LEONARDO

PENSIONS CONSULTATIVE COMMITTEE (PCC)
REPORT TO MEMBERS FOLLOWING THE MEETING ON 28 APRIL 2020

A meeting of the PCC took place via Webex conference call on 28 April 2020.

The PCC has been set up to discuss, co-ordinate, advise and represent the views of the members of the Leonardo Electronics Pension Scheme (LEPS). There are currently twelve representatives on the Committee and their contact details are attached to this Report.

The meeting was attended by:-

Jim Cull	Edinburgh (Chair)
James Fordyce	Edinburgh
Martin Johnson	Pensioner Representative (Deputy Chair)
Tony Kingsbury	Capability Green
Scott McMillan	Basildon
Stuart Rushworth	Capability Green
Tony Sheehan	Basildon
Jack Taylor	Capability Green
Scott Wallace	Edinburgh
Paul Wilton	Southampton
Andrew Letton	HR – Leonardo MW Ltd
Lucy Astbury	HR – Leonardo MW Ltd
Mike Nixon	Head of Pensions
Rachael Skuse	Pensions Manager
Louise Dale	DC Pension and Benefits Manager
Helen Thompson	Pensions Administration Manager

The meeting was held to receive feedback from the LEPS Trustee meeting on 31 March 2020.

<u>Chairman</u>

Tony Kingsbury had previously announced his retirement from the PCC with effect from 28 April 2020. The PCC would like to express their thanks to Tony for all his hard work as Chair of the PCC.

Jim Cull has taken over as Chair of the PCC with effect from the 28 April 2020 meeting. Martin Johnson will continue as Deputy Chair.

<u>New PCC representative</u>

Jack Taylor has been appointed as the new PCC representative from Capability Green.

<u>COVID-19 business continuity planning</u>

Pensions Management have been working with scheme advisers to prioritise tasks during the COVID-19 ‘lock down’, with focus on pensioner payroll, retirements, ill health applications, death cases, and investment activities. Key projects have also been highlighted including the actuarial valuation. Business continuity plans have been provided by key suppliers.

ELECTRONICS
Pension Scheme

Employer Covenant

Every six months, the Trustee's covenant adviser, Ernst & Young, provides a review of the financial strength of Leonardo MW Ltd and Leonardo SpA. At 31 December 2019, the financial position was assessed as remaining strong.

LMWL finance also provided updated commentary on the impact of the COVID-19 pandemic. It is a rapidly developing situation and has presented some challenges to working practices, although all the major sites remain open. The impact on production and delivery of orders remains under review.

Ernst & Young will continue to monitor the covenant strength provided by the business in the coming months, although it was noted that the covenant remains 'robust' with no immediate concerns identified.

Quarterly Funding Update to 31 December 2019

The quarterly funding update showed that the estimated surplus had increased from £134 million at 30 September 2019 to £146 million at 31 December 2019. The returns on the investment fund assets were higher than assumed.

The cost of new benefit accrual had decreased during the period from 30 September 2019 and 31 December 2019, due to a significant increase in real interest rate expectations over the period. The cost remains significantly higher than the contributions being paid to the Scheme, and the surplus is supporting this shortfall.

Post quarter end update

The funding position has deteriorated in the period since 31 December 2019 as a result of the COVID-19 pandemic, with investments falling amid unprecedented market conditions. The surplus will have reduced, and the cost of future accrual has increased. The Scheme has a risk-controlled investment strategy and therefore has ridden this volatility relatively well to date. The Trustee is seeking regular updates on the estimated funding position.

Pensions Regulator (tPR) Developments and Valuation preparation

A consultation has been launched on a new Funding Code of Practice. tPR is seeking a twin-track approach to funding with a fast track route based on meeting predefined tests and a bespoke route providing more flexibility. An assessment will be carried out as part of the 2020 valuation as to which route the Electronics Scheme would fall within when the Funding Code comes into effect (which will be after the 2020 valuation process).

The Company has engaged with the Trustee to open a discussion on possible options for addressing the current economic climate. The 5 April 2020 valuation date has fallen amid unprecedented circumstances causing a number of challenges for the Trustee and Company to work through as part of the valuation process. Consideration is being given to available flexibilities within the funding regime to help ensure the valuation process takes account of expected longer term conditions, in recognition of the fact that the current conditions are not anticipated to reflect the longer term position. The Regulator is expected to release guidance shortly which may assist in how it expects Trustees to approach 2020 valuation dates.

RPI change consultation

The Government has launched a consultation regarding a change in the calculation methodology for the Retail Prices Index (RPI) to align it with the Consumer Prices Index, including housing (CPIH) between 2025 and 2030. If the change proceeds, RPI is expected to be lower than previous levels.

The Trustee continues to assess, with the Scheme's advisers and the Company, what implications this may have for Scheme benefits, funding and investment strategy.

Annual Rates 2020

The following annual rates have been set by the Trustee:

- 2000 Section Credited Interest rate (used for SBS return and Basis 3 calculations) = 6.25%
- Main Section Underpin (Revaluation factor for IPA and Protected Rights Accounts) = 11.2%
- Shadow Earnings Cap = £170,400

Buy Up

The deadline for submitting Buy Up applications has now passed. 28 additional members have increased their accrual rates through Buy Up for 2020/21.

Liability Management

As previously reported, the Trustee has been exploring options to reduce risk and, following engagement with the Company, concluded that a 'buy-in' transaction would be appropriate for the Scheme.

A 'buy in' is an agreement with an insurance company under which a portion of the Scheme's assets are transferred to the insurer (equivalent to the value of the pensioner liabilities to be insured). There is then a cash flow from the insurer back to the Scheme for the monthly pension payments and the Scheme continues to pay the pensioners as normal. The 'buy in' does not give priority to any class of member over another.

The Trustee has now completed a c.£160 million buy-in with Just Group. The Trustee considered 'best and final' quotations from three insurers and concluded that Just was the most appropriate insurer to proceed with. There were significant challenges through the completion process as a result of the extremely volatile market conditions in mid-March 2020.

All pensioners have been written to, advising them that a buy-in has taken place and that they should continue to contact XPS as normal for any queries in relation to their pension. The Trustee is very pleased to have taken this step to improve the financial security of the Scheme for members.

Investment Performance

- The market value of the total assets of the Scheme at 31 December 2019 had increased to £1.08 billion.
- Investment performance of the return-seeking assets over the quarter had been 2.75% which was 1.8% ahead of objective. The returns over periods exceeding 3 years and since inception remain ahead of objective.
- The total performance measure (both the return-seeking and the matching assets) shows a -7.0% return which is -0.6% ahead of the benchmark (which looks at the change in the Scheme's liabilities). Over longer periods and since inception returns are now ahead of objective.

Market update since quarter end

Returns between 1 January 2020 and 31 March 2020 have been extremely challenging amid the COVID-19 outbreak and volatile market conditions.

However the Scheme's risk controlled investment strategy has meant that return seeking assets have dropped 60% of the value they would have dropped if they had been invested purely in equities.

River & Mercantile have been in regular contact with Pensions Management and the Trustee throughout this period, engaging in detailed discussion on their investment strategy and adapting the portfolio as required to address market conditions. The portfolio is defensive at the current time, in recognition of the risks of a further downturn, whilst preparing for the potentially significant investment opportunities which may arise as markets recover and in light of the unprecedented financial stimulus.

Allocation of Assets

At 31 December 2019 the Trustee held 61% of the Scheme's assets "on-risk" and 39% "off-risk". On-risk assets are those seeking to generate an investment return (e.g. equities, property, high yield bonds). Off-risk assets are those seeking to manage risk and match Scheme liabilities (e.g.: Government gilts, cash).

Active Structured Equity & Cashflow Matching

River & Mercantile have provided proposals to the Trustee on two new asset strategies to add to the portfolio.

The first is active structured equity, which seeks to provide equity like returns but with downside protection using equity options. This is a good method of getting back on-risk, whilst not exposing the portfolio to further falls in equity markets.

The second is cashflow matching which involves a portfolio of corporate bonds which mature at different terms thereby providing an income to the Scheme which matches the expected outflow of pension payments at a series of future dates.

Investment Management tender process

The Trustee has engaged Lane, Clark & Peacock (LCP) to manage an investment management tender process, in line with the requirements of the Competitions and Markets Authority (CMA). Five providers submitted tenders (including River & Mercantile) which have been analysed against the current service provision. The process is close to conclusion.

Administration

MyPension.com/LEPS

53% of active members have now logged onto MyPension.com/LEPS, the interactive website provided by XPS Administration. If you log onto MyPension.com you can view and update your personal details, update your Expression of Wish form, view your DC savings and make investment switches, and run retirement quotations (active members only).

If you have misplaced your login details please contact XPS Administration by emailing LEPS@xpsgroup.com.

Joint DC investment committee meeting

A joint DC investment committee meeting of the Leonardo UK pension schemes was held on 4 March 2020. The Leonardo Electronics Pension Scheme benefits which are invested in the common DC strategy are the Additional Voluntary Contributions and the 100+ Retirement Accounts.

Investment performance

The majority of the River and Mercantile ‘blend funds’ (which make up the default fund in the DC investment strategy) had out-performed their long term targets both since the inception of the funds and over the quarter.

During Quarter 1 2020 markets have been extremely volatile due to COVID-19. However the Blend Funds (where the majority of members are invested) have experienced losses of considerably less than those experienced by the Global Equity fund. The investment position continues to be closely monitored.

Environmental, Social and Governance (ESG) fund

Following the results of the member survey last year, the Trustee is implementing a new ESG fund which will be available via the DC Pick and Mix funds. This fund has a climate ‘tilt’ and selects best practice firms (rather than excluding certain industries). Further information will be available once the fund is launched.

Membership

52% of active pension scheme members across Leonardo MW Ltd are now in FuturePlanner, with 63% of the active FuturePlanner members working within the Electronics division.

<u>Date of the Next Meeting</u>

The next meeting of the PCC is scheduled for 7 July 2020.

Contact Details

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