

**THALES UK PENSION SCHEME**

**ANNUAL REPORT AND FINANCIAL STATEMENTS**

**FOR THE YEAR TO 31 DECEMBER 2017**

**Section 1 – PSR 19011001**

**Section 2 – PSR 19011002**

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## Scheme Employers, Service Providers and Advisors

### **Principal Employer (the "Employer")**

Thales UK Ltd

### **Participating Employers**

<b>Section 1</b>	<b>Section 2</b>
Thales UK Ltd	Thales UK Ltd
Thales Transport & Security Ltd	Thales Transport & Security Ltd
Thales Rail Signalling Solutions Ltd	Thales Training & Simulation (Eagle) Ltd
	Thales Training & Simulation (Ace) Ltd
	Thales Training & Simulation (Merlin) Ltd
	Thales Rail Signalling Solutions Ltd

### **Scheme Actuary**

Mr Mark Condron FIA  
Mercer Limited  
1 Tower Place West  
London  
EC3R 5BU

### **Independent Auditor**

Deloitte LLP  
Statutory Auditor  
London  
United Kingdom

### **Investment Managers**

Alcentra  
Allianz Global Investors (Acquired Rogge Global Partners plc June 2016)  
Alpha Real (Appointed Jan 2017)  
Ancala  
Aviva Investors (Appointed December 2017)  
AQR Capital Management  
BlackRock  
Brigade Capital Management  
CarVal  
Credit Suisse Asset Management  
Equitix Ltd  
Highbridge Capital Management (Appointed December 2017)  
Hosking  
Legal & General Investment Management Ltd (LGIM)  
Majedie Asset Management  
MedicX Healthfund II  
M&G Investments  
Orchard Global Asset Management  
Standard Life Investments  
TIAA-CREF (rebranded Nuveen)  
Wadhvani Asset Management (Appointed Jan 2017)

## **Scheme Employers, Service Providers and Advisors (Continued)**

### **Additional Voluntary Contributions (AVC) Providers**

Phoenix life Limited  
Equitable Life Assurance Society  
Scottish Widows  
MGM Assurance  
Prudential  
Friends Provident  
Clerical Medical Investment Group Limited  
Zurich Assurance Limited

### **Legal Advisor**

Gowling WLG (UK) LLP  
4 More London Riverside  
London  
SE1 2AU3

### **Scheme Administrator**

Equiniti Paymaster Ltd  
Sutherland House  
Russell Way  
Crawley  
RH10 1UH

### **Investment Consultants**

Momentum Investment Solutions & Consulting  
Arundel House  
1 Farm Yard  
Windsor, SL4 1QL

### **Covenant Advisor**

Lincoln Pensions  
9th Floor  
6 Bevis Marks  
London  
EC3A 7BA

### **Tax Advisor**

Deloitte LLP  
Hill House  
1 Little New Street  
London  
EC4A 3TR

### **Investment Custodians**

The Northern Trust Company  
50 Bank Street  
Canary Wharf  
London  
E14 5NT

## **Scheme Employers, Service Providers and Advisors (Continued)**

### **Bankers**

Lloyds Bank,  
City Office,  
P.O. Box 72,  
Bailey Drive,  
Gillingham Business Park,  
Kent.  
ME8 0LS

### **Life Assurance Insurers**

Ellipse (Spouses Pension and Death in Service Lump Sum)  
15 Bermondsey Square  
London  
SE1 3UN

### **Secretary to the Trustee**

Philip Cameron

### **Contact for further information**

Philip Cameron, Secretary to the Trustee  
[philip.cameron@uk.thalesgroup.com](mailto:philip.cameron@uk.thalesgroup.com)  
C/o Thales UK Ltd  
350 Longwater Avenue  
Green Park  
Reading  
RG2 6GF

## **TRUSTEE'S REPORT**

### **Introduction**

Thales Pension Trustees Ltd ("the Trustee") of the Thales UK Pension Scheme (the "Scheme") is pleased to present its report together with the financial statements for the year ended 31 December 2017. The Scheme is a Defined Benefit scheme governed by a definitive Trust Deed dated 30 June 2008 and subsequent amendments.

The Scheme has two separate sections; Section 1 formed from the transfer of the four former Racal schemes and the Thales Optronics Scheme and Section 2 formed from the two former Thompson schemes, the Vinten Scheme and the active members of the Avimo Scheme. The two Sections are administered, valued and accounted for in their own right.

### **Management of the Scheme**

Exceeding the requirements of the Occupational Pension Scheme (Member-nominated Trustees and Directors) Regulations 2006 (to have at least one third of the Trustee Directors appointed by the membership), half of the Trustee Directors are appointed by Thales UK Ltd, and half are appointed by the active and pensioner membership. The current member nominated Trustee Directors are scheduled to serve until October 2020, for the three Section 1 positions and October 2021, for the three Section 2 positions.

During the year under review and after the year end the Trustee of the Scheme has been Thales Pension Trustees Ltd, whose Directors are:

Lord Roger Freeman (Employer Nominated) (Chair) Resigned 1 December 2017  
Peter Rowley (Employer Nominated) Appointed Chair 13 December 2017  
Phil Naybour (Employer Nominated)  
Colin Milbourn (Member Nominated)  
Joelle Dumetz (Member Nominated)  
Ken McSweeney (Employer Nominated)  
Robert Scallon (Member Nominated) Resigned 13 October 2017  
Paul Corris (Member Nominated)  
William John Twigg (Member Nominated)  
Nigel Baldwin (Employer Nominated)  
Helen Depree (Employer Nominated)  
Robert Trotter (Member Nominated)  
Steven Murray (Employer Nominated) Appointed 1 December 2017  
Niall Mitchell (Member Nominated) Appointed 13 October 2017

The Member Nominated Trustee Directors may be removed before the end of their term only by agreement of all remaining Trustee Directors, although their appointment ceases should they cease to be an active or pensioner member of the Scheme. In accordance with the Trust Deed, the Employer, Thales UK Ltd, has the power to appoint and remove the Employer Nominated Directors.

The Scheme is provided for all eligible employees of the Employer and the Participating Employers detailed on page 3. The Employer's registered address is 350 Longwater Avenue Green Park Reading RG2 6GF.

## **TRUSTEE'S REPORT (CONTINUED)**

### **Financial Developments**

The financial statements on pages 36 to 61 have been prepared and audited in accordance with the Regulations made under Sections 41 (1) and (6) of the Pensions Act 1995.

During the year the Scheme's assets increased by £98,909,000. This was as a result of a net return on investments of £146,881,000 and contributions and other income of £90,341,000 being offset by benefits and expenditure payments of £138,313,000.

The latest formal valuation of the Scheme was undertaken as at 31 December 2014, and approved by the Scheme Actuary on 16 September 2016.

The Scheme is currently in the process of conducting an actuarial valuation with an effective date of the 31 December 2017.

### **Report on Actuarial Liabilities**

As required by FRS 102, the financial statements do not include liabilities in respect of promised retirement benefits.

Under Section 222 of the Pensions Act 2004, every scheme is 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, assessed using the assumptions agreed between the Trustee and the Employer and set out in the Statement of Funding Principles, which is available to Scheme members on request.

The most recent full actuarial valuations of Sections 1 and 2 of the Scheme were carried out as at 31 December 2014. This showed that on that date:

	Section 1	Section 2
The values of the Technical Provisions were:	£2,257 million	£695 million
The values of the assets at that date were:	£1,590 million	£526 million
Deficit	(£667) million	(£169) million
Funding Level	70%	76%

### **Section 1**

The Trustee and Employer have agreed that from 16 September 2016 the Employer will contribute as follows:-

16.8% of members' Career Average Revalued Earnings (CARE) Salaries, plus £48.2m per annum, payable in monthly instalments for the period 16 September 2016 to 31 December 2028, plus £2m per annum in respect of ongoing administration expenses and amounts equal to the PPF levies.

As part of the 2014 Valuation the Trustee entered into a deed with the Employer agreeing that adjusted contributions would be payable from 31 December 2017 if particular funding level triggers were breached. These funding level triggers were breached and therefore in accordance with the deed the employer will commence paying an additional £11.5m pa from January 2018.

## TRUSTEE'S REPORT (CONTINUED)

### **Report on Actuarial Liabilities (Continued)**

The Scheme Actuary carried out a funding update as at 31 December 2016. The funding update of Section 1 showed that on 31 December 2016 the funding position was as follows:-

Assets	£1,816m
Amount assessed as needed to provide benefits ("Liabilities")	£2,741m
Deficit	(£925m)
Funding level	66%

### **Section 2**

The Trustee and Employer have agreed that from 16 September 2016 the Employer will contribute as follows:-

16.8% of members' CARE Salaries (Pensionable Salary for former Category 1 Thomson Pension Plan members), plus £11.8m per annum, payable in monthly instalments for the period 16 September 2016 to 31 December 2028, plus £1m per annum in respect of ongoing administration expenses and amounts equal to the PPF levies.

As part of the 2014 Valuation the Trustee entered into a deed with the Employer agreeing that adjusted contributions would be payable from 31 December 2017 if particular funding level triggers were breached. These funding level triggers were breached and therefore in accordance with the deed the employer will commence paying an additional £3.5m pa from January 2018.

The Scheme Actuary carried out a funding update as at 31 December 2016. The funding update of Section 2 showed that on 31 December 2016 the funding position was as follows:-

Assets	£609m
Amount assessed as needed to provide benefits ("Liabilities")	£891m
Deficit	(£282m)
Funding level	68%

The method and significant actuarial assumptions used to determine the technical provisions are as follows (all assumptions adopted are set out in the Appendices to the Statements of Funding Principles):

#### ***Method***

The actuarial method to be used in the calculation of the technical provisions is the Projected Unit Method.

#### ***Significant actuarial assumptions***

***Discount interest rate:*** 3.65% per annum at 31 December 2014. The discount rate reflects the expected change in the investment strategy as the Scheme matures and is expressed as a single equivalent rate over the lifetime of the Scheme.

The expected return on the assets in the discount rate assumptions was set based on a realistic asset return model at a level of prudence deemed appropriate.



## **TRUSTEE'S REPORT (CONTINUED)**

### **Report on Actuarial Liabilities (Continued)**

**Future Retail Price inflation (RPI):** 3.1% per annum at 31 December 2014. The RPI assumption takes into account information available in respect of UK government bond markets at the effective date of the actuarial valuation.

**Future Consumer Price inflation (CPI):** 2.4% per annum at 31 December 2014. The assumption for future CPI is set by reference to the RPI assumption and allows for a prudent view of the expected long term gap between RPI and CPI (at 31 December 2014, this long term gap was set at 0.7% per annum).

**Pension increases:** derived from the rates for future retail and consumer price inflation allowing for the caps and floors on pension increases according to the provisions in the Scheme's rules.

**Mortality:** Generally SAPS ("S2 pensioner tables") series with a 99% multiplier for males and a 101% multiplier for females, based on member's year of birth and projected in line with the CMI 2014 Core Projections model with a long term trend of 1.5% p.a. For former members of the Racal Group Executive Pension Plan and of the Racal Group Executive Manager and Senior Manager Pension Scheme a base table of SAPS Light ("S2 Light pensioner tables") series with a 97% multiplier for males and a 76% multiplier for females was assumed.

### **Recovery Plans**

The valuations of Section 1 and Section 2 as continuing Schemes revealed past service deficits as at 31 December 2014 of £667 million and £169 million, respectively. To eliminate these deficits, the Employer is making a series of additional contributions, as set out in the Schedules of Contributions, which are targeted to eliminate the deficit by 31 December 2028.

Taken in conjunction with the assumed rate of investment return on the invested assets, the Actuary certified that he expected the targets of full funding against the ongoing valuation assumptions to be achieved on payment of the above contributions.

The Employer has also agreed to make further special contributions, if applicable, to cover certain adverse deficit outcomes as at 31 December 2020.

In the unlikely event that the Employer ceased paying contributions to the Scheme ("discontinuance"), the Trustee could seek to meet benefits payments by winding up the Sections. The terms available from insurance companies at 31 December 2014 were such that, based on each Section's assets and liabilities at that date, the premiums charged to secure accrued rights in full would have exceeded the value of each Section's assets.

### **Member Contributions**

Member contributions are made in line with the Scheme rules, 9% of CARE Salary up to £40,040 and, in excess of that, 12%. Member contributions are paid through Salary Sacrifice.

### **Pensions Increases**

There have been no pension increases other than those required either by statute, or by reference to the Scheme Rules.

## **TRUSTEE'S REPORT (CONTINUED)**

### **Governance and Risk Management**

The Trustee has in place an annual business plan which sets out its objectives in areas such as administration, investment, funding and communication. It covers all regular aspects of the Scheme management and any ongoing major projects. In addition, the Trustee has dedicated sub-committees made up of Directors of the Trustee which focus on Operations, Governance and Investment matters, all of which meet at least quarterly.

The Trustee has an ongoing process of assessing the risks which face the Scheme, and putting in place mitigating actions. Relevant risks are reviewed at each Trustee and sub-committee meeting.

The Trustee manages the governance of the Scheme by the use of an electronic system called eShare. This system allows the Trustee to store Scheme documentation, share meeting papers and make decisions, electronically, allowing for more robust record keeping. It also houses the Scheme risk register.

### **Trustee Knowledge and Understanding**

The Pensions Act 2004 requires the Trustee Directors to have sufficient knowledge and understanding of pensions and trust law and be conversant with the Scheme documentation. All Trustee Directors are required to successfully complete the Pension Regulator Trustee Toolkit. In addition the Trustee Directors receive regular training from its advisors in order to maintain high standards of knowledge and understanding, and maintain a record to ensure this is managed effectively.

### **Pension Protection Fund**

The Pension Protection Fund (PPF) Levy currently consists of two parts: a scheme based levy, based on the Scheme's PPF liabilities, and a risk-based levy, based on the level of underfunding in the Scheme and the risk of the Employer becoming insolvent.

The Scheme has met all levy requests from the PPF, as detailed in Note 8 of the Financial Statements. The Scheme received contributions from the Employer to cover the cost of the PPF levy as disclosed in note 3 to the Financial Statements.

### **Scheme Changes**

The Scheme's Annual Report and Accounts 2016 ("2016 ARA") set out in some detail (see page 13 of that document) the changes which were made in relation to the indexation of benefits for future Pensionable CARE Service on and from 1 April 2017. Amendments were made to the Scheme's Rules so that CPI applies for the calculation of CARE pension increases and Special CARE pension revaluation in respect of such pensionable service from that date. RPI continues to be used in relation to benefits already built up by reference to Pensionable CARE Service before that date.

As anticipated in the 2016 ARA, a further deed of amendment was executed on 8<sup>th</sup> November 2017. This deed sets out the future change to indexation in full detail. It also makes changes to the calculation of the Pensions Deduction (an offset which reduces a member's pension amount) under the Scheme Rules in order to ensure that the Scheme continues to meet the auto-enrolment requirements.

## **TRUSTEE'S REPORT (CONTINUED)**

### **General Legal Update**

The Trustee worked with its legal advisers to ensure that the Scheme was compliant with the General Data Protection Regulation (GDPR) by 25<sup>th</sup> May 2018. This involved entering into contract updates with the Scheme's third party service providers, reviewing how the Scheme deals with member personal data, and issuing a 'privacy notice' to members explaining how the Scheme deals with such data.

Under the UK's anti-money laundering legislation, certain pension schemes have to register with HMRC's Trust Registration Service. This year, due to certain taxes being applicable to the Scheme's investments, the obligation applied to the Scheme and registration was completed within the required timeframe.

In March 2018, the Government issued a White Paper called "*Protecting Defined Benefit Pension Schemes*". The paper sets out a number of measures which the Department of Work and Pensions (DWP) intends to take forward through further consultation and action. These include: new powers for the Pensions Regulator, a revised code on scheme funding, a requirement for a Chair's Statement in relation to defined benefit arrangements (as currently exists in relation to defined contribution arrangements), and facilitating greater consolidation of smaller schemes. The paper also rules out any Government legislation which would automatically replace RPI (where it applies in a scheme's rules) with another index for pension increases and deferred revaluation. Some parts of the pensions industry had been asking for such an override of a pension scheme's rules, but the DWP will not take that proposal further.

**The above is only a summary of changes made to the Scheme. The Trustee is required to follow the Trust Deed and Rules and cannot pay benefits other than in accordance with the Rules dated 30 June 2008 (as amended).**

**Pensions are a complicated subject and decisions you make in relation to your pension arrangements are important. You should consider taking independent financial advice before making any pensions related decisions.**

**TRUSTEE'S REPORT (CONTINUED)**

**Membership Movements**

The membership reconciliation for the reporting period is detailed below.

Thales UK Pension Scheme - Section 1 membership movements	Active	Deferred	Total Pensioners (Pensioners + Dependants + Children)	Pensioners	Pensioner Dependants	Pensioner Children
<b>Number as at 1 January 2017 (Brought forward numbers from 2016 Accounts)</b>	<b>850</b>	<b>5,149</b>	<b>7,669</b>	<b>6,128</b>	<b>1,535</b>	<b>6</b>
<b>Adjustments*</b>	<b>-3</b>	<b>-11</b>	<b>-33</b>	<b>-17</b>	<b>-16</b>	<b>-</b>
New Entrants	-	-	103	-	103	-
Death in Service	-2	-	-	-	-	-
Death in Deferment	-	-14	-	-	-	-
Death in Retirement	-	-	-271	-195	-76	-
Child Pension Ceasing	-	-	-1	-	-	-1
Retirements from Active	-29	-	29	29	-	-
Retirements from Deferred	-	-189	181	181	-	-
Leavers - Deferred	-43	47	-	-	-	-
Leavers - Opt Out	-	-	-	-	-	-
Retirements (full commutation)	-	-23	-8	-	-8	-
Transfers Out	-	-71	-	-	-	-
<b>Number as at 31 December 2017</b>	<b>773</b>	<b>4,888</b>	<b>7,669</b>	<b>6,126</b>	<b>1,538</b>	<b>5</b>

## TRUSTEE'S REPORT (CONTINUED)

Thales UK Pension Scheme - Section 2 membership movements	Active	Deferred	Total Pensioners (Pensioners + Dependants + Children)	Pensioners (Retired)	Pensioners (Dependant)	Pensioners (Children)
<b>Number as at 1 January 2017 (Brought forward numbers from 2016 Accounts)</b>	959	1,778	2,817	2,435	371	11
<b>Adjustments*</b>	-3	-4	-3	-2	-1	0
New Entrants			27		27	0
Death in Service	-4					
Death in Deferment		-1				
Death in Retirement			-59	-47	-12	
Child Pension Ceasing			-1			-1
Retirements from Active	-43		43	43		
Retirements from Deferred		-100	100	100		
Leavers - Deferred	-35	35				
Leavers - Opt Out						
Retirements (full commutation)		-5	-1	-1	0	
Transfers Out		-22				
<b>Number as at 31 December 2017</b>	874	1,681	2,923	2,528	385	10

\*Relates to members whose status changed in the previous reporting year but their records weren't updated until after the year end.

Total pensioners are a sum of the three columns in beige.

Members who elected to join the Enhanced DC category on the 31/12/07 are classified as deferred members.

Members whose benefits are funded by annuity policies are included in the above tables.

### Annuity policies

The Trustee holds insurance policies that secure pensions payable to specified beneficiaries. While these policies remain assets of the Trustee, the Trustee has assessed that they are not material and have therefore not valued and disclosed these policies in the Statement of Net Assets.

## **TRUSTEE'S REPORT (CONTINUED)**

### **INVESTMENTS**

#### **General**

The Trustee has sole responsibility for establishing and reviewing the investment strategy including setting objectives and the allocation to each asset class. The Trustee delegates the selection and monitoring of fund managers to the Investment Sub Committee.

The Investment Sub Committee monitors the assets of the two sections of the Thales UK Pension Scheme. In broad terms, the two Sections follow the same investment strategy.

During the course of the accounting period, the investment managers have been:

Alcentra

Allianz Global Investors (Acquired Rogge Global Partners plc June 2016)

Alpha Real (Appointed Jan 2017)

Ancala

Aviva Investors (Appointed December 2017)

AQR Capital Management

BlackRock

Brigade Capital Management

CarVal

Credit Suisse Asset Management

Equitix Ltd

Highbridge Capital Management (Appointed December 2017)

Hosking

Legal & General Investment Management Ltd (LGIM)

Majedie Asset Management

MedicX Healthfund II

M&G Investments

Orchard Global Asset Management

Standard Life Investments

TIAA-CREF (rebranded Nuveen)

Wadhvani Asset Management (Appointed Jan 2017)

#### **Investment Policy**

The Trustee is responsible for determining the Scheme's investment strategy. In accordance with section 35 of the Pensions Act 1995 (as amended by the Pensions Act 2004) the Trustee has produced a Statement of Investment Principles ("SIP"). A copy of the SIP can be provided upon request. The main priority of the Trustee when considering the investment policy is to ensure that the commitment made in respect of members' pensions may be fulfilled. Investments are spread by type of investment (equities, bonds etc.), by geography, and across numerous investment managers. Spreading the investments in this way reduces the risk of a sharp fall in one particular market having a substantial impact on the Scheme's total assets.

## **TRUSTEE'S REPORT (CONTINUED)**

### **Investment Objectives**

In setting the Scheme's investment objectives the Trustee has obtained and considered advice from the Scheme's Actuary and Investment Consultant. However, the ultimate responsibility of deciding investment policy lies solely with the Trustee. Although the Scheme is made up of two sections the Investment Objective and General Investment Policy are appropriate for both sections.

The Funding Objective set by the Trustee is for the Scheme to be 100% funded on a technical provisions basis. An additional objective is to invest in assets which generate significant cashflows which can be used in the payment of benefits.

The Investment Objective agreed by the Trustee in consultation with the Employer as part of the 2014 Actuarial Valuation is divided into three distinct phases, each with its own return target, as outlined in the table below:

Phase	Duration	Return Target
1	12 years	Gilts + 3% per annum
2	8 years	Linear reduction until Phase 3
3	Onwards	Gilts + 0.75% per annum

Phase 1 commenced in 2014, at the conclusion of the Actuarial Valuation, and is expected to end in December 2026. Following this, Phase 2 will begin and will be effective until December 2034. During Phase 2, the return objective will reduce linearly at a rate of c. 0.28% per annum until 2034 when the return objective will be equal to Gilts + 0.75% per annum. From December 2034 onwards, Phase 3 begins and the return objective will remain constant at Gilts + 0.75% per annum.

The Trustee will target the above returns while also maintaining an efficient portfolio of assets in terms of risk adjusted returns.

The expected excess return target may be achieved from return sources including active management and funding level improvements due to yields increasing ("yield reversion") in addition to the excess return generated by the Scheme's assets.

### **Strategic Asset Allocation**

As part of the Actuarial Valuation in 2014, in agreement with the Employer, the Trustee developed a Strategic Asset Allocation for Phase 1 to achieve the return objective while simultaneously maintaining a suitably diversified portfolio. The Strategic Asset Allocation categorises assets by their fundamental characteristics and for each category the Trustee has set a target allocation range. The Trustee regularly monitors the Scheme asset allocations to ensure they remain in accordance with the Strategic Asset Allocation. The table below summarises the target asset allocation ranges by asset category and investment managers for the Scheme in Phase 1:

## TRUSTEE'S REPORT (CONTINUED)

Asset Category	Managers	Allocation Range (%)
Quoted Equity	AQR, Hosking, LGIM, Majedie	27-35
Credit and Higher Yielding Credit Like Alternative Assets	Alcentra, AllianzGI, BlackRock, LGIM	22-32
Liquid Alternatives	AQR, Brigade, CarVal, Credit Suisse, Wadhwani	7-14
Illiquid Assets	Alpha Real, Ancala, Aviva, Equitix, LGIM, M&G, Octopus, Standard Life, TIAA-CREF	10-20
Liability Matching Assets including Cash	LGIM	15-21

### Changes in respect of Investment Policy

During the year the following changes to the Investment Policy were implemented:

- In January 2017, £50.5m was committed to and invested in the Keynes Multi Asset Value Fund managed by Wadhwani Asset Management LLP. The funding for this mandate was sourced from the BlackRock US Credit Screened Fund.
- In January 2017, the ISC decided to reduce the Scheme's allocation to equities to 31%. To do this the allocations to the LGIM Global Equity (ex UK) and the LGIM Emerging Market RAFI funds were both sold. Of the proceeds £20m was held in cash to meet future drawdowns.
- In January 2017, a new allocation of £15m was made to Equitix to invest in a 30 year Design, Build, Finance and Operate contract to operate and maintain the M25 and the surrounding road network. This investment was funded from the LGIM equity portfolio.
- In January 2017, Alpha Real was appointed to manage £50m in a commercial ground rent mandate. This mandate draws down over time and will be funded on an ad-hoc basis as the Scheme receives capital calls.
- In May 2017, the Credit Suisse reinsurance mandate was topped up with an additional allocation of \$33.5m. The allocation was funded from the equity disinvestment the Scheme made in January.
- In June 2017, matching interest rate and inflation rate assets equivalent to 7.5% of the Scheme's liabilities were purchased within the LGIM LDI portfolios, as agreed by the Trustee and the Employer as part of the 2014 Valuation. This brings the Scheme's interest and inflation hedge coverage to approximately 31% and 35% respectively, as a proportion of the total liabilities.



### **TRUSTEE'S REPORT (CONTINUED)**

- In September 2017, the Scheme committed £20m to CarVal's latest opportunistic credit fund, CarVal IV, to maintain its overall exposure to CarVal (as the Scheme's first CarVal investment is running down and distributing capital back to investors). This mandate draws down over time and is expected to be funded from the capital and income distributions from the Scheme's investments in the earlier CarVal vehicles.
- At the start of Q4 2017, the Allianz GI Global Active Credit mandate was amended to remove the global interest rate exposure, which resulted in a change of benchmark. The global interest rate sensitivity was replaced with Sterling interest rate sensitivity in the LGIM LDI mandate.
- In December 2017, Highbridge Capital Management was appointed to manage £60m in a private debt mandate to be funded by a reduction in the equity allocation. This mandate draws down over time and capital calls will be funded from the Drawdown Portfolio (see below).
- In December 2017, the Scheme committed £60m to Aviva Investors' Unlevered Infrastructure Equity fund. This mandate draws down over time and will be funded on an ad-hoc basis as the Scheme receives capital calls.
- In December 2017, the Scheme disinvested £120m from the LGIM Global Equity RAFI fund and committed the proceeds to Allianz GI to manage a Drawdown Portfolio. The Drawdown Portfolio is structured as a short dated credit mandate which will be used to fund mandates which draw down their capital commitments over the next few years.
- Following a review of the Scheme's cashflow profile, it was agreed to collect income from the Scheme investments where possible. For investments in pooled funds, this involved moving to an income distributing share class, where this was available. A process has also been put in place to sweep income from the Scheme's segregated mandates with Majedie and Allianz GI. In addition, the ISC authorised the use of repurchase agreements and total return swaps to finance short term cash requirements up to a maximum of £15m per quarter within the LGIM LDI portfolios.

The changes to the investment policy over the year have resulted in a reduction in the Scheme's allocation to listed equities and an increase in the allocation to investments with more predictable cashflows. These changes are expected to reduce the level of investment risk whilst maintaining the current level of expected return, thereby further enhancing the overall efficiency of the Scheme's investment policy. The LDI holding at year end was marginally underweight compared to the target ranges of the SIP, at 14.3%, compared to the 15% lower limit. This is due to the relative performance of different asset classes. The Trustee is monitoring the position and at this time do not plan to rebalance.

### **Review of Investment Performance of the Scheme**

For the year ended 31 December 2017, the Scheme returned 6.5% against a benchmark return of 6.3%. The return over the last three years is 7.5% per annum (p.a.) against a benchmark of 8.3% p.a. Since the combined performance measurement started in January 2005 the assets have returned 7.8% p.a. against a benchmark of 7.3% p.a.

The total net assets held by the Scheme, as at 31 December 2017, were £2.54 billion (31 December 2016: £2.44 billion).

## TRUSTEE'S REPORT (CONTINUED)

Investment performance for the period 1 January 2017 to 31 December 2017 is set out below:

	12 Month Return (%)			Asset Value (£m.) 31/12/2017	Inception Date	Benchmark	Performance Target	Active/ Passive
	Fund	Bench mark	Relative					
<b>Thales UK Pension Scheme</b>	<b>6.5</b>	<b>6.3</b>	<b>0.1</b>	<b>2,500.7</b>	Jan 2005			
<b>Equity</b>	<b>11.4</b>	<b>12.0</b>	<b>-0.6</b>	<b>720.6</b>				
AQR Low Volatility	13.4	9.9	3.5	156.6	May 2013	MSCI World	Track Benchmark with lower volatility	Active
Hosking Global Equity	15.3	13.8	1.5	103.1	Jul 2016	MSCI World US (GBP)	Outperform Benchmark	Active
LGIM Global Equity RAFI	11.3	11.5	-0.1	264.2	Mar 2009	FTSE RAFI AW 3000 GBP	Track Benchmark	Passive
Majedie UK Equity	8.3	13.1	-4.8	196.7	May 2005	FTSE All Share	Outperform Benchmark	Active
<b>Credit</b>	<b>3.3</b>	<b>2.8</b>	<b>0.5</b>	<b>753.5</b>				
Alcentra	-5.8	-6.4	0.6	69.9	Sep 2015	3 month USD LIBOR + 1.25% p.a.	Outperform Benchmark	Active
AllianzGI Drawdown Portfolio	-	-	-	120.0	Dec 2017	n/a	1.8% yield target	Active
AllianzGI Global Active	5.3	4.2	1.2	262.2	Apr 2010	BarCap Global Aggregate Credit GBP hedged	1.5% over Benchmark	Active
BlackRock Corporate Bond Fund	4.5	4.5	-0.0	139.3	Jun 2009	BarCap Agg Corp GBP hedged	Track Benchmark	Passive
LGIM UK AAA-AA-A Fund	5.4	5.4	-0.0	103.2	May 2005	iBoxx Sterling Non Gilts ex BBB 15+	Track Benchmark	Passive
Orchard	0.0	1.4	-1.3	59.0	Nov 2015	3 month USD LIBOR + 9.0% p.a.	Outperform Benchmark	Active
<b>Liquid Alternatives</b>	<b>-6.9</b>	<b>-1.5</b>	<b>-5.4</b>	<b>257.5</b>				
AQR Managed Futures	-1.8	2.4	-4.2	38.6	May 2012	3 month GBP LIBOR +2.0% p.a.	Outperform Benchmark	Active
Brigade	6.7	5.5	1.3	28.9	Nov 2012	Credit Suisse Leveraged Loan Index (50%) Merrill Lynch High Yield Constrained Index (50%)	8.0 - 12.0% p.a.	Active
Carval II	4.5	6.7	-2.2	31.2	Jun 2013	Merrill Lynch High Yield	13.0 - 15.0% p.a.	Active
Carval III	5.7	6.7	-1.0	25.3	Jun 2015	Merrill Lynch High Yield	13.0 - 17.0% p.a.	Active
Carval IV	-	-	-	0.7	Dec 2017	Merrill Lynch High Yield		Active
Credit Suisse IR	-16.7	-7.6	-9.1	90.9	Aug 2011	3 month USD LIBOR	3.0 - 5.0% p.a.	Active
Wadhvani	-	-	-	41.9	Jan 2017	3 month USD LIBOR	7.0 - 9.0% p.a.	Active
<b>Illiquids</b>	<b>8.0</b>	<b>7.6</b>	<b>0.5</b>	<b>407.5</b>				
Alpha Real	-	-	-	31.2	Jan 2017	Index Linked Gilts + 3.5% p.a.	Outperform Benchmark	Active
Ancala	2.3	8.1	-5.8	6.2	May 2016	CPI + 5.0% p.a.	Outperform Benchmark	Active
Equitix II	10.0	5.8	4.2	29.9	Sep 2011	Index Linked Gilts over 5 years + 3.5% p.a.	Outperform Benchmark	Active
Equitix III	16.7	5.8	10.8	23.0	Jun 2013	Index Linked Gilts over 5 years + 3.5% p.a.	Outperform Benchmark	Active

## TRUSTEE'S REPORT (CONTINUED)

	12 Month Return (%)			Asset Value (£m.) 31/12/2017	Inception Date	Benchmark	Performance Target	Active/ Passive
	Fund	Bench mark	Relative					
Equitix IV	10.4	5.8	4.6	32.5	Sep 2015	Index Linked Gilts over 5 years + 3.5% p.a.	Outperform Benchmark	Active
Equitix M25	-	-	-	16.1	Jan 2017	Index Linked Gilts over 5 years + 3.5% p.a.	Outperform Benchmark	Active
LGIM Long Lease Property	9.2	10.5	-1.3	73.2	Feb 2013	AREF/IPD Long Income Property Fund Index	Absolute return	Active
M&G European Long Lease Property	8.1	5.4	2.7	39.9	Dec 2015	European CPI + 4.0% p.a.	Outperform Benchmark	Active
M&G European Property	10.6	5.5	5.2	43.6	Sep 2012	IPD Pan European Property Funds Index	7.0 - 9.0% p.a.	Active
MedicX Healthcare II	10.0	5.8	4.1	22.4	Feb 2014	Index Linked Gilts over 5 years + 3.5% p.a.	Outperform Benchmark	Active
Standard Life Property	9.1	10.2	-1.0	73.7	Nov 2011	IPD All Balanced Index	Outperform Benchmark	Active
TIAA-CREF	-7.5	8.1	-15.5	15.6	Apr 2015	CPI + 5.0% p.a.	Outperform Benchmark	Active
<b>Liability Matching</b>	-	-	-	<b>347.9</b>				
LGIM Swaps & Collateral 1	5.3	5.3	-	264.9	Apr 2012	n/a	n/a	Passive
LGIM Swaps & Collateral 2	4.9	4.9	-	83.0	Apr 2012	n/a	n/a	Passive
<b>Cash</b>	-	-	-	<b>13.5</b>				
Northern Trust Cash	-	-	-	6.5	Nov 2015	n/a	n/a	Passive
Currency Hedge	-	-	-	7.0	Dec 2011	n/a	n/a	Passive

Note: this investment report is related to the Scheme investment assets only. As such it excludes the cash held by the administrator, other current assets, current liabilities and AVC assets.

## **TRUSTEE'S REPORT (CONTINUED)**

### **Additional Voluntary Contribution and other Defined Contribution funds**

Until 31 December 2007, members were able to pay Additional Voluntary Contributions (AVCs) to the Scheme, with the vast majority of these being operated on a defined contribution basis. Additionally, certain groups of members paid, or had paid on their behalf by their employer, supplementary contributions on a defined contribution basis. The Trustee continues to administer the funds built up from these sources on the members' behalf.

The Trustee maintains a suite of core investment funds on an investment platform operated by Zurich Financial Services. This platform provides members with direct online access to fund performance, fees etc. The underlying funds performances are monitored by the Trustee using regular reporting provided by Mercer Limited.

The Pensions Regulator has published a DC Code of Practice and Guidance. The Trustee, having considered legal advice, has concluded that the Scheme has DC investments that mean that the DC Code of Practice and guidance are applicable to the Scheme. As such the required Chairman's Statement on DC assets is included in this report on pages 22 to 31.

### **2014 Actuarial Valuation Employer Guarantees**

As a result of the 2014 Actuarial Valuation and in addition to the Recovery Plan, the Trustee and Employer have put in place a number of guarantees to support the Scheme. Thales SA has provided direct guarantees that total £750m. The Trustee has also agreed a de-risking plan which increases the scheme hedge ratio by 7.5% and amended the existing triggers for the Scheme to hedge further interest rate and inflation risk if market conditions improve ahead of expectation. During 2016 the Trustee monitored the market levels daily against the set trigger levels. To date no de-risking triggers have been breached.

### **Custodial Arrangements**

The Trustee has appointed Northern Trust Company as the Scheme's main custodian. The custodian is responsible for the safe keeping, monitoring and reconciliation of documentation relating to the ownership of investments. Investments are held in the name of the custodians' nominee companies, in line with common practice for pension scheme investments. Equinity Paymaster Limited has been appointed by the Trustee as custodian of the cash held in connection with the administration of the Scheme. The Trustee is responsible for ensuring the Scheme's assets continue to be securely held. It reviews its custodial arrangements from time to time.

### **Basis of Investment Managers' Fees**

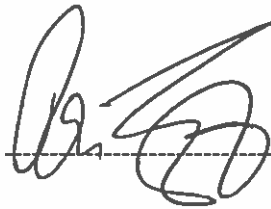
Within the Scheme, investment managers are paid on a mixture of performance-related based fees and fund value based fees rather than a fixed fee basis. The Trustee believed that this provides those investment managers with a greater alignment with the Trustee's interests. The fee bases of the managers will be reviewed periodically by the Investment Sub-Committee on behalf of the Trustee.

**TRUSTEE'S REPORT (CONTINUED)**

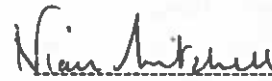
**Further Information**

Further legislative disclosures are included in the Compliance Statement on pages 66 and 67.

Signed on behalf of Thales Pension Trustees Ltd on 26 July 2018



-----TRUSTEE DIRECTOR



-----TRUSTEE DIRECTOR

## Chairman's Statement for the year ended 31 December 2017

### Introduction

Regulations effective from 6 April 2015 require the Trustees to prepare a statement showing how they have met certain minimum governance standards in relation to defined contribution benefits. These standards cover four principal areas relating to the Scheme's defined contribution benefits, namely:

- the Scheme's default investment arrangement;
- core financial transactions;
- value from member-borne deductions;
- value for members; and
- the Trustees' knowledge, understanding and resources.

This Statement constitutes the report to members from the Chairman of the Trustees about the extent to which the Trustees have complied with these minimum standards over the period 1 January to 31 December 2017.

The Scheme holds defined contribution and AVC assets with a range of providers, as indicated in the table below:

Provider
Zurich
Equitable Life
Prudential
Clerical Medical
Friends Life
Scottish Widows
Scottish Friendly (formerly MGM)
Phoenix Life

Given the range of providers, and the need to focus the use of Scheme resources proportionately, compliance with the new governance standards initially focused on those defined contribution ('DC') and AVC assets held with Zurich (given that this provider held a greater proportion of the Scheme's DC and AVC assets than any other).

Following last year's statement, and mindful of the need to maintain a focused use of the Scheme's finite resources, the Trustees have again considered those DC & AVC assets held with the Scheme's top three providers (when measured by the monetary value of DC & AVC assets held). As a result, the Trustees have focused the bulk of their analysis and commentary below on Zurich, Equitable Life and Prudential (which, combined, account for 98% of the Scheme's DC and AVC assets).

## Chairman's Statement (continued)

### 1. The Scheme's default investment arrangement

The Trustees are responsible for setting the Scheme's investment strategy and for appointing investment managers to carry out that strategy. The Trustees do not operate a default arrangement (within the meaning of the Pensions Act 2008) within each of the Scheme's legacy AVC arrangements; all members were required to specify an investment choice.

However, the Trustees sought to consolidate some of the Scheme's DC and AVC assets in 2012. At that time, a bulk transfer of assets from F&C Asset Management, Legal & General Investment Management, Newton Investment Management and Equitable Life to a new arrangement with Zurich was undertaken. The vast majority of these DC and AVC assets were transferred from investment funds in their original arrangement to suitable equivalent replacement funds with Zurich as part of an automatic fund-mapping exercise (for which investment advice was taken). However, the AVC assets from Equitable Life were transferred to a newly-designed lifestyle arrangement.

This new lifestyle arrangement was designed to replace, as far as possible, the returns that might reasonably have been expected from the Equitable Life With Profits Fund (from which the assets were being transferred). Although the affected members were communicated with in advance (and had the opportunity to specify an alternative investment choice from the individual fund options available), their assets were transferred to the lifestyle arrangement by default where no alternative investment selection had been made. Whilst not a universal default investment arrangement, this lifestyle arrangement can be considered a 'default' for the members in question.

The Trustees' Statement of Investment Principles ('SIP') dated 9 October 2014, includes reference to the Scheme's DC and AVC assets. However, the Scheme's SIP does not currently:

- set out the aims and objectives in relation to the default investment arrangement referred to above;
- outline the basis upon which it was designated as a suitable investment arrangement in the context of members' best interests; or
- explain the Trustees' policies in relation to matters such as risk and diversification.

The Trustees have resolved to ensure that these matters are fully-addressed when the Scheme's SIP is next revised.

The nature of this default investment arrangement has not changed over the course of 2017, and therefore it continues to reflect the Trustees' original intention to designate a lifestyle arrangement that would replace, to the extent that is possible, the investment returns that the relevant members may have reasonably expected from the Equitable Life With Profits Fund. Under this lifestyle arrangement, members who are 15 or more years away from their expected retirement age, have their savings predominantly invested in funds which may be expected, over the long-term, to provide a reasonable rate of return relative to interest rates and inflation. In the 15 years leading up to their expected retirement age, members' savings are gradually moved into funds with a lower-risk profile which are considered to offer more protection from market volatility.

Members of this lifestyle arrangement are reminded (via their annual benefit statements) of the investments applying to their assets; this includes a reminder of the automated fund transfers that occur

progressively throughout the 15 years leading up to their retirement age. Members have the opportunity to opt-out of this arrangement at any time.

### Chairman's Statement (continued)

The table below sets out the key features of this lifestyle investment arrangement and explains why the Trustees believe each one to be in members' best interests.

Default feature	Rationale for being in members' best interests
Members' Accounts are invested in global equities and other growth-seeking assets (through a diversified growth fund); a small allocation is also made to corporate bonds and index-linked gilts. This investment arrangement applies until 15 years prior to their selected retirement age.	<p>This asset allocation is designed to generate reasonable rates of return relative to interest rates and inflation during the growth phase of the strategy, whilst managing downside risk. Long-term returns in excess of earnings inflation are generally required for members to attain an adequate income in retirement.</p> <p>Whilst younger members can withstand the potential downside of equities (as they have sufficient time for markets to recover), the Trustees believe it prudent to include an allocation to diversified assets (and bonds) during the growth phase, since this is expected to mitigate the impact of any fall in the value of equities on members' Accounts.</p>
During the 15 years leading up to their expected retirement age, members' Accounts are gradually transitioned away from global equities and other growth-seeking assets, to investment-grade corporate bonds, index-linked gilts, long-dated gilts and cash.	<p>The asset allocation used during this 'risk-reduction' phase is expected to reduce investment risk for members as they approach retirement. This is achieved through a gradually increasing allocation to assets that are expected to broadly move in line with the costs of the benefit format they are expected to take at retirement.</p> <p>The strategy concludes with a 100% allocation to cash that broadly matches the expectation that members will take their funds entirely in the form of tax free cash from the Scheme.</p>

The Trustees will review the suitability of this arrangement periodically. None of the other AVC arrangements in the Scheme have ever had a default investment strategy; members with assets within these arrangements elected to pay AVCs to them and were required to specify their fund choice at the time of joining. Whilst these policies have been closed for some years, these members retain the right to change their investment selection via the Scheme's third party administrator, Equiniti.

## 2. Disclosures on core financial transactions

The Trustees are required to explain how they ensure that the Scheme's core DC and AVC financial transactions are processed promptly and accurately. As noted above, the Scheme holds DC and AVC assets across a range of providers, although the outsourced Scheme administrator (Equiniti) is responsible for liaising with these providers and ensuring that the core financial transactions are implemented efficiently and accurately.



## Chairman's Statement (continued)

Given that the Scheme is now closed to all contributions, core financial transactions in this context constitute:

- The transfer of members' assets out of the Scheme (transfers-in are no longer permitted);
- The transfers of members' assets between different investment options available in the Scheme; and
- Payments from the Scheme to or in respect of members.

The Trustees operate an outsourced operational model with the Scheme's administration being delegated to Equiniti (although each DC and AVC provider retains responsibility for processing trades at the administrator's request). The Trustees have agreed timescales with Equiniti for the processing of all member-related services, including core financial functions relating to quoting and paying benefits. These timescales are well within any applicable statutory timescales.

Equiniti record all member transactions and benefit processing activities in a work management system, which assigns the relevant timescale to the task. Equiniti's administration reports then disclose their performance against these agreed timescales. These disclosures are considered by the Trustees at their routine meetings. The Trustees require additional disclosures in respect of any transactions and benefit processing activity that has not been completed within the agreed timescales, including the cause of the delay, the extent to which agreed timescales were breached and the proposed remedial measures.

Separately, the Trustees arrange for spot-checks of member data and benefit calculations to ensure that core financial transactions and benefit payments are accurate. These are usually undertaken annually as part of the Scheme's independent audit.

The table below sets out the Scheme's core financial transactions and the controls that have continued to exist during the year at Equiniti to ensure accuracy and promptness.

Core financial transaction	Key internal control
Investment switches requested by members	<p><i>Promptness</i></p> <p>The administrator's service level agreement for switching investments is 5 days from the date of request.</p> <p><i>Accuracy</i></p> <p>All switches are reconciled with manager transaction statements. All members are notified by the administrator when a switch is completed.</p>
Payment of transfer values	<p><i>Promptness</i></p> <p>The administrator's service level agreement for the issue of transfer-out details to a member is 10 days; the service level agreement for the payment of transfers-out to a receiving scheme is 5 days.</p> <p><i>Accuracy</i></p> <p>All transfer values are reconciled by the provider with the individual fund managers and subject to periodic audit checks.</p>

Chairman’s Statement (continued)

<p>Payment of benefits to members</p>	<p><i>Promptness</i></p> <p>The administrator’s service level agreement for the payment of death and retirement benefits is 2 days (from receipt of all requirements).</p> <p>Periodic appraisal of the Scheme’s common data helps ensure that member data is accurate, reducing the likelihood of delay arising from data gaps. Clear authorisations exist for the payment of benefits (i.e. all retirement and death benefit settlement cases are referred for Trustee consent). This balances the need for promptness on the one hand with Trustee oversight on the other.</p> <p><i>Accuracy</i></p> <p>The Scheme’s administrator operates a peer review system for all benefit calculations. Data accuracy is subject to regular evaluation and updating.</p>
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There have been no material administration service issues which need to be reported here by the Trustees. They are confident that the processes and controls in place with the administrator are robust and will ensure that the financial transactions, which are important to members, are dealt with properly. Over the period to which this Statement relates (1 January to 31 December 2017), Equiniti have met their Service Level Agreements to the following extent:

- Investment switches requested by members: 100%
- Payment of transfer values: 97.3%
- Payment of benefits to members: 99.1%

**3. Member-borne charges and transaction costs**

As required by Administration Regulations, the Trustees are required to report on the charges and transaction costs for the investments used in the DC and AVC arrangements and their assessment of the extent to which these charges and costs represent good value for members.

For the reasons outlined above, the Trustees have decided this year to focus their assessment of member-borne charges for this purpose on the DC and AVC assets held with the Scheme’s top three DC & AVC arrangements (namely Zurich, Equitable Life and Prudential). Between them, these three providers account for the vast majority of the Scheme’s DC and AVC assets (£16.9 million out of a total £17.2 million as at 31 December 2017).

When assessing the charges and transaction costs which are payable by members, the Trustees are required to consider the extent to which these represent good value for members. On this basis (and with the help of their advisers), the Trustees have undertaken a ‘value for money’ assessment in relation to the DC and AVC assets held with Zurich, Equitable Life and Prudential. The results of each assessment are detailed below.

## Chairman's Statement (continued)

### Zurich

Members with DC and AVC assets held with Zurich only bear investment and platform administration charges in this context; as Zurich is the investment manager, they do not provide any wider administration services (other than processing trades), so no wider administration costs are borne by members. Administration services relating to these DC and AVC assets are provided by the Scheme's administrator, Equiniti, and these costs are settled by the Scheme not members.

Consequently, the assessment undertaken in this context only focuses on the total investment and platform administration costs borne by members with DC and AVC assets held with Zurich.

The table below shows the total expense ratio ('TER') in each of the underlying funds used in the default investment arrangement referred to under Section 1 above. The overall charge being deducted from a member's fund will reflect the member's allocations in each of the underlying funds. The TER is at its highest during the growth phase (at 0.51% p.a. which is below the charge cap of 0.75% p.a. applicable to default investment arrangements in qualifying schemes); it then reduces during the 15 years prior to the member's expected retirement age, to reflect the automated transition of assets to investment-grade corporate bond, UK Government gilt and cash funds (which have lower TERs).

Underlying investment fund	TER
Thales Global Equity†	0.23% pa
Thales Diversified Growth†	0.83% pa
Thales Corporate Bond†	0.47% pa
Thales Long Dated Gilts	0.21% pa
Thales Index-Linked Gilts†	0.21% pa
Thales Money Market	0.22% pa

† Denotes funds used in the growth phase of the default investment arrangement.

Additionally, the funds listed in the table below are available to members on a self-select basis.

Self-select investment fund	TER
Thales UK Equity	0.18% pa
Thales Global Balanced	0.67% pa
Thales Socially Responsible	0.85% pa
Thales Mixed Bond	0.38% pa

The TER consists principally of the manager's 'annual management charge' for managing and operating a fund, but also includes the costs for other services paid for by the fund (such as the legal costs, registration fees and custodian fees). However, they exclude other costs that are also

## Chairman’s Statement (continued)

member-borne and can therefore have a negative effect on investment performance (such as underlying transaction costs). Overall, the funds in place within the Zurich arrangement are deemed to offer good or reasonable value for members.

### *Equitable Life*

Members with AVC assets held with Equitable Life bear a TER that covers investment, platform administration and wider administration services. Whilst these members also benefit from the administration overlay provided by Equiniti, an element of the TER deducted from their fund holdings covers the direct administration undertaken by Equitable Life.

The table below shows the overall TER for each of the self-select fund options in use within this AVC arrangement.

Self-select investment	TER
Equitable Life Managed	0.75% pa
Equitable Life Pelican	0.75% pa
Equitable Life UK FTSE All-Share	0.50% pa
Equitable Life European	0.75% pa
Equitable Life North American	0.75% pa
Equitable Life Far Eastern	0.75% pa
Equitable Life International Growth	0.75% pa
Equitable Life Investment Trusts	0.75% pa
Equitable Life Money	0.50% pa

It is not currently possible to split out the various elements of the TERs in place for each fund, so therefore it is not possible to make a judgement about whether the specific cost being met by members for this service is considered value for money. However, the overall TERs in place for most of the funds listed above have been assessed as being reasonable relative to peer funds available elsewhere in the market. The standard of the direct administration service provided by Equitable Life during the year has also been reasonable.

Assessment of the Equitable Life With Profits Fund remains challenging, given the nature of the fund and the guarantees reflected in its terms. Whilst payouts have been poor and expected future investment performance is weak, the inclusion of the 3.5% guaranteed investment return within the Scheme’s With Profits policies (which cannot be replicated elsewhere) mitigates this to some extent and will represent a high value to members who value the security that such a guarantee offers.

### *Prudential*

Members with AVC assets held with Prudential also bear a TER that covers investment, platform administration and wider administration services. Whilst these members also benefit from the

## Chairman's Statement (continued)

administration overlay provided by Equiniti, an element of the TER deducted from their fund holdings covers the direct administration undertaken by Prudential.

The table below shows the overall TER for each of the self-select fund options in use within this AVC arrangement.

Self-select investment	TER
Prudential Deposit	0.00% pa
Prudential Discretionary	0.77% pa

It is not currently possible to split out the various elements of the TERs in place for the Discretionary Fund, so therefore it is not possible to make a judgement about whether the specific cost being met by members for this service is considered value for money. However, the overall TER in place for the fund has been assessed as being reasonable relative to peer funds available elsewhere in the market. The standard of the direct administration service provided by Prudential during the year has also been reasonable.

Assessment of the Prudential With Profits Fund remains challenging, given the nature of the fund and the guarantees reflected in its terms. However, the Trustees have assessed its annualised performance and have concluded that this compares favourably relative to suitable peer funds.

The Prudential Deposit fund is backed by the assets held within Prudential's With-Profits Fund. Any interest is declared monthly and there are no explicit charges. The fund has, to date, provided what it has intended to and has provided positive returns in a very low interest rate environment.

#### 4. Value for members

In accordance with regulation 25(1) (b), the Trustees are required to undertake a review of the charges and transaction costs incurred by members in order to ascertain whether or not they represent good value for members, relative to peers and alternative arrangements that are available.

The Trustees have concluded that the overall benefits and options within these arrangements represent reasonable value for money in comparison to the charge payable by members.

The reasons underpinning this conclusion include:

- Charges for the 'default' investment within the Zurich arrangement are below the charge cap of 0.75% pa;
- The Annual Management Charge for investment and platform administration for most of the Zurich funds has been assessed by our advisers as comparing favourably with those of peer funds;
- The charges borne by members on investments within the Equitable Life and Prudential arrangements have been assessed by our advisers as being reasonable compared with suitable peer funds;
- The funds used within the Zurich arrangement are highly-rated by Mercer as having good prospects of achieving their objectives; and

## Chairman's Statement (continued)

- The performance of most funds since inception to 31 December 2017 compares favourably relative to their benchmarks and objectives.

Additionally, the Trustees pay for all wider administration, insurance, and advisory costs associated with operating the Scheme, which further enhances the value that members receive.

### *Underlying transaction costs*

The Trustees are presently unable to separately identify the underlying transaction costs associated with, for example, disinvesting from one fund and/or investing in another, across the fund range available within each of the DC & AVC arrangements (including the default investment arrangement within the Zurich arrangement referred to in Section 1).

The FCA published a Policy Statement in September 2017 detailing that, from 3 January 2018, firms managing DC pension schemes must be able to provide, among other things, information about transaction costs calculated according to the 'slippage cost' methodology. Additionally, the DWP is consulting on further disclosure requirements, which will apply to all schemes with a year-end date of 6 April 2018 or later. Since the year-end date is 31 December 2017, the Scheme will not be affected by these regulations until the next Scheme Year.

## **5. Disclosures about Trustee Knowledge and Understanding**

The Pensions Act 2004 requires individual trustees to have appropriate knowledge and understanding of the law relating to pensions and trusts and the investment of the assets.

The degree of knowledge and understanding required is that appropriate for the purposes of enabling the Trustees to exercise the function in question. The Trustees must also be conversant with the Scheme's own documentation (focusing on the Scheme's trust deed and rules and Statement of Investment Principles). The Trustees must also be conversant with any other documentation recording current policy relating to the administration of the Scheme generally. The Pensions Regulator interprets 'conversant' as having a working knowledge of those documents such that the Trustees are able to use them effectively when they are required to do so in the course of carrying out their duties.

The Trustees are required to disclose how these duties have been fulfilled and how their combined knowledge and understanding, together with the advice which is available to them, enables them to properly exercise their duties and responsibilities. The table below indicates how these requirements have been met during the year.

Chairman's Statement (continued)

Requirement	How met
<p>The Trustees must have appropriate knowledge and understanding of the law relating to pensions and trusts and the investment of assets</p>	<p>It is mandatory for the Trustees to complete The Pensions Regulator's online trustee training modules when they are appointed.</p> <p>Ongoing training is then provided by professional advisers collectively, as part of a dedicated training day and at routine Trustees' meetings (the subjects having been agreed in advance, based on periodic self-assessment or gap analysis). Trustees also receive training on an individual basis, through attendance at relevant seminars and conferences etc.</p>
<p>The Trustees must be conversant with the Scheme's own documentation</p>	<p>All key Scheme documentation is accessible by the Trustees. Periodic training focuses on Scheme documentation, such as the Trust Deed &amp; Rules.</p>
<p>Knowledge and resources generally</p>	<p>The Trustees' policy requires that any new Trustee completes The Pensions Regulator's online training modules (relevant to defined contribution benefits) within 6 months of their appointment. All new Trustees are provided with a suitable induction which includes an introduction to the Scheme's key documentation.</p> <p>The Scheme's Trustee board comprises individuals with diverse professional skills and experiences (including finance, HR, and operations management) reflecting the varied nature of the challenges that its governance must address.</p> <p>The Scheme pays all reasonable expenses of the Trustees attending conferences or externally-run training courses relevant to their role. The Trustees also meet with their professional advisers at least twice annually to transact core business, and each meeting includes an overview of topical news and developments.</p>

This concludes the statement confirming how the Trustees have met the new governance requirements for the period 1 January 2017 to 31 December 2017.

Signed:  .....

Chairman of the Trustees of the Thales UK Pension Scheme

Date: 26th July 2018 .....

### **Statement of Trustee's Responsibilities**

The financial statements, which are prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including the Financial Reporting Standard applicable in the UK (FRS 102), are the responsibility of the Trustee. Pension Scheme regulations require, and the Trustee is responsible for ensuring, that those financial statements:

- 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 that year of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year; and
- contain the information specified in the Regulation 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including making a statement whether the financial statements have been prepared in accordance with the relevant financial reporting framework applicable to occupational pension schemes.

In discharging the above responsibilities, the Trustee is responsible for selecting suitable accounting policies, to be applied consistently, making any estimates and judgments on a prudent and reasonable basis, and for the preparing of the financial statements on a going concern basis unless it is inappropriate to presume that the Scheme will not be wound up.

The Trustee is also responsible for making available certain other information about the Scheme in the form of an annual report.

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.

The Trustee is responsible for the maintenance and integrity of the corporate and financial information included on the Scheme's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### **Trustee Responsibilities in Respect of Contributions**

The Trustee is responsible under pension's legislation for preparing, maintaining and from time to time reviewing and if necessary revising a Schedule of Contributions showing the rates of contributions payable towards 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 adopting risk-based processes to monitor whether contributions are made to the Scheme by the employer in accordance with the schedule of contributions. Where breaches of the Schedule of Contributions occur, the Trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to The Pensions Regulator and the members.



## Independent auditor's report to the Trustee of the Thales UK Pension Scheme

### Report on the audit of the financial statements

#### Opinion

In our opinion the financial statements:

- show a true and fair view of the financial transactions of the Thales UK Pension Scheme during the year ended 31 December 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 including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- contain the information specified in Regulation 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995.

We have audited the financial statements of Thales UK Pension Scheme which comprise:

- the fund account;
- the statement of net assets (available for benefits); and
- the related notes 1 to 16.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

#### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs(UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Scheme in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the Trustee's use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the Trustee has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Scheme's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

### Independent auditor's report to the Trustee of the Thales UK Pension Scheme (continued)

#### Other information

The Trustee is responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

#### Responsibilities of the Trustee

As explained more fully in the Trustee's responsibilities statement, the Trustee is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Trustee determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Trustee is responsible for assessing the Scheme's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Trustee either intends to liquidate the Scheme or to cease operations, or has no realistic alternative but to do so.

#### Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditor's report.

## Independent auditor's report to the Trustee of the Thales UK Pension Scheme (continued)

### Use of our report

This report is made solely to the Scheme's Trustee, as a body, in accordance with 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. 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 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's Trustee as a body, for our audit work, for this report, or for the opinions we have formed.

  
Deloitte LLP  
Statutory Auditor  
London, England  
26 July 2018

**Financial Statements**

**Fund Account - For the year ended 31 December 2017**

	Notes	Section 1 £'000	Section 2 £'000	2017 £'000	2016 £'000
<b>Contributions and Benefits</b>					
<b>Contributions receivable</b>					
Employer	3	63,723	25,479	89,202	90,780
Other income	4	327	812	1,139	519
		<u>64,050</u>	<u>26,291</u>	<u>90,341</u>	<u>91,299</u>
<b>Benefits paid or payable</b>					
Benefits paid or payable	5	75,295	22,422	97,717	92,012
Payments to and on account of leavers	6	26,456	5,964	32,420	11,300
Administrative expenses	7	3,894	2,098	5,992	6,020
Other payments	8	1,096	1,088	2,184	2,625
		<u>106,741</u>	<u>31,572</u>	<u>138,313</u>	<u>111,957</u>
<b>Net (withdrawals) from dealings with members</b>		<b>(42,691)</b>	<b>(5,281)</b>	<b>(47,972)</b>	<b>(20,658)</b>
<b>Returns on investments</b>					
Investment income	9	16,183	4,926	21,109	28,572
Change in market value of investments	12	95,992	32,968	128,960	324,874
Taxation	10	-	-	-	(134)
Investment management expenses	11	(2,387)	(801)	(3,188)	(4,680)
<b>Net returns on investments</b>		<u>109,788</u>	<u>37,093</u>	<u>146,881</u>	<u>348,632</u>
<b>Net increase in the fund during the year</b>		<b>67,097</b>	<b>31,812</b>	<b>98,909</b>	<b>327,974</b>
<b>Net Assets of the Scheme</b>					
<b>At 1 January</b>		<u>1,809,763</u>	<u>629,025</u>	<u>2,438,788</u>	<u>2,110,814</u>
<b>At 31 December</b>		<u><u>1,876,860</u></u>	<u><u>660,837</u></u>	<u><u>2,537,697</u></u>	<u><u>2,438,788</u></u>

The notes on pages 38 to 61 form part of these financial statements.

**Financial Statements**

**Statement of Net Assets (available for benefits) – As at 31 December 2017**

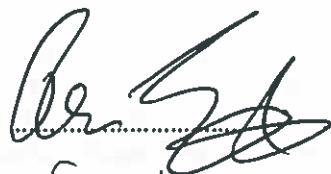
	Notes	Section 1 £'000	Section 2 £'000	2017 £'000	2016 £'000
<b>Investment assets</b>	12				
Equities		137,632	49,455	187,087	189,489
Bonds		865,268	276,488	1,141,756	550,707
Pooled investment vehicles		1,145,327	400,161	1,545,488	1,541,314
Derivatives		33,927	10,854	44,781	38,074
AVC investments		1,841	15,375	17,216	18,589
Cash		57,621	19,897	77,518	88,285
Other investment assets balances		4,563	1,208	5,771	4,363
		<u>2,246,179</u>	<u>773,438</u>	<u>3,019,617</u>	<u>2,430,821</u>
<b>Investment liabilities</b>	12				
Derivatives		(440)	(149)	(589)	(6,928)
Repurchase Agreements		(382,385)	(118,404)	(500,789)	-
Other investment liabilities		(1,782)	(603)	(2,385)	-
		<u>(384,607)</u>	<u>(119,156)</u>	<u>(503,763)</u>	<u>(6,928)</u>
<b>Total net investments</b>		<u>1,861,572</u>	<u>654,282</u>	<u>2,515,854</u>	<u>2,423,893</u>
<b>Current assets</b>	13	16,941	7,294	24,235	19,568
<b>Current liabilities</b>	14	(1,653)	(739)	(2,392)	(4,673)
<b>Net assets at 31 December</b>		<u>1,876,860</u>	<u>660,837</u>	<u>2,537,697</u>	<u>2,438,788</u>

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 7 to 9 and these financial statements should be read in conjunction with that report.

The notes on pages 38 to 61 form part of these financial statements.

The financial statements on pages 36 to 61 were approved on behalf of the Trustee on 26 JULY 2018

Signed on behalf of Thales Pension Trustees Ltd

  
 .....  
 Neil Mitchell

Trustee Director

Trustee Director

## Notes to the Financial Statements For the year ended 31 December 2017

### **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 the guidance set out in the Statement of Recommended Practice (Revised November 2014) ("the Revised SORP").

### **2 Accounting policies**

The following accounting policies have been applied consistently in the current and previous years. The principal accounting policies of the Scheme are as follows:

#### **A Contributions and benefits**

Contributions and benefits are accounted for in the period in which they fall due.

Normal contributions and deficit funding contributions are accounted for in the period they fall due in accordance with the Scheme rules, recommendations of the actuary and applicable schedules of contributions.

Section 75 debts are accounted for when paid or determined by the Scheme actuary whichever is earliest.

Augmentations relate to the cost of augmenting benefits of certain retiring members, as advised by the Actuary, and are accounted for in accordance with the agreement under which they are received, or in the absence of an agreement, on a receipts basis.

#### **B Transfers**

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

#### **C Investment income**

Investment income arising on fixed interest, index linked securities and pooled investment vehicles has been accounted for on an accruals basis when the income has been advised by the investment manager.

Income from equity securities has been recognised on the date the stocks were quoted ex-dividend.

Receipts or payments under swap contracts, representing the difference between the swapped cash flows, are included in investment income

#### **D Administrative expenses and investment management expenses**

All administrative and investment manager expenses are met by the Scheme.

#### **E Apportionment of Investment Funds**

The Scheme owns total units within the Unitised Investment Funds (IF) in issue. For administrative purposes Section 1 and Section 2 invest separately in the Investment Funds to meet their investment requirements. Units are offered for subscription or surrender each month at a price which reflects the market value of the underlying assets of the IFs. At the end of each month, the IFs are revalued and a unit price calculated for each IF. Purchases and sales of units by each Section are transacted on the first working day of the month using the relevant unit values.

## Notes to the Financial Statements For the year ended 31 December 2017 (Continued)

### 2 Accounting policies (continued)

#### F Valuation of investments

Quoted investments are valued at the last traded bid price on the relevant stock exchange. The market value of pooled investment vehicles is taken at the Net Asset Value or single price, at the accounting date as advised by the investment managers.

Bonds are valued on a clean basis, net of accrued interest.

Investments not denominated in sterling have been translated at the closing exchange rate as of that date. Investments include cash balances held by the custodians on behalf of the investment manager, which are required for the day to day management of the investments.

All gains and losses on investments including those arising on derivative financial instruments, whether realised or unrealised, excluding unrealised gains or losses on futures contracts, are included in the change in market value for the period.

Repurchase agreements (where the Scheme has sold assets with the agreement to repurchase at a fixed date and price) are included in the financial statements at the cost of the repurchase agreement (as a liability). The assets sold are reported in the appropriate asset class in the investments note at their fair value reflecting the fact that the Scheme retains the risks and rewards of ownership of those assets.

#### G Derivatives

Derivative contracts are valued at fair value. Derivative contract assets are fair valued at bid prices and liabilities are fair valued at offer prices.

Derivative contracts' changes in fair value are included in change in market value where the economic purpose of the contracts relates to assets. Where the economic purpose relates to income the change in fair value is included in investment income.

The fair value of futures contracts and swaps are determined using exchange prices at the reporting date. The fair value is the unrealised profit or loss at the current bid or offer market quoted price of the contract. The amounts included in change in market value are the realised and unrealised gains and losses.

The fair value of forward currency contracts is based on market forward exchange rates at the year end date and represents the gain or loss that would arise if the outstanding contract was matched at the year end with an equal and opposite contract.

Receipts and payments arising from derivative instruments are reported as sale proceeds or purchase investments, except for swap receipts and payments, which are recorded as investment income.

#### H Foreign Currencies

Transactions in foreign currencies during the period are converted at the rate of exchange ruling at the dates of the transactions. Overseas investments and bank and short term deposits in foreign currencies are translated at the rates of exchange ruling at the Scheme year end. Differences arising on translation are included within change in market value of the investments for 2016.

**Notes to the Financial Statements**

**For the year ended 31 December 2017 (Continued)**

**2 Accounting policies (continued)**

**I Annuities**

The cost of annuity purchases are charged to the Fund Account as incurred. Any income receivable from annuities is accounted for on an accruals basis and is included within investment income.

**3 Contributions**

	Section 1 £'000	Section 2 £'000	2017 £'000
<b>Contributions from employer:</b>			
Normal	11,437	11,558	22,995
Additional contributions - Augmentations	-	271	271
Deficit funding	48,200	11,800	60,000
Additional deficit contributions <sup>1</sup>	-	-	-
Other - PPF Levy	1,678	850	2,528
Other – Employers expense contribution	2,000	1,000	3,000
Other - Top ups	408	-	408
	<u>63,723</u>	<u>25,479</u>	<u>89,202</u>

	Section 1 £'000	Section 2 £'000	2016 £'000
<b>Contributions from employer:</b>			
Normal	11,439	11,605	23,044
Additional contributions - Augmentations	-	-	-
Deficit funding	45,400	9,667	55,067
Additional deficit contributions <sup>1</sup>	7,000	2,000	9,000
Other – PPF Levy	1,530	750	2,280
Other – Employers expense contribution	667	333	1,000
Other - Top ups	389	-	389
	<u>66,425</u>	<u>24,355</u>	<u>90,780</u>

<sup>1</sup> Additional deficit contributions have been made to the Scheme during 2016. These were triggered due to the position of the Scheme funding as at 31 December 2014 as per the Additional Contribution Deed dated 30 April 2013. They ceased following the agreement of the 2014 Actuarial valuation and the commencement of revised schedule of contributions in September 2016.

Normal contributions from the employer include £4,216,877 and £4,186,219 (2016: £4,439,093 and £4,431,703) member contributions paid through a salary sacrifice arrangement in respect of Section 1 and Section 2 respectively.

Ongoing deficit funding of £48.2m per annum is payable for Section 1 for the period 16 September 2016 to 31 December 2028, to reduce the funding shortfall.



**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**3 Contributions (continued)**

Ongoing deficit funding of £11.8m per annum is payable for Section 2 for the period from 16 September 2016 to 31 December 2028, to reduce the funding shortfall.

Employer other top up contributions relate to amounts received from the employer to fund additional benefit payments made to existing pensioners.

The Scheme no longer offers AVC investments to members of the legacy schemes.

**4 Other income**

	Section 1 £'000	Section 2 £'000	2017 £'000
Claims on term insurance policies	279	812	1,091
Other income	48	-	48
	<u>327</u>	<u>812</u>	<u>1,139</u>

	Section 1 £'000	Section 2 £'000	2016 £'000
Claims on term insurance policies	-	519	519

**5 Benefits paid or payable**

	Section 1 £'000	Section 2 £'000	2017 £'000
Pensions	68,306	17,742	86,048
Commutations and lump sums on retirement	6,536	3,732	10,268
Lump sums death benefits	424	943	1,367
Refund on death	28	5	33
Special lump sum death benefits	1	-	1
	<u>75,295</u>	<u>22,422</u>	<u>97,717</u>

	Section 1 £'000	Section 2 £'000	2016 £'000
Pensions	66,100	16,572	82,672
Commutations and lump sums on retirement	5,350	3,505	8,855
Lump sums death benefits	78	395	473
Refund on death	8	4	12
	<u>71,536</u>	<u>20,476</u>	<u>92,012</u>

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

6 Payments to and on account of leavers	Section 1	Section 2	2017
	£'000	£'000	£'000

Individual transfers to other schemes	26,456	5,964	32,420
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	Section 1	Section 2	2016
	£'000	£'000	£'000

Individual transfers to other schemes	7,973	3,327	11,300
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7 Administrative expenses	Section 1	Section 2	2017
	£'000	£'000	£'000

Administration fees	584	237	821
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Actuarial and consulting fees	968	382	1,350
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Legal fees	546	546	1,092
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Audit fees	35	35	70
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Other expenses	47	21	68
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PPF Levy	1,714	877	2,591
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	3,894	2,098	5,992
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	Section 1	Section 2	2016
	£'000	£'000	£'000

Administration fees	539	216	755
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Actuarial and consulting fees	1,231	527	1,758
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Legal fees	516	516	1,032
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Audit fees	30	30	60
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Under provision of prior year fees	8	8	16
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Other expenses	47	22	69
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PPF Levy	1,560	770	2,330
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	3,931	2,089	6,020
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**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

8 Other payments	Section 1 £'000	Section 2 £'000	2017 £'000
Premiums on term insurance policies	1,096	1,088	2,184

	Section 1 £'000	Section 2 £'000	2016 £'000
Premiums on term insurance policies	1,292	1,332	2,624
Ex Gratia Payments	-	1	1
	<u>1,292</u>	<u>1,333</u>	<u>2,625</u>

Term insurance is secured by policies underwritten by Legal and General.

9 Investment income	Section 1 £'000	Section 2 £'000	2017 £'000
Dividends from equities	10,456	3,581	14,037
Income from bonds	10,966	3,123	14,089
Income from pooled investment vehicles	1,547	546	2,093
Interest on cash and deposits	270	154	424
Swap income received	146	54	200
Annuity income	1,223	7	1,230
	<u>24,608</u>	<u>7,465</u>	<u>32,073</u>
Swap expenses paid	(8,017)	(2,539)	(10,556)
Repurchase agreement charges	(408)	-	(408)
	<u>(8,425)</u>	<u>(2,539)</u>	<u>(10,964)</u>
	<u>16,183</u>	<u>4,926</u>	<u>21,109</u>

There was no swap income or expenses incurred by the Scheme in 2016.

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

9 Investment income (continued)	Section 1	Section 2	2016
	£'000	£'000	£'000
Dividends from equities	7,330	2,449	9,779
Income from bonds	11,660	3,712	15,372
Income from pooled investment vehicles	371	122	493
Interest on cash and deposits	1,154	500	1,654
Annuity income	1,266	8	1,274
	<u>21,781</u>	<u>6,791</u>	<u>28,572</u>

**10 Taxation**

The Scheme is a registered Pension Scheme under Chapter 2 of Part 4 of the Finance Act 2004 and is therefore exempt from income tax and capital gains tax. The tax charge in the Revenue Account represents irrecoverable withholding taxes arising on investment income of £Nil (2016: £134,000).

11 Investment management expenses	Section 1	Section 2	2017
	£'000	£'000	£'000
Administration, management and custody*	<u>2,387</u>	<u>801</u>	<u>3,188</u>

	Section 1	Section 2	2016
	£'000	£'000	£'000
Administration, management and custody*	<u>3,498</u>	<u>1,182</u>	<u>4,680</u>

\*Included within administrative, management and custody fees are investment manager fees for Majedie Asset Management Limited of £939,012 (2016: £2,275,243). This is due to a performance related element of the management fee agreement.

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments**

The table below shows the investment assets split between Sections by investment strategy type.

	Section 1 £'000	Section 2 £'000	2017 £'000	2016 £'000
<b>Investments by strategy type</b>				
Cash	-	2	2	2
Equity	564,320	202,463	766,783	830,383
Illiquids	301,721	104,891	406,612	308,794
Investment Grade Credit	561,938	190,182	752,120	684,641
Liquid Alternative	159,839	55,827	215,666	203,546
Derivatives	33,487	10,705	44,192	31,146
<b>Total Unitised funds</b>	<b>1,621,305</b>	<b>564,070</b>	<b>2,185,375</b>	<b>2,058,512</b>
<b>Non unitised funds</b>				
Fixed interest bonds	238,426	74,803	313,229	346,792
	1,859,731	638,873	2,498,604	2,405,304
<b>AVC investments</b>	<b>1,841</b>	<b>15,375</b>	<b>17,216</b>	<b>18,589</b>
<b>Other investment assets</b>	<b>-</b>	<b>34</b>	<b>34</b>	<b>-</b>
	<b>1,861,572</b>	<b>654,282</b>	<b>2,515,854</b>	<b>2,423,893</b>

The investments are further analysed within the various funds that comprise Unitised and Derivative Funds of the Thales UK Pension Scheme in sections headed **the movements of investments in the year** on pages 47 and 48.

Non unitised fixed bonds represent investments designated as collateral. However none was pledged at the year end.

Investment liabilities relate to derivative investments and other investment liabilities. Investment assets include derivative related assets of £44,781,000 (2016: £38,074,000).

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

Year for the total Scheme investments held:

	Market Value at 1 January 2017 £'000	Purchases at cost and derivative payments £'000	Sales proceeds and derivative receipts £'000	Change in Market Value £'000	Market Value at 31 December 2017 £'000
Equities	189,489	76,644	(88,174)	9,128	187,087
Bonds	550,707	1,334,805	(750,192)	6,436	1,141,756
Pooled investment vehicles	1,541,314	224,127	(303,109)	83,156	1,545,488
Derivatives	31,146	5,204,781	(5,223,170)	31,435	44,192
AVC investments	18,589	48	(3,069)	1,648	17,216
	<u>2,331,245</u>	<u>6,840,405</u>	<u>(6,367,714)</u>	<u>131,803</u>	<u>2,935,739</u>
Cash - Sterling	824			-	2,837
Cash - Foreign currency	86,712			(2,843)	73,268
Cash - Variation margin	749			-	2,558
Cash - Variation margin payable	-			-	(1,145)
Investment income receivable	4,355			-	5,737
Other investment assets	8			-	34
Other investment liabilities	-			-	(2,385)
Repurchase agreements	-			-	(500,789)
	<u>2,423,893</u>			<u>128,960</u>	<u>2,515,854</u>

Included within the above purchases and sales figures are transaction costs of £455,025 (2016: £997,200). Indirect transaction costs are also borne by the Scheme which are incurred through the bid-offer spread on investments within pooled investment vehicles. However, such costs are taken into account in calculating the market price and are not therefore separately identifiable.

The change in market value of investments during the year comprises of 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.

Included within pooled investment vehicles as at 31 December 2017 is an investment in an investment vehicle with a year-end value of £157m. At the year end, the Scheme owned 76% of the shares issued by this Fund. However, the Scheme has no ability to control the investing activities of the Fund, and as such the substance of the investment is that the investment is a pooled investment vehicle, and has been treated as such in the financial statements.

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Section 1**

The movements of investments in the year:

	Market Value at 31 December 2016 £'000	Purchases at cost and derivative payments £'000	Sales proceeds and derivative receipts £'000	Change in Market Value £'000	Market Value at 31 December 2017 £'000
Equities	140,344	56,664	(65,659)	6,283	137,632
Bonds	419,237	906,418	(466,465)	6,078	865,268
Pooled investment vehicles	1,144,370	169,268	(230,982)	62,671	1,145,327
Derivatives	23,736	3,861,262	(3,874,803)	23,292	33,487
AVC investments	2,023	48	(356)	126	1,841
	<u>1,729,710</u>	<u>4,993,660</u>	<u>(4,638,265)</u>	<u>98,450</u>	<u>2,183,555</u>
Cash - Sterling	616			-	2,127
Cash - Foreign currency	64,916			(2,458)	54,442
Cash - Variation margin	563			-	1,911
Cash - Variation margin payable	-			-	(859)
Investment income receivable	3,280			-	4,563
Other investment assets	8			-	-
Other investment liabilities	-			-	(1,782)
Repurchase agreements	-			-	(382,385)
	<u>1,799,093</u>			<u>95,992</u>	<u>1,861,572</u>

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Section 2**

The movements of investments in the year:

	Market Value at 31 December 2016 £'000	Purchases at cost and derivative payments £'000	Sales proceeds and derivative receipts £'000	Change in Market Value £'000	Market Value at 31 December 2017 £'000
Equities	49,145	20,441	(22,976)	2,845	49,455
Bonds	131,470	430,510	(285,850)	358	276,488
Pooled investment vehicles	396,944	61,560	(78,828)	20,485	400,161
Derivatives	7,410	1,343,519	(1,348,367)	8,143	10,705
AVC investments	16,566	-	(2,713)	1,522	15,375
	<u>601,535</u>	<u>1,856,030</u>	<u>(1,738,734)</u>	<u>33,353</u>	<u>752,184</u>
Cash - Sterling	208			-	710
Cash - Foreign currency	21,796			(385)	18,826
Cash - Variation margin	186			-	647
Cash - Variation margin payable	-			-	(286)
Investment income receivable	1,075			-	1,174
Other investment assets	-			-	34
Other investment liabilities	-			-	(603)
Repurchase agreements	-			-	(118,404)
	<u>624,800</u>			<u>32,968</u>	<u>654,282</u>



**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Investment Fair Value Hierarchy**

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

Level 1	The unadjusted quoted price in an active market for identical assets or liabilities 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.

For the purposes of this analysis daily priced funds have been included in (1), weekly priced funds in (2), monthly net asset values for Pooled Investment Vehicle funds and monthly net asset values for Private Equity funds in (3). The Scheme's investment assets and liabilities have been fair valued using the above hierarchy categories as follows:

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
<b>At 31 December 2017</b>				
<b>Combined sections</b>				
Equities	186,990	-	97	187,087
Bonds	532,921	608,835	-	1,141,756
Pooled investment vehicles	-	628,077	917,411	1,545,488
Derivatives	915	43,277	-	44,192
AVC investments	-	16,749	467	17,216
	<u>720,826</u>	<u>1,296,938</u>	<u>917,975</u>	<u>2,935,739</u>
Cash – balances held				77,518
Other investment balances				5,771
Other investment – liabilities				(2,385)
Repurchase agreements				(500,789)
				<u>2,515,854</u>

Investment assets not included in the main fair value table are held at amortised cost, and therefore are not held at fair value.

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Investment Fair Value Hierarchy (continued)**

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
<b>At 31 December 2016</b>				
<b>Combined Sections</b>				
Equities	189,395	-	94	189,489
Bonds	244,939	305,768	-	550,707
Pooled investment vehicles	-	782,621	758,693	1,541,314
Derivatives	(76)	31,222	-	31,146
AVC investments	-	17,780	809	18,589
	<u>434,258</u>	<u>1,137,391</u>	<u>759,596</u>	<u>2,331,245</u>
Cash – balances held				88,285
Other investment balances				4,363
Other investment – liabilities				-
				<u>2,423,893</u>

**Investment risks**

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 of 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 of 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.

## Notes to the Financial Statements

### For the year ended 31 December 2017 (Continued)

#### 12 Investments (continued)

The Scheme has exposure to the risks above because of the investments it makes in following the investment strategy. The Trustee manages investment risks, including credit and market risk, within risk limits which are considered when setting the Scheme's strategic investment objectives. The Trustee implements the investment objectives and risk limits through the investment management agreements that are in place with the Scheme's investment managers and these are monitored by the Investment Sub-Committee, on behalf of the Trustee, through regular reviews of the investment portfolio.

Further information on the Trustees' approach to risk management and the Scheme's exposures to credit and market risks are set out below. This does not include annuity insurance policies or AVC investments as these are not considered significant in relation to the overall investments of the Scheme.

#### (i) Credit Risk

The Scheme is exposed to credit risk because it invests directly in bonds, over the counter (OTC) derivatives, has cash balances and enters into repurchase agreements. This pertains primarily to the Scheme's investments in global corporate bonds and the liability hedging portfolio. The Scheme also invests in pooled investment vehicles and is therefore exposed to credit risk in relation to instruments it holds in the pooled investment vehicles. The overall level of credit risk taken by the Scheme is monitored and compared to the level of its other main investment risks

The credit risk that arises through bonds held directly by the Scheme is mitigated by investing in government bonds where the credit risk is minimal, or corporate bonds which are rated investment grade. A relatively small proportion is held directly in sub-investment grade bonds, however, the expectation is that the additional return achieved should provide sufficient compensation for the additional credit risk that is taken. In addition, the Scheme's exposure to credit risk is managed by ensuring the investment managers' portfolios are sufficiently diversified to minimise the impact of default by any one issuer.

Credit risk arising on derivatives depends on whether the derivative is exchange traded or OTC. OTC derivative contracts are traded directly between counterparties and are not guaranteed by any regulated exchange and therefore the Scheme is subject to the risk of failure of the counterparty it transacts with. The credit risk for OTC derivatives is mitigated by collateral arrangements. Similarly, credit risk on repurchase agreements is mitigated through collateral arrangements. Credit risk also arises on forward currency contracts. Although there are no explicit collateral requirements for these contracts, cash is held to meet unrealised losses and all counterparties are required to be at least investment grade rated.

The Scheme's cash is held with financial institutions which are at least investment grade rated.

Credit risk arising from pooled investment vehicles relates to the legal or operational structure of the pooled vehicle leading to the Scheme being unable to realise the full net asset value of its holding in the vehicle. This risk is mitigated by the underlying assets of the pooled arrangements being ring fenced from the pooled fund manager, the regulatory environments in which the pooled managers operate, and diversification of investments amongst the number of pooled arrangements. The Trustee conducts due diligence on all of these points when making a new investment.

## Notes to the Financial Statements For the year ended 31 December 2017 (Continued)

### 12 Investments (continued)

#### (ii) Currency risk

The Scheme is subject to currency risk because some of the Scheme's investments are held in overseas markets. Some of this risk is mitigated through investing in the hedged share classes of the pooled investment vehicles where available. In addition, the Scheme has a currency hedging overlay managed by Legal & General Investment Management to manage total scheme currency exposure to an appropriate level. The level of currency hedging is reviewed by the ISC, on behalf of the Trustee, as part of the regular review of the Scheme's investment policy.

#### (iii) Interest rate and inflation risk

The Scheme is subject to interest rate risk because some of Scheme's investments are held in bonds, derivative contracts, and cash. In addition, the Scheme is exposed to inflation risk because some of the Scheme's investments are in assets which have payments linked to inflation (in particular, inflation linked bonds, derivative contracts and illiquid assets).

However, the predominant exposure to interest rate and inflation risk is in respect of the Scheme's liabilities. The value of the Scheme's liabilities will fluctuate with changes in interest rates. Changes in inflation will also impact the value of the liabilities because a proportion of the Scheme's benefit payments increase in line with inflation in various ways.

The Scheme's exposure to interest rate and inflation risk in respect of the liabilities is mitigated by investing in assets that respond in a similar way to changes in interest rates and inflation. In particular, there is a segregated liability hedging mandate in place which seeks to hedge a specific proportion of the Scheme's exposure to interest rate and inflation risk. Under this strategy, if interest rates fall the value of the liability matching assets will rise to help match the increase in the value of the actuarial liabilities from a fall in the discount rate. Similarly, if interest rates rise the investments will fall in value as will the actuarial liabilities because of an increase in the discount rate.

#### (iv) Other price risk

Other price risk arises in relation to the Scheme's holdings in equities, hedge funds, insurance linked securities, infrastructure, property (including ground leases and farmland), opportunistic credit, and private debt. These assets are held to generate outperformance over the liabilities, which is required for the Scheme to reach its funding target. The Scheme manages this exposure to price risk, as far as reasonably practicable, by constructing a diverse portfolio of investments across various markets.

**Notes to the Financial Statements**

**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Analysis of Pooled Investment Vehicles (PIVs)**

	2017	2016
	£'000	£'000
Equity	332,252	466,374
Bonds	247,190	410,645
Hedge funds	374,460	326,152
Property	278,033	162,608
Private Equity	299,693	154,149
Cash	13,860	21,386
	<u>1,545,488</u>	<u>1,541,314</u>

**Derivatives**

**Objectives and Policies**

The Trustee has authorised the use of derivatives by the investment managers as part of the overall investment strategy for the Scheme. The main objectives for the use of derivatives are summarised as follows:

**Swaps**

Swaps are used to modify the Scheme's exposure to various asset classes. Interest rate swaps were held to decrease the Scheme's risk to the impact of interest rate fluctuations on floating rate loans.

**Futures**

Futures contracts are entered into as a method of balancing the Scheme's exposure to a particular market or sector. Futures often provide a cheap and efficient way of modifying portfolio risk to remain within asset allocations governed by the investment strategy of the Scheme.

**Forward foreign exchange contracts**

The forward foreign currency contracts are held to hedge against foreign currency exposure from various investments. As there are multiple contracts in various currencies, it is impractical to list in detail all of the currencies sold.

At the year end, the Scheme held the following derivatives:

	2017	2017	2016	2016
	Assets	Liabilities	Assets	Liabilities
	£'000	£'000	£'000	£'000
Swaps (Over the Counter)	32,969	-	30,892	-
Futures (Exchange Traded)	1,122	(207)	385	(461)
Forward foreign currency contracts (Over The Counter)	10,690	(382)	6,797	(6,467)
	<u>44,781</u>	<u>(589)</u>	<u>38,074</u>	<u>(6,928)</u>

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Swaps**

	Notional Amounts £	Expiry	Assets £'000	Liabilities £'000
<b>Swaps (over the counter)</b>				
Interest rate swaps – Libor to fixed rate	25,517,000	May 2024	4,874	-
Interest rate swaps – Libor to fixed rate	25,517,000	June 2025	5,559	-
Interest rate swaps – Libor to fixed rate	26,878,000	June 2026	6,570	-
Interest rate swaps – Libor to fixed rate	26,878,000	May 2027	7,287	-
Interest rate swaps – Libor to fixed rate	7,866,000	May 2024	1,503	-
Interest rate swaps – Libor to fixed rate	7,866,000	June 2025	1,714	-
Interest rate swaps – Libor to fixed rate	8,286,000	June 2026	2,026	-
Interest rate swaps – Libor to fixed rate	8,286,000	May 2027	2,246	-
Interest rate swaps - SONIA to fixed rate	77,130,000	Sept 2022	365	-
Interest rate swaps - SONIA to fixed rate	30,050,000	Sept 2022	527	-
Interest rate swaps - SONIA to fixed rate	25,710,000	Sept 2022	122	-
Interest rate swaps - SONIA to fixed rate	10,020,000	Sept 2022	176	-
<b>Total for 2017</b>			<b>32,969</b>	<b>-</b>
<b>Total for 2016</b>			<b>30,892</b>	<b>-</b>

Swaps	Assets £'000	Liabilities £'000
Section 1	25,182	-
Section 2	7,787	-
<b>Total for 2017</b>	<b>32,969</b>	<b>-</b>
<b>Total for 2016</b>	<b>30,892</b>	<b>-</b>

**Swaps** – The notional principle (economic exposure) of the swaps is the amount used to determine the value of swapped interest receipts and payments.

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Futures**

Futures (Exchange traded)	Economic exposure £	Expiry	Assets £'000	Liabilities £'000
10 Year USA Treasury Notes	(65,657,031)	March 2018	309	-
5 Year USA Treasury Notes	(46,800,521)	March 2018	210	-
CBT UL Treasury Bonds	(16,483,665)	March 2018	-	(75)
Eur0 Buxl Bond	5,818,165	March 2018	-	(107)
Eurx Eur-Schatz	(14,213,801)	March 2018	15	-
Eurx Eur-Bobl	(50,585,949)	March 2018	270	-
Eurx Eur-Bund	(21,384,332)	March 2018	169	-
LIF Long Gilt	(3,754,800)	March 2018	-	(25)
EUR FOAT	(7,576,202)	March 2018	93	-
USA Treasury Bonds	(22,959,893)	March 2018	20	-
2 Year USA Treasury Notes	(18,993,252)	March 2018	36	-
<b>Total for 2017</b>			<b>1,122</b>	<b>(207)</b>
<b>Total for 2016</b>			<b>385</b>	<b>(461)</b>

**Split by Section (Unitisation)**

	Assets £'000	Liabilities £'000
Section 1	843	(156)
Section 2	279	(51)
<b>Total for 2017</b>	<b>1,122</b>	<b>(207)</b>
<b>Total for 2016</b>	<b>385</b>	<b>(461)</b>

**Futures** – The economic exposure represents the notional value of stocks purchased under the futures contract and therefore the value is subject to market movements.

The futures contracts are not split by section as the contracts are in the name of the Scheme, and not separately by Section. Therefore the closing balance of the future assets and liabilities have been split 76% / 24% in line with the year end unitisation of the Scheme.

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Derivative assets/(liabilities) (continued)**

**Forward foreign currency contracts (over the counter)**

Number of Contracts	Settlement date	Currency bought code	Currency bought '000	Currency sold code	Currency sold '000	Assets £'000	Liabilities £'000
2	1 month	USD	4,128	GBP	(3,064)	-	(13)
4	1 month	EUR	3,284	GBP	(2,911)	8	(3)
1	1 month	USD	173	CAD	(217)	-	-
11	1 month	GBP	96,158	EUR	(108,399)	25	(137)
25	1 month	GBP	232,437	USD	(310,115)	3,333	-
1	1 month	GBP	24	JPY	(3,697)	-	-
2	1 month	SEK	57,311	EUR	(27)	7	(24)
1	1 month	EUR	2,768	SEK	(27,425)	-	(19)
2	1 month	EUR	7,455	USD	(8,842)	87	-
1	1 month	USD	131	EUR	(111)	-	(1)
1	1 month	CAD	89	GBP	(52)	-	-
7	2 months	GBP	240,813	USD	(316,868)	6,865	-
3	2 months	GBP	51,875	EUR	(58,589)	-	(185)
2	2 months	GBP	19,049	JPY	(2,845,561)	365	-
<b>Total for 2017</b>						<b>10,690</b>	<b>(382)</b>
<b>Total for 2016</b>						<b>6,797</b>	<b>(6,467)</b>

**Split by Section (Unitisation)**

	Assets £'000	Liabilities £'000
Section 1	7,904	(284)
Section 2	2,786	(98)
<b>Total for 2017</b>	<b>10,690</b>	<b>(382)</b>
<b>Total for 2016</b>	<b>6,797</b>	<b>(6,497)</b>

The forward foreign currency contracts are not split by section as the contracts are in the name of the Scheme, and not separately by Section. Therefore the closing balance of the further assets and liabilities have been split 76% / 24% in line with the year-end unitisation of the Scheme.



**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Repurchase agreements**

The Trustee uses gilt repurchase agreements to maintain gilt returns while using the cash released by the gilt sales to achieve investment objectives.

The Scheme held the following open repurchase agreements at the year-end:

Duration	Notional principal and liability at year end £'000s
September 2017 to January 2018	(358,990)
September 2017 to February 2018	(12,430)
October 2017 to January 2018	(81,784)
October 2017 to February 2018	(41,304)
November 2017 to January 2018	(6,281)
	(500,789)

**Collateral**

The Scheme also receives collateral in the form of cash or securities in respect of derivative contracts and stock borrowing contracts in order to reduce credit risk. Collateral received in the form of cash managed by Legal & General Assurance (Pensions Management) Limited is recorded in the net asset statement with a corresponding liability. These items are designated as deposits received from counterparties. Any interest payable or receivable arising is recorded as interest expense or interest income respectively.

Collateral in the form of bonds was pledged by the Scheme to counterparties as at 31 December 2017 in relation to swap contracts amounted to £3,227,000 Section 1 and £1,096,000 for Section 2 (2016: £10,192,000 Section 1 and £2,954,000 for Section 2). Swap collateral held by the Scheme in the form of cash as at 31 December 2017 for Section 2 amounted to £7,518,000 (2016: £nil). No collateral was held by the Scheme with respect to Section 1 for either year.

Collateral pledged by the Scheme in the form of bonds to counterparties as at 31 December 2017 in relation to Repurchase agreements amounted to £3,848,000 for Section 1 and £1,072,000 for Section 2 (2016: £nil for both Sections). Repurchase agreements collateral held by the Scheme in the form of bonds as at 31 December 2017 amounted to £1,988,000 for Section 1 and £517,000 for Section 2 (2016: £nil for both Sections). The underlying assets collateralised remain assets of the Scheme, or the counterparty.

**Custodian**

The Northern Trust Company has been appointed by the Scheme as custodian of the securities held by the Scheme, except those securities held with Legal & General Assurance (Pensions Management) Limited. These securities were held in the name of HSBC Global Investors Services and Citibank, who provide custodian services for Legal and General directly.

**Notes to the Financial Statements**  
**For the year ended 31 December 2017 (Continued)**

**12 Investments (continued)**

**Employer Related Investments**

The Scheme does not hold any direct employer related investments. Due to the nature of the pooled funds that the Scheme invests in, the Trustee recognises there will be exposure to indirect employer related investments by virtue of composition of some of the pooled investment vehicles. The Trustee has considered the quantum of the potential exposure, and have concluded that the indirect exposure is minimal and certainly less than 5% of the net assets of the Scheme at the year end.

**Concentration of Investments**

The following investments represent more than 5% of the net assets of the Scheme at the Scheme year end:

	At 31 December 2017		At 31 December 2016	
	£'000	%	£'000	%
L&G YX - FTSE RAFI AW 3000 Equity Index Fund	263,931	10.4	340,382	14.0
AQR Global Defensive Equity Fund	156,585	6.2	138,051	5.7
BlackRock Selection Fund	138,330	5.5	132,256	5.4

**Transaction costs**

Transaction costs within the Scheme incurred in the year amounted to £457,000 (2016: £997,000). In addition to these transaction costs, indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. These costs are not separately advised to the Scheme.

	Fees £'000	Commission £'000	2017 £'000
Equities	327	129	456
Pooled investment vehicles	-	-	-
Other assets	1	-	1
	<u>328</u>	<u>129</u>	<u>457</u>

	Fees £'000	Commission £'000	2016 £'000
Equities	342	146	488
Pooled investment vehicles	142	-	142
Other assets	367	-	367
	<u>851</u>	<u>146</u>	<u>997</u>

**Notes to the Financial Statements****For the year ended 31 December 2017 (Continued)****12 Investments (continued)****Capital commitments**

At the Scheme year end, the Scheme had undrawn but committed investments with existing investment managers of £235.0m.

**Additional voluntary contributions**

The Trustee holds assets which are separately invested from the main fund, in the form of individual policies of assurance arising from members' additional voluntary contributions to the Thales legacy schemes. The Scheme no longer offers AVC arrangements for members. The AVC investments secured additional benefits, on a money purchase basis, for those members who had elected to pay AVCs. Members participating in this arrangement receive an individual annual statement made up to 31 March each year, confirming the amounts held in their account and the movements in the year. AVC assets are included in the net assets statement.

**AVC investments**

	2017			2016		
	Section 1 £'000	Section 2 £'000	Total £'000	Section 1 £'000	Section 2 £'000	Total £'000
Zurich	544	15,298	15,842	583	16,493	17,076
Equitable Life Assurance Society	824	7	831	1,013	7	1,020
MGM Assurance	72	-	72	75	-	75
Phoenix	65	-	65	70	-	70
Prudential	244	-	244	240	-	240
Friends Provident	57	-	57	9	-	9
Scottish Widows	35	-	35	33	-	33
Clerical Medical	-	70	70	-	66	66
	<u>1,841</u>	<u>15,375</u>	<u>17,216</u>	<u>2,023</u>	<u>16,566</u>	<u>18,589</u>

The fund unit values and movement will continue to be maintained for the two Sections separately.

**Notes to the Financial Statements**

**For the year ended 31 December 2017 (Continued)**

13 Current assets	Section 1 £'000	Section 2 £'000	2017 £'000
Pensions paid in advance	4,173	1,238	5,411
Contributions Employer - Normal	924	934	1,858
Contributions Employer - Deficit	4,183	1,067	5,250
Life assurance death benefit receivable	133	-	133
Overpayment of death benefit receivable	82	-	82
Life assurance premiums paid in advance	167	167	334
PPF levy paid in advance	431	219	650
Cash deposits held with Scheme Administrator	6,825	3,669	10,494
Inter section balance	23	-	23
	<u>16,941</u>	<u>7,294</u>	<u>24,235</u>

	Section 1 £'000	Section 2 £'000	2016 £'000
Pensions paid in advance	4,006	1,139	5,145
Contributions Employer - Normal	991	1,000	1,991
Contributions Employer - Deficit	4,183	1,067	5,250
Life assurance premiums paid in advance	206	212	418
PPF levy paid in advance	384	192	576
Cash deposits held with Scheme Administrator	4,013	2,122	6,135
Inter section balance	53	-	53
	<u>13,836</u>	<u>5,732</u>	<u>19,568</u>

The contributions due as at 31 December 2017 were received after the year end in accordance with the due date set out in the Schedules of Contributions. Normal contributions from the Employer include £340,871 and £337,321 (2016: £364,457 and £363,057) member contributions paid through a salary sacrifice arrangement in respect of Section 1 and Section 2 respectively.

**Notes to the Financial Statements**

**For the year ended 31 December 2017 (Continued)**

14 Current liabilities	Section 1 £'000	Section 2 £'000	2017 £'000
Lump sums on retirement	84	17	101
Death benefits	148	17	165
Accrued expenses	990	425	1,415
Equitable Life compensation payments	-	37	37
Other creditors	431	220	651
Inter section balance	-	23	23
	1,653	739	2,392
	1,653	739	2,392

	Section 1 £'000	Section 2 £'000	2016 £'000
Lump sums on retirement	51	5	56
Death benefits	-	10	10
Accrued expenses	2,731	1,210	3,941
Equitable Life compensation payments	-	37	37
Other creditors	384	192	576
Inter section balance	-	53	53
	3,166	1,507	4,673
	3,166	1,507	4,673

The Equitable Life compensation payments relate to proceeds received by the Scheme in respect of compensation from the Equitable Life Payment Scheme. This compensation is to be distributed to the membership that previously held benefits via the Scheme's group policy with Equitable Life.

**15 Related party transactions**

Certain Directors of the Trustee are active members or pensioners of the Scheme. Their benefits are accrued and paid in accordance with the Scheme Rules and were on the same terms as normally granted to members.

Certain pensions ("top ups") are paid on behalf of the Principal Employer. The Scheme is reimbursed in advance by the Employer for these unfunded pension payments (details are on Page 25).

**16 Post balance sheet events**

No post balance sheet events have occurred that have not been reported elsewhere in the Trustee report.

**CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS**  
**SECTION 1**



**CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS**

**Name of Scheme and name of Section**

Thales UK Pension Scheme – Section 1

**Adequacy of rates of contributions**

I certify that, in my opinion, the rates of contributions shown in this schedule of contributions are such that the statutory funding objective could have been expected on 31 December 2014 to be met by the end of the period specified in the recovery plan dated 16 September 2016.

**Adherence to statement of funding principles**

I hereby certify that, in my opinion, this schedule of contributions is consistent with the statement of funding principles dated 16 September 2016.

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

**Signature**

**Scheme Actuary**

Mark Condon

**Qualification**

Fellow of the Institute and Faculty of Actuaries

**Date of signing**

20 January 2017

**Name of employer**

Mercer Limited

**Address**

Tower Place West  
 London  
 EC3R 5BU

**CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS**  
**SECTION 2**



**CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS**

Name of Scheme and name of Section

Thales UK Pension Scheme – Section 2

**Adequacy of rates of contributions**

I certify that, in my opinion, the rates of contributions shown in this schedule of contributions are such that the statutory funding objective could have been expected on 31 December 2014 to be met by the end of the period specified in the recovery plan dated 16 September 2016.

**Adherence to statement of funding principles**

I hereby certify that, in my opinion, this schedule of contributions is consistent with the statement of funding principles dated 16 September 2016.

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

Signature

Scheme Actuary

Mark Condron

Qualification

Fellow of the Institute and Faculty of Actuaries

Date of signing

20 January 2017

Name of employer

Mercer Limited

Address

Tower Place West  
London  
EC3R 5BU

**CERTIFICATE OF TECHNICAL PROVISIONS – SECTION 1**

SCHEME FUNDING REPORT OF THE  
ACTUARIAL VALUATION AS AT 31 DECEMBER  
2014

THALES UK PENSION SCHEME –  
SECTION 1

**F**

**CERTIFICATE OF TECHNICAL PROVISIONS**

Name of the Scheme and name of section

Thales UK Pension Scheme – Section 1

**Calculation of technical provisions**

I certify that, in my opinion, the calculation of the section's technical provisions as at 31 December 2014 is made in accordance with regulations under section 222 of the Pensions Act 2004. The calculation uses a method and assumptions determined by the trustees of the section and set out in the statement of funding principles dated 16 September 2016.

Signature



Name

Mark Condron

Date of signing

16 September 2016

Name of employer

Mercer Limited

Address

Tower Place  
London  
EC3R 5BU

Qualification

Fellow of the Institute and Faculty of Actuaries



**CERTIFICATE OF TECHNICAL PROVISIONS – SECTION 2**

SCHEME FUNDING REPORT OF THE  
ACTUARIAL VALUATION AS AT 31 DECEMBER  
2014

THALES UK PENSION SCHEME –  
SECTION 2

# F

## CERTIFICATE OF TECHNICAL PROVISIONS

Name of the Scheme and name of section **Thales UK Pension Scheme – Section 2**

### Calculation of technical provisions

I certify that, in my opinion, the calculation of the section's technical provisions as at 31 December 2014 is made in accordance with regulations under section 222 of the Pensions Act 2004. The calculation uses a method and assumptions determined by the trustees of the section and set out in the statement of funding principles dated 16 September 2016.

Signature



Name

Mark Condron

Date of signing

16 September 2016

Name of employer

Mercer Limited

Address

Tower Place  
London  
EC3R 5BU

Qualification

Fellow of the Institute and Faculty of Actuaries

## **COMPLIANCE STATEMENT**

### **Constitution**

The Scheme is a defined benefit Career Average Revalued Earnings (CARE) arrangement, with legacy final salary benefits, and was established by deed on 9 January 2008. It is governed by the Supplementary Deed and Rules.

### **Taxation status**

In accordance with the provisions of Schedule 36 of Finance Act 2004 the Scheme became a registered pension scheme under Chapter 2 of Part 4 of Finance Act 2004.

### **Pension increases**

Pensions in payment during the year were increased in accordance with the Rules.

The Guaranteed Minimum Pension ("GMP") element of both deferred pensions and pensions in payment were increased as required by legislation. These increases are also provided for in the Rules of the Scheme. Deferred Pensions in excess of the GMP are increased in line with statutory requirements.

### **Calculation of transfer values**

No allowance is made in the calculation of transfer values for discretionary pension increases.

All cash equivalents (transfer values) paid during the year have been 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 paid were less than the amount provided for under section 94(1) of the Pension Schemes Act 1993.

### **Pension Tracing Service**

The Pension Tracing Service provides a service that enables members (and their dependants) to trace a benefit entitlement under a former employer's scheme. Enquiries should be addressed to:-

Pension Tracing Service  
Tyneview Park  
Whitley Road  
Newcastle upon Tyne  
NE98 1BA  
Tel No: 0845 600 2537

The information provided includes details of the address at which the Trustees of a pension scheme may be contacted. This Scheme has been registered with the Registrar.

### **COMPLIANCE STATEMENT (CONTINUED)**

#### **The Pensions Advisory Service**

Members and beneficiaries of occupational pension schemes that have problems concerning their Scheme, which are not satisfied by the information or explanation given by the administrators or the Trustees, can consult with The Pensions Advisory Service (TPAS). A local advisor can usually be contacted through a Citizen's Advice Bureau. Alternatively, TPAS can be contacted at:-

#### **The Pensions Advisory Service**

11 Belgrave Road

London

SW1V 1RB

Tel No: 0800 011 3797

#### **Pensions Ombudsman**

In cases where a complaint or dispute cannot be resolved, normally after the intervention of TPAS, an application can be made to the Pensions Ombudsman for him to investigate and determine any complaint or dispute of fact or law involving occupational pension schemes. The address is:

#### **The Pensions Ombudsman**

10 South Colonnade

Canary Wharf

London

E14 4PU

Tel No: 020 7630 2200

## Independent auditor's statement about contributions to the Trustee of the Thales UK Pension Scheme

We have examined the summary of contributions to the Thales UK Pension Scheme for the Scheme year ended 31 December 2017 on page 69.

In our opinion contributions for the Scheme year ended 31 December 2017 as reported in the summary of contributions and payable under the Schedules of Contributions have in all material respects been paid for the period from 1 January 2017 to 19 January 2017 at least in accordance with the Schedules of Contributions certified by the Scheme actuary on 16 September 2016, and for the period from 20 January 2017 to 31 December 2017 at least in accordance with the Schedules of Contributions certified by the Scheme actuary on 20 January 2017.

### Scope of work on statement about contributions

Our examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported in the attached 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 the Trustee and the auditor

As explained more fully in the Trustee's responsibilities statement, the Scheme's Trustee is responsible for preparing, and from time to time reviewing and if necessary revising, a Schedule of Contributions 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.

### Use of our report

This statement is made solely to the Trustee, as a body, in accordance with Regulation 4 of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. Our work has been undertaken so that we might state to the Trustee those matters we are required to state to them in an auditor's statement about contributions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Trustee as a body for our work, for this statement, or for the opinion we have formed.

  
Deloitte LLP  
Statutory Auditor  
London  
20 July 2018

**SUMMARY OF CONTRIBUTIONS**

The contributions payable to the Scheme during the year are shown below, split between those contributions paid per the Schedules of Contributions and those paid in addition to the amounts required by the Schedules of Contributions.

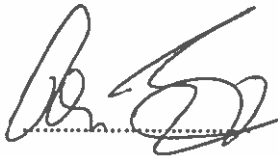
	Section 1 £'000	Section 2 £'000	2017 £'000
<b>Contributions from Employer:</b>			
Normal	11,437	11,558	22,995
Additional contributions - Augmentation	-	271	271
Deficit funding	48,200	11,800	60,000
Other – PPF Levy	1,678	850	2,528
Other – Employers expense contribution	2,000	1,000	3,000
<b>Total contributions payable under the schedules of contributions (as reported on by the Scheme auditor)</b>	<b>63,315</b>	<b>25,479</b>	<b>88,794</b>
<b>Other contributions payable:</b>			
Other Employer - Top ups	408	-	408
<b>Total contributions payable per the Fund Account</b>	<b>63,723</b>	<b>25,479</b>	<b>89,202</b>

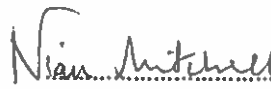
Normal contributions from the employer include £4,216,877 and £4,186,219 member contributions paid through a salary sacrifice arrangement in respect of Section 1 and Section 2 respectively.

Normal contributions are based on members' Pensionable Earnings. Member contribution rates 9% of CARE Salary up to £40,040 and in excess of that 12%, as per the Scheme Rules.

Employer other top up contributions relate to amounts received from the Employer to fund additional employer benefit payments made to existing pensioners and are outside the scope of the auditor's statement about contributions, as these amounts are not required under any of the Schedules of Contributions in place in the year.

Signed on behalf of Thales Pension Trustee Ltd

  
 Trustee Director  
 Date  
 26th July 2018

  
 Trustee Director  
 Date  
 26<sup>th</sup> July 2018.

