

BAE Systems Pension Funds Investment Management Limited
Disclosure of commitment to the Financial Reporting Council's Stewardship Code

Background

The following statement has been prepared to demonstrate BAE Systems Pension Funds Investment Management Limited's ('BAPFIM') commitment towards the UK's Stewardship Code. BAPFIM is a wholly owned subsidiary of BAE Systems plc and acts as the lead investment manager to the BAE Systems plc pension schemes. External investment managers have also been appointed by the pension scheme Corporate Trustees in a number of asset classes.

The Trustees of the schemes support the UK Stewardship Code and believe that as long-term investors effective stewardship will improve accountability of management which ultimately will enhance future returns.

Each pension scheme's Corporate Trustees have appointed Hermes Equity Ownership Services ('Hermes EOS') to assist them in fulfilling their fiduciary responsibilities as long-term shareholders. The trustees believe that through the oversight of their equity shareholdings by Hermes EOS, it enables them to provide the highest standards of stewardship on behalf of the beneficiaries of the respective schemes.

BAPFIM's investment approach is based on active fund management and stewardship is an integral part of its investment process. BAPFIM maintains a constant dialogue with Hermes EOS and assists them where necessary in performing its obligations whether through corporate engagement or voting intentions.

The Corporate Trustees acknowledge their role as the asset owner. In fulfilling this role they continually seek to hold both Hermes EOS, their service provider, and where relevant their managers, to account for their stewardship activities.

For further information, please contact David Adam, Chief Investment Officer,
david.adam2@baesystems.com

Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Hermes EOS, on behalf of BAPFIM, undertakes company-specific engagements where the main objectives are in seeking both beneficial and sustainable change. The key underlying principle of their engagement policy is based on the promotion of long-term corporate value. Their engagement strategy seeks to challenge (where necessary) corporate governance, strategy and risk and the management of environmental, social and ethical issues of companies. All engagements undertaken by Hermes EOS, on behalf of the schemes, are guided by the Hermes Responsible Ownership Principles

www.hermes-investment.com/wp-content/uploads/2015/09/the-hermes-corporate-ownership-principles.pdf

Besides engagement on an individual company level, the schemes through Hermes EOS also work to establish effective regulatory regimes in the various markets in which they invest to encourage governance structures that facilitate accountability of companies to their owners, give companies the certainty they need to plan for the future and to level the playing field to ensure companies are not disadvantaged for prioritising long-term profitability.

Principle 2

Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed

BAPFIM has a written policy to identify, manage and disclose any potential conflicts of interest that may arise in relation to the stewardship of its investments. Our approach has been to identify those aspects of our business, including how we interact with other BAE Systems plc companies and third party suppliers, which could result in a conflict of interest. BAPFIM maintains and operates arrangements to prevent any conflict from giving rise to a material risk of damage to the interests of any of its clients.

On a corporate level, BAPFIM has no ongoing commercial relationships which may result in any conflicts of interest. However, potential conflicts can arise, for example, when:

- The firm acts as agent for more than one Client – this risk is mitigated provided the portfolio manager is acting in the best interests of both Clients
- The firm buys an investment for one Client and sells that investment for another (transferring assets) - this risk is mitigated provided the relevant portfolio manager believes that the transaction is separately suitable for both funds, irrespective of the intentions of the other fund.
- An individual undertakes transactions on a personal basis - our personal account dealing rules are intended to avoid any conflicts arising between personal interests and the interests of the clients.
- Investment in the sponsoring firm or interests of the sponsoring firm - the Scheme Trust Deed and our Investment Management Agreements with the Trustees prevents any active investment decision in the schemes' sponsor BAE Systems plc.

Our relationship with Hermes EOS also enables us to effectively manage conflicts of interest in relation to our stewardship work. Hermes EOS themselves are governed by their own conflicts of interest policy which requires that it identifies and manages actual or potential conflicts of interest between itself and its clients, or between different clients of Hermes EOS. In the event that a conflict occurs between Hermes EOS and its clients, clients' interests are put first.

www.hermes-investment.com/wp-content/uploads/2016/03/Hermes_Conflicts_of_Interest_Policy_2016.pdf

Principle 3

Institutional investors should monitor their investee companies

Both Hermes EOS and BAPFIM's investment managers monitor the performance of investee companies. Through a specific three year engagement plan Hermes EOS measure and monitor progress on engagements by setting clear engagement objectives and systematically assessing progress against four key milestones. These are raising the issue with the company, recognition by the company that the concern is valid, a plan to address the particular issue and successful delivery of the objective.

BAPFIM's investment managers also engage directly with company management on stewardship issues primarily through company meetings. In the UK, for example during 2016, BAPFIM held over 200 company meetings in which a wide range of topics were discussed such as: strategy, capital allocation, company performance, management

succession, executive remuneration and also environmental and social issues where relevant. Where appropriate any concerns are escalated to Hermes EOS for further evaluation and engagement.

On occasion while undertaking monitoring and/or engagement activities with investee companies BAPFIM may become an insider. Where BAPFIM has become an insider the company is added to a list of securities in which BAPFIM employees are classed as insiders. As such all staff are prohibited from carry out any transactions in relation to these securities until the relevant inside information has been made public and the restriction lifted.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities

Where we feel a company's action or policy may be detrimental to creating sustainable, long-term shareholder value, BAPFIM will engage directly with companies in a confidential basis and will endeavour to identify problems at an early stage to minimise any potential loss of shareholder value. Issues where we have intervened in the past include concerns over executive remuneration policies, board composition, governance, mergers and acquisitions activity, risk management, and strategy. Furthermore, BAPFIM portfolio managers also respond to requests from companies for comment on their governance and strategic issues.

BAPFIM maintains an open dialogue with Hermes EOS on all stewardship issues. Issues arising from our own company meetings and/or written correspondence with company executives that, in our opinion, need further analysis and/or are inconclusive are escalated to Hermes EOS. The effectiveness of the engagement would be assessed through the extent of the company management's willingness to address any of the concerns identified by BAPFIM through the engagement process. If serious problems arise, consideration will be given as to whether it is in the schemes' best interests to continue to hold the investment.

Hermes EOS themselves use a clear set of screens to identify companies which are in or near breach of any material governance, social and environmental issues. These engagements are measured against clear engagement objectives and are systematically assessed against key milestones. Where necessary, Hermes EOS will escalate the engagement process to ensure a successful outcome.

Principle 5

Institutional investors should be willing to act collectively with other investors where appropriate

BAPFIM accepts that collective action with other like-minded investors can add to the effectiveness of engagement. In this regard, BAPFIM is part of an investor alliance of in-house pension fund investment managers. These meetings form part of our investment process and the focus of the meetings are similar to our own one-to-one meetings with companies where we engage with company management on a broad range of topics.

Furthermore, we would be open to further collaborative action with other investors on governance and any other wider issues. Any such involvement will be considered on a case by case basis and based on the size of our investment, the materiality of the issues and where the potential for collaborative action will be more effective than in acting alone. We are not currently members of any other collective group, although this is kept under review.

Furthermore, by appointing Hermes EOS, the schemes are signalling their commitments to the benefits of collective shareholder engagements. Hermes EOS pools together investors'

resources and aggregates its clients' holdings to create scale so as to deliver a 'best-in-class' engagement service and which should help to protect and enhance shareholder value.

Principle 6

Institutional investors should have a clear policy on voting and disclosure of voting activity

BAPFIM's policy is to vote at all company meetings. Working with Hermes EOS, the schemes are able to ensure that all of its holdings are voted consistently across the portfolios. All voting decisions are based on a thorough analysis of publicly available information and always take into account a company's individual circumstances. Hermes EOS informs companies where it has concerns and seeks, where appropriate, a resolution prior to taking the decision to vote against any resolution. In this way, it uses the schemes votes as a lever for positive change at companies.

BAPFIM holds regular meetings with Hermes EOS to identify and review key areas of engagement and any contentious issues which may potentially arise. These meetings are attended by the Head of UK Equities and the Chief Investment Officer.

We currently do not undertake a stock lending programme.

Principle 7

Institutional investors should report periodically on their stewardship and voting activities

We disclose, on a quarterly basis, a summary of our historic voting and details of engagements that Hermes EOS has undertaken on our behalf with our investee companies to the Trustees. These reports include a summary of all voting broken down by region and whether we voted for, abstained or against management. These are disclosed in arrears so that we are fully transparent, accountable and furthermore ensure that any dialogue between Hermes EOS and companies in our portfolios are not compromised. Due to client confidentiality, these voting and engagement records are not publically disclosed.

BAPFIM recognises the role for an independent assurance on aspects of its business operations which includes compliance with the Stewardship Code. The schemes utilise BAE Systems' internal audit department to provide this service. They are entirely independent of BAPFIM and the Trustees.