

BAE Systems Pension Scheme

Important information about your savings in the Selected Benefits Scheme (SBS)

We are writing to provide an update on the Additional Voluntary Contributions (**AVCs**) you have paid into the Selected Benefits Scheme (**SBS**) while a member of the BAE Systems Pension Scheme (BAE Systems Section) – 2000 Plan benefits (**the Scheme**).

This communication explains:

- how the SBS arrangement works;
- what influences your SBS fund;
- what AVC options are available to you; and
- how your AVCs can be used at retirement.

You do not need to take any action, however you may wish to review your AVC investments to ensure these remain appropriate and support your retirement plans.

Please note that information provided in this communication about AVC investment options is for **general information purposes only**. It is not intended to constitute financial advice, nor should it be relied upon as such. Neither BAE Systems, the Scheme's Trustee nor any of its advisers can provide investment advice and cannot recommend any particular investment option. If you are considering changes to your AVC investments, you should ensure you understand the risks and seek independent financial advice if you are unsure about the options available or what may be most suitable for your individual circumstances.

Understanding your benefits in the SBS

Your SBS fund is invested alongside the Scheme's assets. Your SBS fund receives interest each year, known as 'Credited Interest'. This increase is based on the Scheme's actual investment performance, with a minimum guaranteed return of **2.5% per year**.

The Scheme's investment performance depends on prevailing financial market conditions and the investment strategy of the Scheme. In general, defined benefit pension schemes invest in lower risk (and therefore lower returning) assets as they mature. The Scheme has significant investments in government bonds, as these are a very good match for pensioner payments. Financial conditions over recent years, in particular rising interest rates on government bonds, has reduced the value of the Scheme's assets. This means that investment returns in recent years have been lower than they were historically and that trend is expected to continue.

The financial conditions described above haven't negatively impacted the Scheme's funding position as these conditions also reduce the value of the Scheme's liabilities. Indeed, the Scheme's funding level has increased

from 100% as at 31 March 2021 to 104% as at 31 March 2024. You can find out more about the Scheme's funding position by reading the recent Funding Update and Annual Review Newsletter, which are both available on OneView (www.contactpensionsadmin.com/baes) under **Scheme Information > Newsletters/Funding Updates**.

What does this mean for your SBS fund?

As described above, in recent years the Scheme's investment returns have been lower than 2.5% per year meaning that the Credited Interest guarantee of 2.5% per year has been awarded.

Due to the Scheme paying this interest even in years when the Scheme's investment returns have been lower than this, a shortfall has emerged between the money invested to meet SBS benefits, and the benefits promised to members (as 2.5% was still awarded in years when the Scheme's actual returns have been less than this).

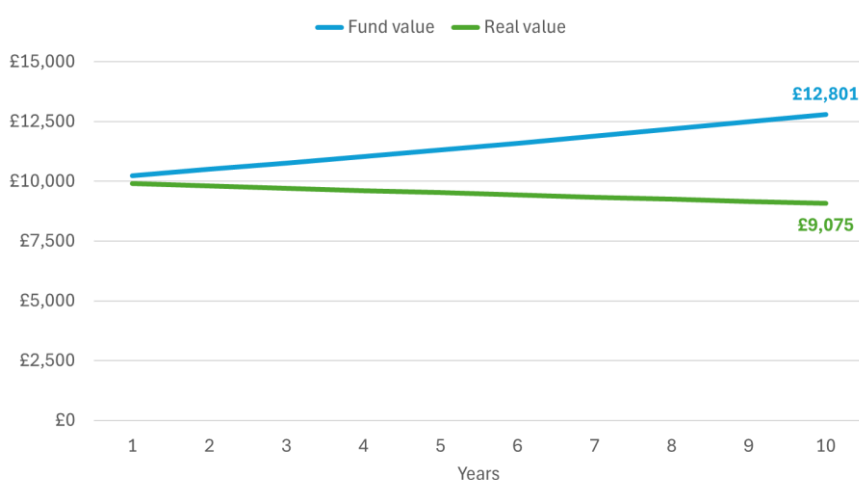
In the future, if the Scheme's investments earn more than 2.5% per year, the extra returns will be used to remove this shortfall. It could take many years to remove the shortfall and only once this is removed could Credited Interest potentially be more than 2.5% for a given year.

Based on current assumptions, the Scheme Actuary estimates that it will be around 10 years before the Scheme can provide Credited Interest above 2.5%. Please note this is only an approximate estimate and is sensitive to changes in assumptions and the amount of money paid into and out of the SBS over that time.

What does this mean in real terms?

As explained in your 2025 Annual Benefit Statement, the Trustee's current long-term assumption for inflation is **3.5% per year**. This means that in real (inflation-adjusted) terms the value of your SBS fund is expected to fall by around 1% per year and this is expected to continue in the near term before potentially improving in the longer term. As you may have noticed from your statement, this means that when valuing your projected fund, your estimated SBS fund at age 65 may be lower than the current value, in real terms.

The following chart is an illustrative example of how expected returns on an SBS fund worth £10,000 today could be eroded by inflation over a period of 10 years.



The **blue line** shows how an SBS fund of £10,000 would increase by 2.5% per year and would be **£12,801** in 10 years' time. The **green line** shows how this could be impacted by a long-term inflation assumption of 3.5% per year. This shows that in real terms the fund would be worth **£9,075** (based on the cost of living in 10 years' time, meaning it would be worth less than it is today).

The purpose of the chart is to illustrate the principle that when long-term inflation is expected to be higher than the investment return, the real purchasing power of your fund may reduce over time, even though the fund increases each year in cash terms.

This helps explain why inflation is an important part of understanding how pension savings may change in value in the future.

Please note that this assumed rate of inflation is used by the Trustee for planning and funding purposes. It is a long-term smoothed assumption based on expected average inflation over many years. In reality, actual inflation does not move in a straight line, it will vary from year to year, sometimes significantly, and will almost certainly differ from the assumed 3.5% in any individual year. The inflation figure used here is therefore not a prediction, but an assumption taken at a point in time for the purpose of long-term planning. For information, the most recently published inflation figure from the Office for National Statistics for the rise in the Consumer Prices Index was **3.4%** (for the year to December 2025).

Are there any alternative AVC options?

As a member of the Scheme you also have the option to pay AVCs into an alternative arrangement called the **BAE Systems Additional Retirement Savings Plan**, which is a separate defined contribution arrangement through the **Mercer Master Trust**. You can commence (or cease) contributions to this arrangement at any time during your employment should you wish. This arrangement offers:

- a range of investment options, from low-risk cash or bond funds to higher-risk growth funds, allowing members' personal risk attitudes to be reflected;
- investment performance based on your chosen fund(s), rather than the Scheme's asset returns; and
- greater flexibility at retirement, including drawdown, lump sum, or annuity options, as well as the option to transfer these funds back into the Scheme on your retirement to fund your tax-free cash option in the Scheme.

The BAE Systems Additional Retirement Savings Plan operates a default investment strategy which means that your AVCs would be invested in the **Mercer SmartPath – Target Cash Path**. This is designed to move your investments from growth assets (like stocks and shares) to lower risk assets (such as bonds) as you get closer to your retirement date, with the target that when you get to retirement all of your fund is invested in cash.

However, you are able to actively select other fund options in the Mercer Master Trust should you wish to, ranging from funds that target lower risk capital preservation to higher risk growth options. Full details of the available funds, including their recent performance, can be found in the fund factsheets available at scottishwidows.co.uk/save/baesarsp

As an example, the **Mercer Active Money Market Fund** targets capital preservation and has returned 4.58% over the 12 months to 30 September 2025 (net of fees). Of course, past performance is no guarantee of future performance, this is simply illustrating an alternative AVC option.

Please note that if you choose to cease future contributions to the SBS this would not affect funds already built up. Your SBS fund would remain within the Scheme and would continue to receive Credited Interest each year. Separately, you have the option to transfer your SBS fund to another pension arrangement (please see below).

What are your options for using your AVCs at retirement?

At retirement, your AVC fund, whether held in the SBS arrangement or the BAE Systems Additional Retirement Savings Plan, can normally be used in several ways:

- take it as tax-free cash, subject to HMRC limits;
- use it to buy additional pension (within the Scheme for SBS funds or for the BAE Systems Additional Retirement Savings Plan by purchasing an annuity via an insurance company); or
- for AVCs held in the BAE Systems Additional Retirement Savings Plan you can access your funds flexibly, including flexible drawdown or full withdrawal, or a combination of different options.

Can you transfer your SBS fund to another pension scheme?

You have the option to transfer your SBS fund to another pension arrangement. However, please note that if you transfer your SBS fund before retirement a Market Value Adjustment (**MVA**) would be applied. The MVA reflects the difference between the guaranteed value of your SBS fund and the underlying asset value. Currently, the assets within the SBS are insufficient to fully cover the guaranteed payments owed to members, resulting in a funding level below 100%. Reflecting this position, the MVA is currently **0.727** and is reviewed every year by the Trustee and subject to change each year. The MVA would apply to any transfer, including if you were to choose to transfer your SBS fund to the BAE Systems Additional Retirement Savings Plan.

Please note that no MVA is applied if you transfer your SBS fund at retirement or up to 12 months after retirement.

Where can you find more information?

For more information about AVCs (including how to start, stop or amend AVC payments) please read the **Paying AVCs** guide available at baesystems.com/pension-guides

You can find more information about the SBS by reading the **SBS Member Booklet** available at baesystems.com/pension-booklets

Fund details and recent performance information for the BAE Systems Additional Retirement Savings Plan is available at scottishwidows.co.uk/save/baesarsp

If you are considering transferring your AVCs or changing your contributions, you may wish to seek independent financial advice. You can find a regulated financial adviser by going to unbiased.co.uk

On Behalf of the Trustee of the BAE Systems Pension Scheme
January 2026