A newsletter for the members of the SELEX Pension Scheme

Issue 2. September 2006

Welcome

In this issue of IN FOCUS we provide you with:

- a summary of what happened to the Scheme in the year to 5 April 2006; and
- information on the funding position of the Scheme – a new requirement from the Government requiring us to keep you updated on an annual basis about the funding position.

News

SMART

SMART is now in operation and since 1 July 2006 the majority of our members are paying their contributions to the pension scheme through "SMART". This means that both you and the company are saving money. We are pleased to say that 95.6% of eligible members are participating in SMART.

Thank you all for your support in participating in SMART. We hope you all notice the benefits of paying less national insurance.

Trustee Directors' training

The Trustee Directors attended 4 days of training on essential pension information including learning about aspects of legal, management, investment and actuarial issues that affect pensions. At the end of the course the Trustee Directors sat an examination and each passed, gaining the PMI Trustee Certificate of Essential Pensions Knowledge.

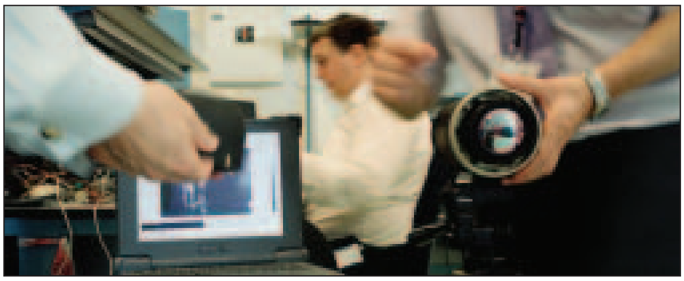
Well done to all our Trustee Directors!

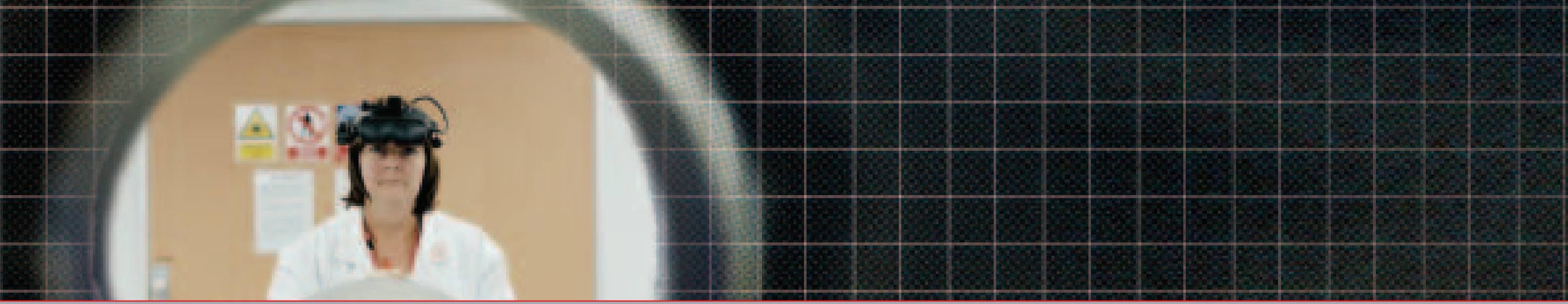
Benefit statements

The first SELEX benefit statements have been designed and the systems are being tested to ensure that your benefit data is correctly inputted into the statements. It is targeted to issue your first SELEX benefit statement towards the end of the year.

Pensions legislation

Further information about how the Company proposes to amend the Scheme following the introduction of the new pensions legislation will be communicated in the coming months.





Report and Accounts

Each year the Trustee is required to publish a report and audited accounts for the Scheme. The summary below is based on the accounts for the period to 5 April 2006, which have been signed off by our independent auditors Ernst & Young LLP.

If you would like to see a copy of the full annual Report and Accounts, a copy has been placed on the Scheme's website, **www.selexpensions.co.uk**.

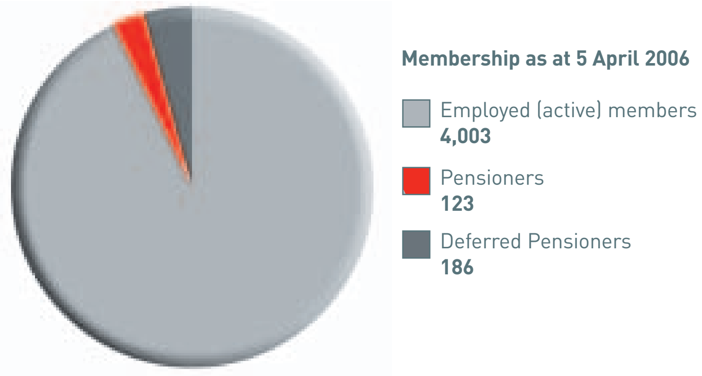
Scheme assets

The assets of the Scheme have grown in this first period to £26.3 million. Further information is set out below:

	Assets of Scheme at 29 April 2005	**£0.0 million**
+	**Income** (Company contributions, member contributions and other income)	£30.6 million
-	**Outgoings** (Pensions, lump sums, death in service insurance and administration expenses)	£1.9 million
-	**Net return on investments** (Market value of investments after allowing for expenses)	£2.4 million
=	**Assets of Scheme at 5 April 2006**	**£26.3 million**

Membership numbers

As our Scheme was only launched in 2005 it is very 'young'. This means that the majority of our members are employees who are paying contributions and building up benefits. This chart shows that out of a total of 4,312 members, 92.8% are employed (active) members.



Investing the assets of the Scheme

One of the most important things the Trustee has to do is invest the money that is in the Scheme. This year the Trustee Directors have prioritised the need to appoint investment advisers to help identify objectives and plan a suitable strategy.

We rely on our professional investment advisers to provide expert advice. Following advice, we have drawn up a strategy which takes account of the Scheme's needs and our attitudes to risk.

The overall aim is to achieve a fully funded Scheme (using the Scheme actuary's funding basis) over 10 years from inception of the Scheme i.e. by 29 April 2015. The Trustee's strategy to achieve this aim is to stabilise the Scheme's deficit and aim for regular investment returns each year. This will help to keep the level of contributions stable and ensure the value of the Scheme grows steadily irrespective of economic movements. We publish our strategy in our Statement of Investment Principles, a copy of which is available on request from the Pensions Service Centre.

We measure our manager's performance regularly and receive detailed reports on our investments.

Investment Strategy	
Objective	Achieve a fully funded Scheme over 10 years
Steps taken to achieve objective	Step 1: Stabilise the Scheme's deficit Action: Enter into swaps arrangements
	Step 2: Achieve regular investment returns each year Action: Invest funds in diverse range of assets

Entering into swaps arrangements

We have to calculate the deficit of the Scheme so we know how much money needs to be raised in the next 10 years to ensure the Scheme is fully funded. Therefore we asked the actuary to calculate the liabilities (i.e. the value of the members' benefits) of the Scheme.

Changes in long term interest rates and inflation impact on the value which the actuary places on the liabilities of the Scheme. Long term interest rates and inflation are regularly moving and the trustee cannot stop this. However, we can link our assets to interest rates and inflation by entering into swaps contracts.

By entering into the swaps contracts, the Trustee has ensured that:

- when inflation rises and the deficit of the Scheme increases, the value of the Scheme's assets will also increase; and
- when long term interest rates fall and the deficit of the Scheme increases, the value of the Scheme's assets will also increase.

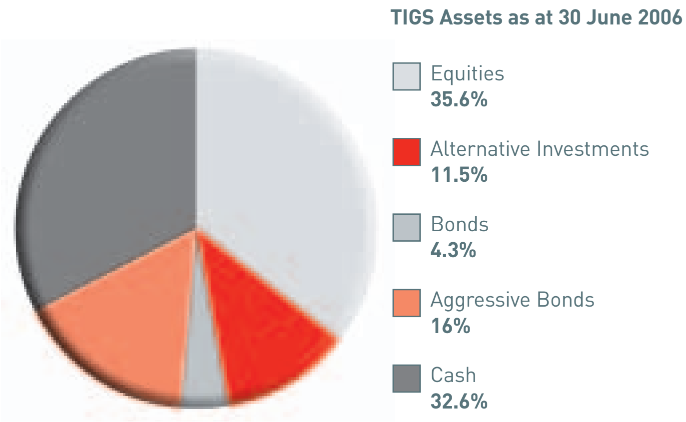
By linking our assets to our liabilities we are able to be more certain about the size of our deficit. The current negative returns on investment represent falls in the value of the swaps contracts. As explained above, these reductions will be broadly offset by reductions in the level of liabilities.

Achieving regular investment returns each year

After taking advice, we have decided to invest the Scheme's assets in an investment vehicle called Total Investment Governance Solutions (TIGS). This is an investment vehicle in which our investment manager, PSigma Investments Limited, invests the Scheme's assets in a diverse range of investments which are targeted to achieve returns in line with, or in excess of, the Trustee's specified target.

TIGS investment spread

The allocation of assets varies each month but currently our assets in TIGS are invested as follows:



A fairly large amount of our assets is cash as we have only recently moved our assets into the TIGS arrangement. Our investment managers are investing our assets in stages to ensure that we are investing in the markets at the correct time. Over time, less of our assets will be held as cash.

Annual Funding Update

The annual report and accounts contains information about the funding of the Scheme. In addition the Pensions Act 2004 has introduced a requirement that the Trustee informs you on an annual basis about the funding of the Scheme. Set out below are details of the Scheme's funding position as at 29 April 2005 (the date of inception).

How is the Scheme funding assessed?

The actuary carried out a funding valuation of the Scheme as at 29 April 2005. The Scheme had no assets at that time as it had only just been set up and no members had accrued any benefits.

When the valuation was carried out on 29 April 2005, the actuary valued the Scheme on three different bases:

- **Minimum Funding Requirement (MFR) basis**

  This is the amount of money needed to ensure the Scheme has enough assets to comply with the law. The actuary valued the Scheme as 100% funded on a MFR basis. This means that the Scheme complies with the law.

  100% funded

- **Ongoing basis**

  This is the amount of money needed to pay pensions as they fall due. The actuary must take into account various factors, including that salaries will increase and the assets will grow due to investment returns. The actuary valued the Scheme as underfunded by £40.9 million on an ongoing basis. If the Scheme continues to be open, it is estimated that the Scheme would need £40.9 million in order to be able to pay the benefits that Scheme members are expected to accrue in future as a result of the Scheme's link with BAE's pension schemes. (The link with BAE's pension schemes is discussed further overleaf.) The assets were nil at 29 April 2005 and therefore the Scheme had a deficit of £40.9 million.

  Underfunded

- **Buy out/discontinuance basis**

  This is the amount of money needed to buy an insurance policy to pay your benefits. This would only be relevant if it was decided to wind up the Scheme. The actuary valued the Scheme as 100% funded on a buy out basis. This means that all members' benefits could have been secured in full if the Scheme had started winding up on 29 April 2005.

  100% funded

What is the Trustee doing to eliminate the deficit?

As a result of the valuation, it has been agreed that the participating employers will pay additional contributions each year (in addition to the cost of funding future benefits) to eliminate the shortfall over the next ten years.

We anticipate that you will have questions about the funding of the Scheme. We hope the information below will answer your questions.

How is my pension funded?

Active members and the participating employers pay contributions to the Scheme based upon members' pensionable salaries. The Scheme holds the money in a common fund from which it pays members' pensions when they retire.

If you pay additional voluntary contributions to the Selected Benefit Scheme then these contributions are also held in this common fund. Other AVCs and your Retirement Account (100+ Section only) are held separately with Standard Life.

How is the amount the Scheme needs worked out?

The Trustee obtains regular valuations of the benefits earned by members. Using this information and recommendations from the Scheme actuary, SELEX decides on the future contributions that must be paid to ensure there is sufficient money in the Scheme to pay the benefits.

Which funding basis is used?

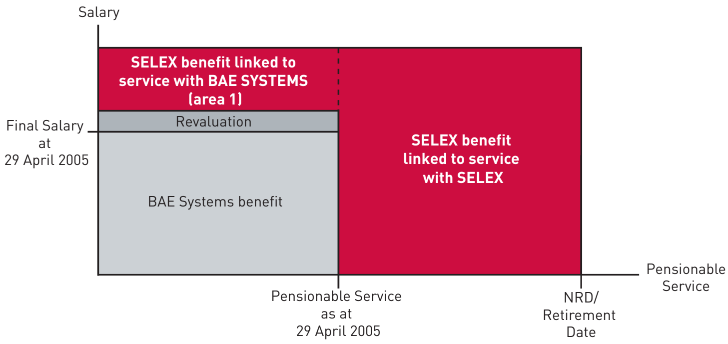
The ongoing basis is used to assess the amount needed to ensure the Scheme is adequately funded and to determine how much needs to be paid into the Scheme by participating employers and members. It assumes that SELEX will continue in business and support the Scheme.

The buy out basis is not used as it assumes that benefits will be secured by buying insurance policies. Insurers need to make a profit and therefore charge more to insure pensions than it costs the Scheme to provide benefits. This basis would be relevant if the Scheme wound up and the benefits needed to be insured.

Why did the Scheme have a deficit when it was set up?

You may be wondering why the Scheme had a deficit on an ongoing basis on 29 April 2005, even though no one had accrued any benefits. The reason is that members who joined the Scheme on 29 April 2005 have SELEX benefits which are linked to their BAE Systems benefits.

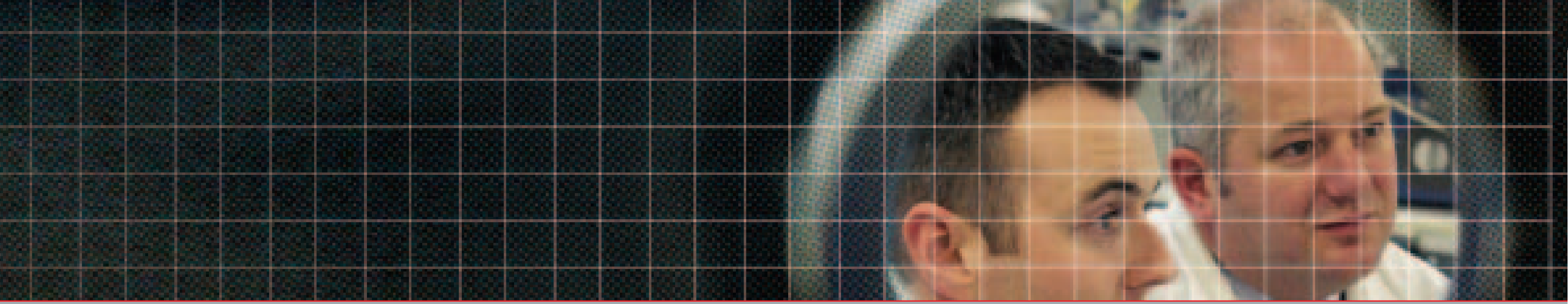
The following diagram shows how these benefits are structured:



The SELEX Pension Scheme will pay the benefits shaded red. The BAE Systems pension schemes will pay the benefits shaded grey.

You will see that the SELEX Pension Scheme will pay some benefits which are linked to your service in the BAE Systems scheme (marked as area 1 on the diagram). The amount of area 1 will depend on how much pensionable salaries of SELEX employees grow compared to inflation.

The actuary has estimated that the cost to the Scheme of paying the benefits highlighted in area 1 of the diagram will be £40.9 million, resulting in the deficit.



What would happen if the Scheme started to wind up?

We are legally required to tell you what would happen if the Scheme were to wind up. This does not mean that there is any intention to wind up the Scheme in the foreseeable future.

If the Scheme were to start to wind up, SELEX is required to pay enough into the Scheme to enable members' benefits to be insured with an insurance company. If SELEX is not able to pay the deficit (if any), the Pension Protection Fund (PPF) might be able to take over the Scheme and pay some compensation to members.

The PPF's main function is to provide compensation to members of eligible defined benefit (final salary) pension schemes, when there is a qualifying insolvency event in relation to the employer, and where there are insufficient assets in the pension scheme to cover the Pension Protection Fund level of compensation.

What would be the funding position of the Scheme at the current date?

The shortfall in assets in the Scheme is likely to be larger if the actuary were to carry out a funding valuation at the current date. This is because the interest rates that investors can receive by investing money have fallen since 29 April 2005 which means that the actuary would now calculate that the Scheme needs more money to pay benefits that have accrued to members. The interim investment strategy was not in place until December 2005 so the protection from the swaps contracts only took effect in relation to the changes in interest rates which occurred after that date.

In addition, employers' and members' contributions to the Scheme have only recently been increased to reflect the amount needed to be paid into the Scheme to reduce the shortfall and to meet the cost of benefits accruing.

When will the next valuation be carried out?

The next formal valuation is likely to be carried out with effect from 5 April 2008. This valuation will fall within the new legislation and will require the Trustee and employers to agree the funding basis.

The Trustee is monitoring the funding of the Scheme on a quarterly basis and will take action at an earlier date if necessary.

Other information

The law requires the Trustee to inform you that no payments have been made from the Scheme to any participating employers in the last 12 months.

If you are thinking of leaving the Scheme for any reason, you should consult a professional adviser, such as an independent financial adviser, before taking any action.

Remember, if you move house, keep the Trustee informed so you can continue to receive up to date information.

Contact details

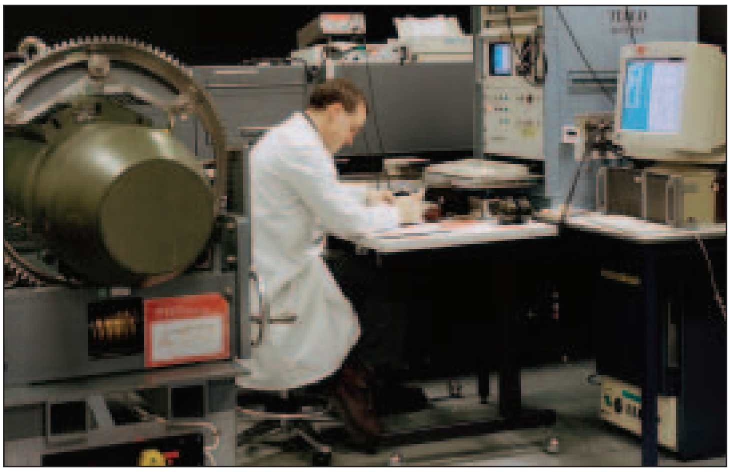
Pensions Helpline: **01772 677300**

Email: **selex.pensions@hr.xchanging.com**

Pensions Website: **www.selexpensions.co.uk**

Address: **SELEX Pension Scheme, Pensions Service Centre, Fulwood Park, Caxton Road, Fulwood, Preston, PR2 9NZ**

The majority of queries addressed to Xchanging are dealt with in two weeks. Some queries may take longer to process.



Disclaimer

The content of this newsletter is given for the purpose of providing you with information about the Scheme only and has no legal effect. The rules of the Scheme govern how the Trustee must act and if the rules of the Scheme are inconsistent with the information given in this newsletter, the rules will prevail. Copies of the rules are available from Xchanging.