>	<u>20,190</u>

#### CONCENTRATION OF INVESTMENTS

The following investments, excluding UK Government Securities, accounted for more than 5% of the Scheme's net assets as at the year end:

	5 April 2017 Market value £000		5 April 2016 Market value £000	%
Vanguard S&P 500 ETF Trust (USD)	<u>76,551</u>	<u>7.96 %</u>	<u>95,742</u>	<u>12.82 %</u>

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 17. INVESTMENT MANAGEMENT EXPENSES

	Defined benefits section £000	Defined contributions section £000	For the year ended 5 April 2017 £000
Administration, management & custody	3,069	-	3,069
Investment fee rebate	(762)	-	(762)
	<u>2,307</u>	<u>-</u>	<u>2,307</u>
	Defined benefits section £000	Defined contributions section £000	For the year ended 5 April 2016 £000
Administration, management & custody	2,021	-	2,021
Investment fee rebate	(254)	-	(254)
	<u>1,767</u>	<u>-</u>	<u>1,767</u>

## LEONARDO ELECTRONICS PENSION SCHEME

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

#### 18. FAIR VALUE

The fair value of financial instruments has been prepared using the following fair value hierarchy:

Level 1: The unadjusted quoted price in an active market for an identical asset or liability that the entity can access at the measurement date;

Level 2: Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability either directly or indirectly;

Level 3: Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

	As at 5 April 2017			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Defined Benefit section				
Bonds	-	439,897	-	439,897
Pooled investment vehicles	193,529	274,445	11,972	479,946
Derivative contracts	-	3,664	-	3,664
Cash deposits	14,759	-	-	14,759
Accrued investment income	1,076	-	-	1,076
Other investments	3,761	-	-	3,761
	<u>213,125</u>	<u>718,006</u>	<u>11,972</u>	<u>943,103</u>
Defined Contributions section				
Pooled investment vehicle	-	19,764	-	19,764
	<u>-</u>	<u>19,764</u>	<u>-</u>	<u>19,764</u>
	<u>213,125</u>	<u>737,770</u>	<u>11,972</u>	<u>962,867</u>

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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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	<i>At 5 April 2016</i>			
	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Defined Benefit section:				
Bonds	-	256,643	-	256,643
Pooled investment vehicles	167,362	263,547	6,850	437,759
Derivative contracts	-	13,629	-	13,629
Cash deposits	20,190	-	-	20,190
Accrued investment income	779	-	-	779
	<u>188,331</u>	<u>533,819</u>	<u>6,850</u>	<u>729,000</u>
Defined Contributions section:				
Pooled investment vehicles	-	15,870	-	15,870
Sub total	<u>-</u>	<u>15,870</u>	<u>-</u>	<u>15,870</u>
	<u>188,331</u>	<u>549,689</u>	<u>6,850</u>	<u>744,870</u>

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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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#### 19. INVESTMENT RISK

FRS 102 requires the disclosure of information in relation to certain investment risks. These risks are set out by FRS 102 as follows:

**Credit risk:** this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

**Market risk:** this comprises currency risk, interest rate risk and other price risk.

- **Currency risk:** this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates.
- **Interest rate risk:** this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates.
- **Other price risk:** this is the risk that the fair value of future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Trustee determines its investment strategy after taking advice from a professional investment adviser. The Scheme has exposure to these risks because of the investments it makes in following the investment strategy set out below. The Trustee manages investment risks, including credit risk and market risk, within agreed risk limits which are set taking into account the Scheme's strategic investment objectives. These investment objectives and risk limits are implemented through the investment management agreements in place with the Scheme's investment managers and monitored by the Trustee by regular reviews of the investment portfolio.

#### **Credit Risk**

The Scheme is subject to credit risk because the Scheme directly invests in bonds, over the counter (OTC) derivatives and has cash balances. The Scheme also invests in pooled investment vehicles and is therefore indirectly exposed to credit risk in relation to the instruments it holds in the pooled investment vehicles. The Trustee's policy for managing credit risk is detailed in the Statement of Investment Principles.

The Scheme holds £439.9m in directly held bonds (2016: £256.6m), £3.7m in OTC derivatives (2016: £13.6m) and £18.6m in directly held cash balances (2016: £20.2m). The Scheme also holds £97.7m in bonds and cash through underlying pooled fund investments (2016: £127.7m).

Credit risk arising on derivatives held directly depends on whether the derivative is exchange traded or over the counter. The Scheme holds OTC derivative contracts which are not guaranteed by any regulated exchange and therefore the Scheme is subject to risk of failure of the counterparty. Credit risk for OTC derivative contracts is mitigated by placing restrictions on P-Solve which ensure that new contracts are only entered into with counterparties that are investment grade. The credit risk in respect of OTC swaps is further reduced by collateral arrangements.

Credit risk arising on bonds held directly is mitigated by P-Solve choosing to only invest in government bonds, where the credit risk is minimal, or corporate bonds which are rated at least investment grade.

Directly held cash balances are at financial institutions which are at least investment grade credit rated. This is the position at the year-end.

In all above instances, "investment grade" is defined as being rated at least BBB- by Standard & Poor's or Baa3 by Moody's.



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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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Indirect credit risk arises in relation to underlying investments held in bond and cash pooled investment vehicles. This risk is mitigated by the Trustee mandating P-Solve that the underlying investment in sub-investment grade debt may not exceed 30% of the Investment Fund.

Both direct and indirect credit risk is mitigated by holding a diversified portfolio to minimise the impact of default by any one issuer. The Trustee monitors the investment strategy adopted by P-Solve to ensure that the arrangement remains diversified.

Direct credit risk arises in respect of pooled investment vehicles. The Scheme's Investment Fund is invested across a large number of different pooled funds which have various legal structures in various domiciles (e.g. open-ended investment companies, unit trusts, limited partnerships etc.).

The direct credit risk associated with these managers is also mitigated by:

- the regulatory environments in which those managers operate;
- diversification amongst a large number of pooled arrangements; and
- due diligence checks by P-Solve on the appointment of new pooled managers, and monitoring on an ongoing basis for any changes to the operating environment of each manager.

#### Currency risk

The Scheme is subject to currency risk because some of the Scheme's investments are held in overseas markets, either as segregated investments or via pooled investment vehicles. The Trustee's policy for managing this risk is detailed in the Statement of Investment Principles.

Currency risk is mitigated by delegating management of currency exposures at total portfolio level to P-Solve. P-Solve implement currency hedging through the use of hedged shared classes of pooled funds (where available) and the use of FX forward contracts.

Net of currency hedging, 11.4% of the Scheme's holdings were exposed to overseas currencies as at year end (2016: 14.0%).

#### Interest rate risk

The Scheme's assets are subject to interest rate risk because some of the Scheme's investments are held in bonds & interest/inflation rate swaps for the purpose of liability hedging. Under this strategy if interest rates fall the value of these investments will rise to help match the increase in actuarial liabilities arising from a fall in the discount rate. Similarly, if interest rates rise these investments will fall in value as will actuarial liabilities because of an increase in the discount rate. At the year end, the assets held for liability hedging purposes comprised of:

	2017 £000	2016 £000
<b>Direct</b>		
Bonds	439,897	256,646
Swaps	2,539	17,849
<b>Indirect</b>		
Bond PIVs	87,092	127,781
Cash PIVs	10,563	2

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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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#### Other price risk

Other price risk arises principally in relation to the Scheme's return seeking portfolio which includes equities held in pooled vehicles, equity options, hedge funds, other alternatives and property. The Scheme manages this exposure to overall price movements by constructing a diverse portfolio of investments across various markets.

At the year end, the Scheme's exposure to investments subject to other price risk was:

	2017	2016
Direct	£000	£000
Equity Options	3,855	2,092
Indirect		
Bond PIVs	87,092	127,782
Cash PIVs	10,563	2
Equity PIVs	242,829	229,379
Property PIVs	26,240	6,843
Alternatives PIVs	113,222	73,753

# LEONARDO ELECTRONICS PENSION SCHEME

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

### 20. CURRENT ASSETS AND LIABILITIES

	Defined benefits section £000	Defined contributions section £000	For the year ended 5 April 2017 £000
<b>Current assets</b>			
Cash balances	1,508	181	1,689
Death in service premiums prepaid	211	-	211
	<u>1,719</u>	<u>181</u>	<u>1,900</u>
<b>Current liabilities</b>			
Unpaid benefits	547	-	547
Accrued expenses	2,770	-	2,770
HM Revenue & Customs	160	-	160
	<u>3,477</u>	<u>-</u>	<u>3,477</u>
<b>Total current assets and liabilities</b>	<u>(1,758)</u>	<u>181</u>	<u>(1,577)</u>
	<i>Defined benefits section £000</i>	<i>Defined contributions section £000</i>	<i>For the year ended 5 April 2016 £000</i>
<b>Current assets</b>			
Cash balances	2,817	-	2,817
Death in service premiums prepaid	202	-	202
	<u>3,019</u>	<u>-</u>	<u>3,019</u>
<b>Current liabilities</b>			
Unpaid benefits	480	-	480
Accrued expenses	733	-	733
HM Revenue & Customs	50	-	50
	<u>1,263</u>	<u>-</u>	<u>1,263</u>
<b>Total current assets and liabilities</b>	<u>1,756</u>	<u>-</u>	<u>1,756</u>

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## LEONARDO ELECTRONICS PENSION SCHEME

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 5 APRIL 2017

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#### 21. RELATED PARTY TRANSACTIONS

Transactions with related parties of the Scheme have been disclosed in the accounts as follows:

- 21.1 Contributions receivable from employers are disclosed in note 4.
- 21.2 The Principal Employer, Leonardo MW Ltd pays the Scheme administration expenses to enable Value Added Tax to be recovered and then recharges the net expense to the Scheme. Administration expenses are disclosed in note 10.
- 21.3 During the year, contributions in respect of six Trustee Directors who are active members of the Scheme were calculated and paid to the Scheme in accordance with the rules.
- 21.4 Two of the Trustee Directors are pensioner members of the Scheme, who receive benefits in line with the Scheme Rules.
- 21.5 Trustee Directors who are pensioner members of the Scheme receive remuneration from Group companies. Leonardo MW Ltd provides governance services to the Scheme and recharges management and governance costs to the Scheme. Trustee remuneration fees for the 2016/17 Scheme year amounted to a total of £20,475 (2015/16: £19,525), with the costs met either directly by Group companies or indirectly through agreed governance fees recharged to the Scheme.

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## LEONARDO ELECTRONICS PENSION SCHEME

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### STATEMENT ABOUT CONTRIBUTIONS FOR THE YEAR ENDED 5 APRIL 2017

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**Independent Auditor's Statement about Contributions, under Regulation 4 of The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, to the Trustee of the Leonardo Electronics Pension Scheme**

#### **Statement about contributions payable under the Schedules of Contributions**

We have examined the Summary of Contributions payable to the Leonardo Electronics Pension Scheme, in respect of the Scheme Year ended 5 April 2017.

In our opinion contributions for the Scheme Year ended 5 April 2017 as reported in the attached Summary of Contributions on page 52 and payable under the Schedules of Contributions have in all material respects been paid at least in accordance with the Schedules of Contributions certified by the Scheme Actuary on 30 June 2015 and 26 May 2016.

#### **Scope of work on statement about contributions**

Our examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported on page 52 in the Summary of Contributions have in all material respects been paid at least in accordance with the Schedules of Contributions. This includes an examination, on a test basis, of evidence relevant to the amounts of contributions payable to the Scheme and the timing of those payments under the Schedules of Contributions.

#### **Respective responsibilities of Trustee and Auditor**

As explained more fully on page 21 in the Statement of Trustees' Responsibilities, the Scheme's Trustee is responsible for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions showing the rates and due dates of certain contributions payable towards the Scheme by or on behalf of the Employer and the active members of the Scheme. The Trustee is also responsible for keeping records in respect of contributions received in respect of active members of the Scheme and for monitoring whether contributions are made to the Scheme by the Employer in accordance with the Schedule of Contributions.

It is our responsibility to provide a statement about contributions paid under the schedule of contributions and to report our opinion to you.

This statement is made solely to the Scheme's Trustee as a body, in accordance with the Pensions Act 1995. Our audit work has been undertaken so that we might state to the Scheme's Trustee those matters we are required to state to them in an auditor's statement and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme and the Scheme's Trustee as a body, for our audit work, for this statement, or for the opinions we have formed.

RSM UK Audit LLP  
Statutory Auditor  
Chartered Accountants  
25 Farringdon Street  
London  
EC4A 4AB

Date 10/10/2017

## LEONARDO ELECTRONICS PENSION SCHEME

### APPENDIX 1: SUMMARY OF CONTRIBUTIONS FOR THE YEAR ENDED 5 APRIL 2017

#### Summary of contributions payable during the Scheme year ended 5 April 2017

Contributions payable to the Scheme under the Schedules of Contributions in respect of the year ended 5 April 2017 were as follows:

	Employers £'000	Members £'000	Total £'000
<b>Required by the Schedules of Contributions</b>			
<b>Employer:</b>			
Normal contributions	17,018	-	17,018
Smart contributions	9,422	-	9,422
<b>Member:</b>			
Normal	-	137	137
<b>Total contributions required by the Schedules of Contributions</b>	<b>26,440</b>	<b>137</b>	<b>26,577</b>
<b>Other contributions payable:</b>			
Additional voluntary contributions	-	1,676	1,676
SBS (additional pension benefits)	-	864	864
<b>Total contributions per notes 3 &amp; 4</b>	<b>26,440</b>	<b>2,677</b>	<b>29,117</b>

The Schedule of Contributions at the start of the year took effect from 1 August 2015. The schedule was certified by the Scheme Actuary on 30 June 2015. A replacement Schedule of Contributions was put in place in May 2016 to clarify the contributions payable following the adoption of new Scheme Rules on 31 March 2016. This Schedule was certified by the Scheme Actuary on 26 May 2016 and his certificate can be found in Appendix 2.

Name:

Trustee Director, Leonardo Electronics Pension Scheme (Trustee) Ltd

Date: 10/10/2017

Name:

Trustee Director, Leonardo Electronics Pension Scheme (Trustee) Ltd

Date: 10 Oct 17

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## LEONARDO ELECTRONICS PENSION SCHEME

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### APPENDIX 2: ACTUARIAL STATEMENTS

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#### Actuary's certification of schedule of contributions dated 23 May 2016

Name of scheme: Selex Pension Scheme

#### Adequacy of rates of contributions

1. I certify that, in my opinion, the rates of contributions shown in the schedule of contributions dated 23 May 2016 are such that the statutory funding objective can be expected to continue to be met for the period for which the schedule is to be in force.

#### Adherence to statement of funding principles

2. I hereby certify that, in my opinion, the schedule of contributions dated 23 May 2016 is consistent with the statement of funding principles dated 24 June 2015.

The certification of the adequacy of the rates of contributions for the purpose of ensuring that the statutory funding objective can be expected to be met is not a certification of their adequacy for the purpose of securing the Scheme's liabilities by the purchase of annuities, if the Scheme were to be wound up.

Signature: D Vassiliades

Date: 26 May 2016

Danny Vassiliades  
Fellow of the Institute and Faculty of Actuaries  
Punter Southall Limited  
1 Colmore Row  
Birmingham  
B3 2BJ

