Rolls-Royce UK Pension Fund

Trustee's annual report and financial statements for the year ended 31 March 2021

Pension Scheme Registration Number: 12001014

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Trustee and advisors

Trustee:	Rolls-Royce UK Pension Fund Trustees Limited
Trustee directors:	Company appointed directors Liz Airey – Chairman Jo Durkan Iain Foster Steve Jones Will Mansfield Mark McIntosh Member nominated directors Paul Butler Craig Gibson (resigned on 10 June 2021) Stuart Hedley Colin High (appointed on 10 June 2021) Mark Porter
Secretary:	Caroline Veitch, Rolls-Royce Pensions Department
Sponsoring employer:	Rolls-Royce plc, Kings Place, 90 York Way, London N1 9FX
Administrator:	Rolls-Royce Pensions Department, Jubilee House, Pride Park, Derby, DE24 8JY
Banker:	National Westminster Bank
Investment managers:	Capital Dynamics Limited Hg Capital LLP The Rohatyn Group Asian Infrastructure & Related Resources Opportunity Fund UK LP Insight Investment Management (Global) Limited Legal & General Assurance (Pensions Management) Limited M&G Investment Management Limited Pantheon Ventures (UK) LLP Royal London Asset Management Limited
Custodian and performance measurement:	State Street Bank and Trust Company
Investment consultant:	Mercer Limited, Tower Place, London, EC3R 5BU
Fund Actuary:	Alastair McIntosh FIA Aon Solutions UK Limited, The Aon Centre, The Leadenhall Building, 122 Leadenhall Street, London, EC3V 4AN
Legal advisor:	Linklaters LLP, One Silk Street, London, EC2Y 8HQ
Auditor:	Deloitte LLP, Four Brindleyplace, Birmingham, B1 2HZ (appointed 12 November 2020) KPMG LLP, One Snowhill, Snow Hill Queensway, Birmingham B4 6GH (resigned 6 November 2020).
Covenant advisor:	Penfida Limited, One Carey Lane, London, EC2V 8AE

Annual report

Establishment

The Rolls-Royce UK Pension Fund (the "Fund") provides retirement and life assurance benefits for employees of Rolls-Royce plc and related, participating companies (the "Company"). The Fund was originally established on 23 December 2008 but was significantly revised on 31 October 2016 when four of the Company's other defined benefit pension schemes were consolidated into the Fund. The Fund is governed by a Trust Deed and Rules as amended by supplementary deeds. The Trustee is a UK limited company, Rolls-Royce UK Pension Fund Trustees Limited (the "Trustee").

The Fund's assets are held in the name of the Trustee and are entirely separate from the assets of the Company. The Fund is registered with Her Majesty's Revenue & Customs for tax purposes. Consequently, the majority of the Fund's income and investment gains are free of taxation. However, the Fund cannot reclaim certain amounts of withholding taxes relating to overseas investment income.

The Fund was contracted-out of the State Second Pension until 5 April 2016.

Management of the Fund

The Trustee board

The directors of the Trustee are appointed and removed in line with the provisions of the Trustee's Articles of Association. There are currently ten directors comprising six directors appointed by the Company (including a Chairman and a director nominated by the Company's Central Negotiating Committee) and four directors nominated by members.

Prior to the outbreak of Covid-19, the Trustee directors met six times a year, with two strategy events and four quarterly meetings. The Trustee Board has agreed to extend the number of meetings to ten a year, four of which will be quarterly and face-to-face once this is possible, plus two strategy events and four virtual meetings. This will allow the Board to continue to be agile and to work proactively in managing the Fund. All directors have the same function except that the Chairman (or, if they are not present at any meeting the director appointed as Chairman of the meeting) will have a casting vote. Mr Iain Foster was appointed to act as Deputy Chairman for a period of two years to 31 December 2020 and was succeeded by Mr Mark Porter in that role from 1 January 2021). During the Fund year there were many more meetings to address the impact of Covid-19 and oversee work related to the triennial actuarial valuation as at 31 March 2020. Attendance at the Trustee meetings during the year is shown in the table below:

Director	Meetings attended	Meetings applicable
Liz Airey – Chairman	19	19
Paul Butler	19	19
Jo Durkan	17	19
Iain Foster	18	19
Craig Gibson	17	19
Stuart Hedley	19	19
Steve Jones	18	19
Will Mansfield	19	19
Mark McIntosh	19	19
Mark Porter	17	19

Each director has been provided with relevant documentation required to perform their role as a pension scheme trustee and pension scheme trustee training is undertaken on a regular basis. These training arrangements are designed to meet The Pensions Regulator's pension scheme trustee training requirements, which were established by the *Pensions Act 2004*.

The audit committee

The Trustee has established an audit committee (the "Committee") to oversee a range of activities, pursuant to ensuring the integrity of the Fund's financial statements, identifying, monitoring and controlling risks, and monitoring the cost and performance of service providers. The Trustee sets the terms of reference for the audit committee. The current terms of reference require a minimum of three directors appointed by the Trustee and for the audit committee to meet at least twice a year and more frequently as required. The members of the Committee and their attendance at meetings during the year are shown in the table below:

Director	Meetings attended	Meetings applicable
Will Mansfield – Chairman	5	5
Paul Butler (appointed from 10 November 2020)	2	2
Jo Durkan	5	5
Craig Gibson (resigned on 10 November 2020)	4	3
Mark McIntosh	5	5

The Committee had oversight of the following significant business during the year:

- In line with good governance practice, the Committee commenced a review and appointment process for the Fund's auditor during the year. Following this process, the Trustee agreed to appoint Deloitte as auditor with effect for the year ended 31 March 2021.

- Following the year end, the Committee reviewed the Trustee's annual report and financial statements prepared by management and a report produced by the Fund's external auditor (Deloitte LLP). The Committee was satisfied that appropriate judgements and estimates had been made by management and that the disclosures were appropriate. The Committee was also satisfied with the quality of the audit undertaken by Deloitte. The Committee recommended approval to the Trustee Board.

- The Committee expects that the implementation of an EU Directive on the activities and supervision of institutions for occupational retirement provision (IORP II) will require Funds such as this one to have an internal audit function. In anticipation of this, and in parallel with the above review and appointment process, the Committee also initiated a appointment process for a provider of additional business assurance services to support the Committee. Following this process the committee decided to appoint Ernst & Young.

- During the year, the Committee focussed on reviewing the information security measures and assurance provided by the Trustee's appointed service providers. It was pleased to note that Procentia Limited, WPS Advisory Limited and the four main outsourced providers of the Company's information technology environment, have all achieved the ISO 27001 information security standard certification.

For the 2021/22 year, the Committee's key areas for focus will be:

- Further monitoring and enhancement of the Fund's information security environment.

- Further development of the risk register to incorporate the Trustee's strategic objectives.

- Ensuring the basis of the Fund's financial statements are consistent with the financial position of the Company.

- Establishing the appointment of Ernst & Young as provider of additional business assurance services.

Changes to the Fund

Directors

There were no changes of directors during the Fund year. Following the end of the Fund year Mr Craig Gibson resigned as a member-nominated director on 10 June 2021. Accordingly, Mr Gibson also left the Trustee's audit committee. Mr Gibson was succeeded by Mr Colin High who was appointed as a member-nominated director following an appointment process. Mr Butler replaced Mr Gibson on the Trustee's audit committee. The Trustee would like to place on record its thanks to Mr Gibson for his many long years of service to the Fund.

Covid-19

As a result of the impact of Covid-19, during the Fund year the Company requested a deferral of contributions payable to the Fund, the implementation of a new benefit for members leaving employment – the Bridging Pension Option, and ultimately decided to close the Fund to future accrual of benefits. In considering and responding to these issues the Trustee focussed carefully on the Company's willingness and ability to support the Fund in accordance with advice from its professional advisers. Further information about these issues is provided below.

Deferral of contributions

As a result of the impact of the Covid-19 virus on the financial position of the Company, the Company had requested in March 2020 that the Trustee amend the Schedule of contributions certified by the Fund Actuary on 19 December 2017 to enable it to defer payment of the employer contributions due for the quarter ended 31 March 2020 from April 2020 to July 2020. In accordance with advice from its professional advisers the Trustee agreed to the request and a new Schedule of contributions was agreed and certified by the Fund Actuary on 7 April 2020.

Subsequently the Company requested that the deferred contributions, and those due for the quarter ended 30 June 2020, were deferred to October 2020. Again, in accordance with advice from its professional advisers and subject to provisions requiring early payment in specified circumstances, the Trustee agreed to the request and a new Schedule of contributions was agreed and certified by the Fund Actuary on 6 July 2020.

The Company again requested that the deferred contributions, and those due for the quarter ended 31 October 2020, were deferred to 31 December 2020. Again, in accordance with advice from its professional advisers, subject to provisions requiring early payment in specified circumstances and subject to the payment of all deferred member contributions (including those payable by Salary Sacrifice) on or before 19 October 2020, the Trustee agreed to the request and a new Schedule of contributions was agreed and certified by the Fund Actuary on 19 October 2020.

Finally, the Company requested that the Schedule of contributions be amended to align the date to which the Fund would continue to pay its own expenses with the statutory deadline for completing the 31 March 2020 actuarial valuation (30 June 2021) and to provide flexibility to pay the remaining deferred contributions in early January instead of on or before 31 December 2020. Again, in accordance with advice from its professional advisers and subject to provisions requiring early payment in specified circumstances, the Trustee agreed to the requests and new Schedules of contributions was agreed and certified by the Fund Actuary on 14 December 2020 and 18 December 2020 respectively. Accordingly, all remaining deferred contributions were paid in early January 2021.

Bridging Pension Option

Following a request by the Company to introduce a new Bridging Pension Option for the significant number of active members leaving employment as a result of the impact of Covid-19, the Trustee agreed to implement a Bridging Pension Option. The Bridging Pension Option allowed active members to use any severance payment they received upon leaving employment, to purchase a higher initial pension to be paid for a temporary period until their State Pension Age. This made retirement more affordable for some members leaving employment earlier than expected as a result of the impact of Covid-19 on the Company. The Trustee will consider whether the Bridging Pension Option should be provided to deferred members in future.

Closure of the Fund to future accrual

In June 2020 the Company informed the Trustee and members that it intended to close the Fund to future accrual on 31 December 2020. The Company commenced a statutory consultation period with affected employees from 31 July 2020 until 29 September 2020 (subsequently extended to 6 October 2020). The Fund closed to future accrual of benefits on 31 December 2020.

Following closure of the Fund the Company requested that the Trustee agree that the following transitional benefits be provided to active members at the date of closure:

- Extended access to “share of fund” transfer values to 31 December 2021.
- Death in service benefits calculated on service to 31 December 2020 to continue to be paid up to 31 December 2023.
- Ill health early retirement benefits calculated on service to 31 December 2020 to continue to be paid up to 31 December 2023.
- Early retirement for non-manager members to be calculated using “with consent” early retirement factors up to 31 December 2023.
- Partial transfers and the Bridging Pension Option described on page 5.

Following careful consideration of the Company’s request in accordance with advice from its professional advisers, the Trustee agreed to implement the transitional benefits by deed of amendment dated 1 December 2020.

Deeds of amendment

In order to implement the Bridging Pension Option and close the Fund to future accrual of benefits, deeds of amendment were executed on 30 June and 1 December 2020 respectively.

Formal actuarial valuation at 31 March 2020

The results of the formal actuarial valuation in accordance with Pensions Act 2004 was as at 31 March 2020 and was completed by the statutory deadline of 30 June 2021. A new Schedule of contributions was agreed and certified by the Fund Actuary on 25 June 2021. Further information is provided in the report on actuarial liabilities on page 8.

As part of the agreement of the actuarial valuation the Company requested that the Trustee agree the following contingent benefit improvements for members that were active at the date of closure to future accrual of benefits on 31 December 2020:

- For non-manager members, uplifts to deferred benefits of 1.33% on 31 December 2021, 2022 and 2023 subject to remaining in Company employment until those dates and funding and covenant tests being met. Similar uplifts were requested for manager members of 0.33% (or 0.58% if at 31 December 2020 a manager member’s accrued pension was less than 40% of their full-time equivalent salary).
- Early retirement for non-manager members to be calculated using “with consent” early retirement factors in any calendar year after 31 December 2023.

The funding and covenant tests referred to above are that on 30 September prior to any benefit improvement being awarded:

- The Fund being at least 107% funded for its technical provisions excluding any reserves for contingent benefit improvements or expenses; and

- The Company having at least £2.5 billion of available liquidity.

The Company also requested that the contingent benefit improvements become guaranteed if either:

- The Company receives an investment grade credit rating from both S&P and Moody's for a period of six months; or

- The Fund being 110% funded for its technical provisions on average over 12 consecutive month ends, as calculated by the Fund Actuary and including any reserves for contingent benefit improvements or expenses.

The Company also requested that the contingent benefit improvements continue to apply to 31 December 2023 for any member that leaves Company employment subject to the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) before that date.

The Company also requested that death in service benefits of four times pensionable salary be maintained until 31 December 2023 for all members that were active at the date of closure to future accrual. This benefit improvement would cease in the case of a member leaving Company employment subject the TUPE Regulations.

Following careful consideration of the Company's request and in accordance with advice from its professional advisers, the Trustee agreed to implement the above benefit improvements by deed of amendment dated 25 June 2021.

Change of auditor

Following a review and appointment process overseen by the Trustee's audit committee, Deloitte LLP was appointed to replace KPMG LLP as the Fund's auditor with effect for the year ended 31 March 2021. KPMG LLP formally resigned as the Fund's auditor on 6 November 2020 and Deloitte LLP was formally appointed on 12 November 2020. KPMG LLP confirmed that there were no circumstances connected with its resignation which affect the interests of the members, prospective members or beneficiaries of the Fund.

Report on actuarial liabilities

Under Section 222 of the Pensions Act 2004, every pension 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 receive, based on pensionable service to the valuation date. The present value of those benefits is assessed using assumptions agreed between the Trustee and the Company and set out in a Statement of Funding Principles, which is available to members on request. A formal actuarial valuation of the Fund is carried out by the Fund Actuary at least every three years.

The latest formal actuarial valuation was undertaken as at 31 March 2020 by the Fund Actuary, Alastair McIntosh of Aon plc. The results of this valuation and an updated position as at 30 June 2021 using equivalent assumptions are shown below.

	31 March 2020	30 June 2021
The value of the assets was:	£9,336m	£8,787m
The value of the technical provisions was:	£8,874m	£7,871m
Surplus / (deficit):	£462m	£916m
Funding ratio:	105.2%	111.6%

The method and significant actuarial assumptions used to determine the technical provisions for the formal actuarial valuation were as follows:

Method

The actuarial method that was used in the calculation of the technical provisions was the Projected Unit Method.

Significant actuarial assumptions

Discount rate: Term structure derived from the yields on conventional UK Government bonds appropriate to the date of each future cashflow plus an additional 0.5% per annum to reflect the allowance the Trustee has agreed for additional investment returns based on the investment strategy as set out in the Trustee's Statement of Investment Principles.

Future Retail Price inflation: Term structure derived from the difference between the yield on conventional and index-linked UK Government bonds at the date of each future cash flow.

Future Consumer Price inflation: Derived from the RPI inflation assumption with an appropriate adjustment to recognize the difference between expectations of future RPI increases and future CPI increases. At the 31 March 2020 valuation the adjustment was a deduction of 0.54% per annum.

Salary increases: Salary increases are no longer applicable following closure of the Fund to future accrual on 31 December 2020.

Pension increases in payment: Term structure derived from price inflation annual forward rates allowing for the maximum and minimum annual increase entitlements or fixed increases where known and guaranteed. In addition to guaranteed increases, if the Fund retains a surplus of at least 4% on a basis set out in the Trust Deed and Rules, contingent increases of up to 2% a year apply to pensions earned before 6 April 1997 and that receive no guaranteed increases under the Trust Deed and Rules or legislation. The value of these contingent increases is not included in the above technical provisions.

Mortality: SAPS S3 year of birth tables S3PMA and S3PFA_M adjusted as follows:

	Male	Female
Active members	101%	94%
Deferred members	101%	95%
Pensioners	102%	99%

Note that different adjustments are applied to contingent dependants.

The allowance for improvements is based on the actuarial profession's Continuous Mortality Investigation 2019 model with a period smoothing parameter of 7.0, "A" parameter of 0.5 and a long-term improvement rate of 1.5% p.a.

Membership

The changes in membership during the period 1 April 2020 to 31 March 2021 are shown in the table below. Opening balance adjustments take account of any retirements, leavers and deaths that occurred before the last Fund year end but were not processed until after the Trustee's report and financial statements had been signed for that year.

Active members		
Members at 1 April 2020		9,915
Adjustments for movements prior to 1 April but processed after that date		(114)
		9,801
Less:	Active members retiring	(771)
	Active members leaving service	(7,709)
	Deaths	(4)
	Transfers out	(1,317)
Members at 31 March 2021		**0**

Deferred members		
Members at 1 April 2020		18,905
Adjustments for movements prior to 1 April but processed after that date		(101)
		18,804
Add:	Active members leaving service	7,709
Less:	Deferred members retiring	(472)
	Deaths	(14)
	Transfers out	(267)
	No further liability	(2)
Members at 31 March 2021		**25,758**

Pensioners		
Pensioners at 1 April 2020		13,088
Adjustments for movements prior to 1 April but processed after that date		121
		13,209
Add:	Active members retiring	771
	Deferred members retiring	472
	Dependants pensions commencing	221
Less:	Deaths	(782)
Pensioners at 31 March 2021		**13,891**

Statement of Trustee's responsibilities

Statement of Trustee's responsibilities for the annual report and financial statements

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 Fund during the Fund 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 Fund 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 Fund will not be wound up.

The Trustee is also responsible for making available certain other information about the Fund 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 Fund 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 Fund's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Trustees responsibilities in respect of contributions

- The Trustee is responsible under pensions 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 Fund by or on behalf of the employer and the active members of the Fund and the dates on or before which such contributions are to be paid; and

- The Trustee is also responsible for adopting risk-based processes to monitor whether contributions are made to the Fund by the employer in accordance with the Schedule of Contributions. Where breaches of the Schedule occur, the Trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to The Pensions Regulator and the members.

Financial development of the Fund

The financial statements of the Fund for the year are set out on pages 24 to 41. The financial statements have been prepared and audited in accordance with Sections 41(1) and (6) of the *Pensions Act 1995*. A summary of the Fund's financial statements is set out in the table below:

	31/03/2021	31/03/2020
	£'000	*£'000*
Member related income	91,324	172,694
Member related payments	(1,023,890)	(5,377,920)
Net withdrawals from dealings with members	(932,566)	(5,205,226)
Net returns on investments	138,053	848,773
Net decrease in Fund	(794,513)	(4,356,453)
Net assets at start of year	9,335,564	13,692,017
Net assets at end of year	**8,541,051**	**9,335,564**

Transfer Payments

As a minimum, all cash equivalent transfer values (CETVs) paid during the year were calculated as prescribed by legislation and represented the value of the member's preserved benefits. No allowance for discretionary pension increases was included. CETVs paid to active members who have reached the UK minimum retirement age are provided with a transfer value calculated as a share of Fund, based on advice from the Fund Actuary. Authorised financial advice is also provided to active members to enable them to consider their retirement options.

Pension Increases

Deferred pensions are increased in line with statutory requirements when deferred members retire. Pensions in payment were increased on 1 April 2021 as shown in the following table:

Legacy Scheme	Pension Element	Increase
Rolls-Royce Pension Fund / Rolls-Royce Ancillary Benefits Plan	Pension earned before 6 April 1997	2% (1)
	Pension earned between 6 April 1997 and 5 April 2005	0.5% (2)
	Pension earned after 5 April 2005	0.5% (3)
	Bridging pension	0.5% (3)
Rolls-Royce Group Pension Scheme / Vickers Group Pension Scheme	Pension earned before 6 April 1997	1.2% (4)
	Pension earned between 6 April 1997 and 5 April 2005 (31 March 2007 for former members of the Vickers Group Pension Scheme)	1.2% (5)
	Pension earned after 5 April 2005 (31 March 2007 for former members of the Vickers Group Pension Scheme)	1.2% (6)
	For managers, pension earned after 5 April 2006	0.6% (13)
	Bridging pension	1.2% (6)
Rolls-Royce Engine Control Systems Pension Scheme – Closed, SRBS and Open Sections	Pension earned before 1 April 2008	1.4% (7)
	Pension earned between 1 April 2008 and 30 September 2016	1.4% (9)
	Pension earned after 30 September 2016	1.2% (6)
	Temporary Pension	2.5% (10)
	For managers, pension earned after 30 September 2016	0.6% (13)
	Bridging pension	1.2% (6)
Rolls-Royce Engine Control Systems Pension Scheme – 2004 Section	Pension earned before 1 April 2008	1.4% (8)
	Pension earned between 1 April 2008 and 30 September 2016	1.4% (9)
	Pension earned after 30 September 2016	1.2% (6)
	Temporary Pension	2.5% (10)
	For managers, pension earned after 30 September 2016	0.6% (13)
	Bridging pension	1.2% (6)

See notes on following page.

Guaranteed Minimum Pension (GMP)

GMP earned between 6 Apr 1978 and 5 Apr 1988	N/A (11)
GMP earned between 6 Apr 1988 and 5 Apr 1997	0.5% (12)

Notes:

(1)	Guaranteed 2% increases on 1 April in the years 2021, 2022 and 2023. From 1 April 2024, contingent increases of up to 2% a year will apply if the Fund retains a surplus of at least 4% on a basis set out in the Trust Deed and Rules.
(2)	Annual CPI increase (September 2020) up to maximum of 5%.
(3)	Annual CPI increase (September 2020) up to maximum of 2.5%.
(4)	Annual RPI increase (December 2020) up to maximum of 3%.
(5)	Annual RPI increase (December 2020) up to maximum of 5%.
(6)	Annual RPI increase (December 2020) up to maximum of 2.5%.
(7)	Annual RPI increase (January 2021) up to maximum of 7%.
(8)	Annual RPI increase (January 2021) up to maximum of 5%.
(9)	Annual RPI increase (January 2021) up to maximum of 4%.
(10)	Increases in line with Basic State Pension.
(11)	All increases are provided by the State.
(12)	Annual CPI increase (September 2020) up to a maximum of 3%. Additional inflationary increases are provided by the State.
(13)	Annual CPI increase (December 2020) up to maximum of 2.5%.

Pensions Act 1995/2004

The following appointments have been made in accordance with statutory requirements:

- Fund Actuary –Alastair McIntosh FIA - Aon plc
- Auditor – Deloitte LLP
- Legal advisor – Linklaters LLP
- Investment consultant – Mercer Limited

The Trustee regularly reviews the performance of its appointed advisors and service providers (including those mentioned above).

Investments

Governance

The Trustee has implemented an investment governance framework. In accordance with this framework, significant investment matters are reserved for the Trustee to enable it to consider, agree and monitor implementation of its investment strategy, monitor investment management expenses and review the performance of its appointed investment consultant. The framework also provides a clear role for the Trustee's appointed investment consultant and formally delegates other operational and administrative matters to the Trustee's appointed service providers. Day-to-day management of investments is delegated to appointed investment managers in written agreements with those investment managers.

The Trustee maintains a statement of investment principles (SIP) in accordance with the *Pensions Act 1995*, which documents the principles governing the Trustee's decisions about investment. A copy of the latest SIP is appended to this annual report and financial statements. Copies are also available from the Trustee Secretary on written request. The Trustee can confirm that there were no breaches of the SIP during the year.

Custody

The Fund's assets are owned directly or indirectly by the Trustee and are entirely separate from the assets of the Company. The Trustee has appointed State Street Bank and Trust Company (State Street) to provide custody services for the safekeeping of segregated assets. The Fund's segregated assets are separately identified in State Street's records as belonging to the Trustee and State Street requires its sub-custodians to segregate the Trustee's assets from their own assets. State Street's records of securities and cash are reconciled to the Trustee's appointed investment managers' records on a monthly basis. Custody of the underlying investments in pooled investment vehicles is arranged by the managers of the pooled investment vehicles. Cash is normally held in liquid, diversified pooled investment vehicles managed by the investment managers.

Investment strategy

The Trustee's primary objective is to meet the Fund's liabilities as and when they fall due. In pursuit of this objective, the Trustee seeks to invest the Fund's assets at an appropriate level of risk relative to the Fund's liabilities.

In seeking to achieve the primary objective, the Trustee follows a low-risk investment strategy in pursuit of excess return relative to the Fund's liabilities by investing a proportion of assets in:

- A Liability-Driven Investment (LDI) portfolio, expected to match or "hedge" closely the interest rate and inflation risk profile of the Fund's liabilities.

- A credit portfolio expected to generate excess returns relative to the Fund's liabilities primarily by harvesting credit spreads above yields on "pure" hedging assets. The credit portfolio may contribute to the LDI strategy through investment in fixed interest assets but may also hold floating rate or non-matching assets. The credit portfolio may also hold a mixture of public and private assets.

- A Return-Seeking Asset (RSA) portfolio, expected to generate excess returns relative to the Fund's liabilities through investment in other non-matching assets such as equities.

Within these portfolios the Trustee invests in segregated assets and pooled investment vehicles. A summary of the assets contained in these portfolios at the end of the year is shown in the following table:

Asset Class	Segregated	Pooled investment vehicles	Total	
	£'000	£'000	£'000	%
Liability-Driven Investment (LDI) Portfolio	**4,270,430**	**118,942**	**4,389,372**	**51**
UK Government bonds - fixed interest	3,386,693	-	3,386,693	40
UK Government bonds - index-linked	3,785,663	-	3,785,663	44
Gilt repurchase agreements	(1,604,587)	-	(1,604,587)	(19)
Derivatives	17,772	-	17,772	-
Cash, liquidity funds and other net investment assets	(1,315,111)	118,942	(1,196,169)	(14)
Credit Portfolio	**3,200,041**	**845,142**	**4,045,183**	**47**
Global non-government (public and private)	3,142,078	720,777	3,862,855	45
Derivatives	31,330	-	31,330	-
Cash, liquidity funds and other net investment assets	26,633	124,365	150,998	2
Return-Seeking Asset (RSA) Portfolio	**66,455**	**59,379**	**125,834**	**2**
Global equities	-	-	-	-
Private equity funds	-	59,379	59,379	1
Derivatives	51,556	-	51,556	1
Cash, liquidity funds and other net investment assets	14,899	-	14,899	-
Total net investment assets	**7,536,926**	**1,023,463**	**8,560,389**	**100**

The segregated UK Government bonds are quoted on recognised stock exchanges. The pooled investment vehicles are valued and traded daily, weekly or monthly by the investment managers. All other assets are traded in "over the counter" markets.

The Trustee has authorised the use of derivatives by the investment managers to reduce certain investment risks and for efficient portfolio management purposes. The principal investments in derivatives are:

- Collateralised interest rate swap, inflation swap and futures contracts within the LDI and credit portfolios.

- Forward foreign exchange contracts to hedge assets denominated in overseas currencies back to Sterling.

A summary of the derivative contracts held within the Fund's segregated investments for this purpose at the end of the year is included under note 17 to the financial statements.

Performance

The level and type of assets in the Fund was significantly changed by the transfer of assets and liabilities from three other Company pension arrangements into the Fund on 31 October 2016. Annual performance data is therefore only available for the Fund's assets and liabilities (technical provisions described on page 8) from the Fund year ended 31 March 2018. Data for the previous three Fund years is shown below:

Year ending 31 March	Assets	Liabilities
2021	1.07%	(1.7%)
2020	8.25%	11.80%
2019	5.03%	5.70%

Stewardship and responsible investment

The Trustee has considered how Environmental, Social and Governance (ESG) factors should be integrated into the Fund's investment management processes and stewardship practices, taking into account the expected time horizon of the Fund. The Trustee's policy is that the Fund's investment managers have full discretion in integrating ESG and sustainability factors into their investment processes to assess the potential impact on financial performance in deciding on the selection, retention and realisation of investments.

The Trustee supports the UK Stewardship Code. The Trustee has given the appointed investment managers, both segregated and pooled, full discretion when undertaking engagement activities in accordance with their own corporate governance policies and current best practice.

The Trustee is open to engaging directly through written communication with debt or equity issuers on a range of issues including, but not limited to, performance, strategy, risks, ESG and sustainability factors. This might take place if the manager requests the engagement and if the Trustee believes that this may be more effective than the investment manager's stewardship engagement activity on its own. Before engaging the Trustee will seek advice from its appointed investment consultant and other appointed advisers.

The Trustee has commissioned its investment consultant to undertake an annual responsible investment monitoring framework exercise covering ESG integration, stewardship activities and carbon footprinting analysis. The Trustee will engage with its investment managers on the key findings as necessary, particularly where a manager is judged to be lagging its peers. The Trustee will use this assessment and the investment consultant's ESG ratings in decisions around selection, retention and cessation of manager appointments.

The Trustee supports the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) as a best-practice framework to manage and report on the actions being taken to identify climate change related risks and incorporate climate change risk management into investment processes. The Fund's investment managers are expected to adopt these recommendations. Since 2019 the investment managers have been required to provide portfolio carbon risk metrics consistent with the framework and the Trustee reports these metrics on an annual basis. A copy of the current TCFD report is included in Appendix 2.

In addition to requiring all managers to adhere to the UK Stewardship Code all managers are expected to be signatories to the UN supported Principles for Responsible Investment (PRI).

The Trustee does not currently have a policy of taking into account "non-financial matters" when considering the selection, retention and realisation of assets. For this purpose "non-financial matters" means the views of the members and beneficiaries, including their ethical views and views in relation to social and environmental impact and their present and future quality of life.

Contact details

Internal Disputes Procedure

The Trustee operates an Internal Disputes Procedure for resolving complaints by members in accordance with statutory requirements. All complaints should be made in writing to:

The Trustee Secretary
Pensions Department
Rolls-Royce plc
PO Box 31 (JH-19)
Derby
DE24 8BJ

The Money and Pensions Service

The Money and Pensions Service (MAPS) is an independent voluntary organisation that provides free, impartial guidance to members and beneficiaries of pension schemes on a range of issues. MAPS can be contacted at:

120 Holborn
London
EC1N 2TD

The Pensions Ombudsman

The Pensions Ombudsman may investigate and determine any complaint or dispute of fact or law in relation to an occupational pension scheme. The Ombudsman can be contacted at:

10 South Colonnade
Canary Wharf
London
E14 4PU

Pension Tracing Service

The Pension Tracing Service has been established to help individuals to keep track of benefits they may have as a result of service with former employers. The Pension Tracing Service can be contacted at:

The Pension Service 9
Mail Handling Site A
Wolverhampton
WV98 1LU

The registration number of The Rolls-Royce UK Pension Fund is 12001014.

The Pensions Regulator

The Pensions Regulator (TPR) is the regulatory body for occupational pension schemes in the UK. TPR can be contacted at:

Napier House
Trafalgar Place
Brighton
East Sussex
BN1 4DW

Information to Members

Further information about the Fund can be requested by writing to:

The Trustee Secretary
Pensions Department
Rolls-Royce plc
PO Box 31 (JH-19)
Derby
DE24 8BJ

Information can also be requested by e-mailing pensions.web@rolls-royce.com.

This report or other information about the Fund can be provided in large print or Braille formats upon request. The Trust Deed and Rules is available for inspection by members by writing to the same address. Further information about members' benefits and the Fund in general is available at www.rolls-roycepensions.com.

Approval of Trustee's Annual Report and Financial Statements

The Trustee's Annual Report and the Financial Statements were approved at a meeting of the Trustee held on 13 September 2021.

Caroline Veitch
Trustee Secretary

13 September 2021

Independent auditor's report to the Trustee of the Rolls-Royce UK Pension Fund for the year ended 31 March 2021

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of the Rolls-Royce UK Pension Fund (the 'Fund'):

- show a true and fair view of the financial transactions of the Fund during the year ended 31 March 2021 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 which comprise:

- the fund account;

- the statement of net assets (available for benefits); and

- the related notes 1 to 28.

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 Fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (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

In auditing the financial statements, we have concluded that the Trustee's use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Fund's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the Trustee with respect to going concern are described in the relevant sections of this report.

Other information

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

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 course of 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 this gives rise to a material misstatement in the financial statements themselves. 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 this regard.

Responsibilities of Trustee

As explained more fully in the Statement of Trustee's responsibilities, 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 Fund'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 Fund 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 FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

We considered the nature of the Fund's industry and its control environment, and reviewed the Fund's documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of the Trustee and pension management, their own identification and assessment of the risks of irregularities.

We obtained an understanding of the legal and regulatory framework that the Fund operates in, and identified the key laws and regulations that:

- had a direct effect on the determination of material amounts and disclosures in the financial statements. These included the Pensions Act 2004, the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013; and

- do not have a direct effect on the financial statements but compliance with which may be fundamental to the Fund's ability to operate or to avoid a material penalty. These included the Fund's regulatory requirements.

We discussed among the audit engagement team including relevant internal specialists such as pensions actuarial and IT specialists regarding the opportunities and incentives that may exist within the organisation for fraud and how and where fraud might occur in the financial statements.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

In addition to the above, our procedures to respond to the risks identified included the following:

- reviewing financial statement disclosures by testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;

- performing analytical procedures to identify unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;

- enquiring of the Trustee and pension management and legal counsel concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and

- reading minutes of Trustee meetings and reviewing correspondence with the Pensions Regulator.

Use of our report

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

Deloitte LLP

Deloitte LLP
Statutory Auditor
Birmingham, United Kingdom
Date: 14th September 2021

Financial Statements

Fund account

	Note	31st March 2021	31st March 2020
		£'000	£'000
Contributions and benefits			
Employer contributions	5	88,514	168,722
Employee contributions	5	1,622	2,491
Total contributions		**90,136**	**171,213**
Transfers in	6	1,188	981
Other income	7	-	500
		91,324	**172,694**
Benefits payable	8	(139,542)	(271,075)
Payments to and on account of leavers (including bulk annuity premium)	9	(877,795)	(5,100,752)
Other payments	10	(1,800)	(680)
Administrative expenses	11	(4,753)	(5,413)
		(1,023,890)	**(5,377,920)**
Net withdrawals from dealings with members		**(932,566)**	**(5,205,226)**
Returns on investments			
Investment income	12	184,094	307,789
Change in market value of investments	15	(37,277)	552,215
Investment management expenses	13	(8,841)	(11,174)
Taxation	14	77	(57)
Net returns on investments		**138,053**	**848,773**
Net decrease in the Fund during the year		**(794,513)**	**(4,356,453)**
Net assets of the Fund at 1 April		9,335,564	13,692,017
Net assets of the Fund at 31 March		**8,541,051**	**9,335,564**

The notes on pages 26 to 41 form part of these financial statements.

Statement of net assets (available for benefits)

	Note	31 March 2021	31 March 2020
		£'000	*£'000*
Investment assets			
Bonds	15	10,314,434	10,868,190
Pooled investment vehicles	16	1,023,430	1,087,431
Derivatives	17	167,595	63,862
Cash	15	30,094	154,732
Other investment balances	15	1,585,434	1,615,386
		13,120,987	**13,789,601**
Investment liabilities			
Short sold bonds	15	(1,317,054)	(1,050,223)
Derivatives	17	(66,937)	(205,244)
Other investment balances	15	(3,176,607)	(3,216,564)
		(4,560,598)	**(4,472,031)**
Total investments		**8,560,389**	**9,317,570**
Current assets	24	1,491	33,828
Current liabilities	25	(20,829)	(15,834)
Total net assets of the Fund as 31 March		**8,541,051**	**9,335,564**

The notes on pages 26 to 41 form part of these financial statements.

The financial statements summarise the transactions of the Fund 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 Fund year. The actuarial position of the Fund, which takes into account such obligations, is dealt with in the Report on Actuarial Liabilities on page 8 and these financial statements should be read in conjunction with that report.

Signed for and on behalf of the Trustee of the Rolls-Royce UK Pension Fund

Director

Colin High

Director

13 September 2021

Notes (forming part of the financial statements)

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 - 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 2018).

The financial statements are prepared on a going concern basis, which the Trustee believes to be appropriate as it believes that the Fund has adequate resources to realise its assets and meet accrued benefit payments in the normal course of affairs (continue to operate) for at least the next twelve months.

Whilst the Fund currently has surplus net assets to meet pension payments that have been accrued to date on an ongoing basis, if the Principal Employer, Rolls-Royce plc, became insolvent then the Fund would nevertheless be subject to an assessment by the Pension Protection Fund (the Pension Protection Fund is a statutory fund in the United Kingdom, intended to protect members if their defined benefits pension fund becomes insolvent. It was created under the Pensions Act 2004). This could potentially result in the Fund being wound up and its assets and liabilities transferred to the Pension Protection Fund. In such circumstances members would receive at least the level of benefits provided by the Pension Protection Fund. Alternatively, if the Fund was allowed to continue to provide members' benefits outside the Pension Protection Fund, it is possible that the Trustee would decide to wind-up the Fund and secure members' benefits immediately.

Rolls-Royce plc is a significant part of the Rolls-Royce group of companies which are ultimately owned by Rolls-Royce Holdings plc (the "Group"). The outbreak of the Covid-19 virus has created significant challenges and high levels of uncertainty for the Group given its significant exposure to the civil aerospace industry. The Trustee has been closely monitoring the strength of the Group and the action it is taking to mitigate the impact of Covid-19. The Trustee has considered the going concern statement included in the Group's 2021 half-year results published on 5 August 2021. This considered the period to 28 February 2023 and concluded that under "base case" and "severe but plausible downside" scenarios", the Group expects to continue as a going concern. On this basis, whilst the impact of Covid-19 on the Group cannot be accurately predicted, the Trustee currently considers that the Group will nevertheless continue to operate for the next twelve months, and therefore the Trustee believes that it remains appropriate to prepare the Trust's financial statements on a going concern basis. However, the circumstances of the possible impact on the Group of a possible second wave of COVID 19 and associated government action to limit the spread of the virus constitute a material uncertainty that may cast significant doubt on the Fund's ability to continue as a going concern and hence to realise its assets and meet accrued benefit payments in the normal course of affairs. The financial statements do not include any adjustments that would result from the basis of preparation being inappropriate. It should also be noted that investments in the financial statements are £8,560m within total net assets of £8,541m. Investments are recognised at fair value, which would not change if the financial statements were not prepared on a going concern basis.

2. Identification of the financial statements

The Fund is established as a trust under English law. The address for enquiries to the Fund is included in the annual report.

3. Prior year reclassifications

Several reclassifications have been made to the 2020 comparatives within the financial statements to better reflect the recommendations of the SORP. These matters have had no impact on the 2020 fund account and no impact to the overall net asset balance as at 31 March 2020. The reclassifications are summarised below:

- Bonds previously shown in investment assets have been reclassified to reflect that they are short sold bonds and therefore should be shown within investment liabilities. This has had the impact of increasing bonds shown within investment assets by £1,050.2m and increasing bonds within investment liabilities by the corresponding amount.
- Repurchase agreements previously shown in investment liabilities have been reclassified to reflect that that are reverse repurchase agreements and therefore should be shown within investment assets. This has had the impact of increasing repurchase agreements shown within investment assets by £1,505.6m and increasing repurchase agreements within investment liabilities by the corresponding amount.
- Within note 17, the asset and liability values of the swap contracts have been reclassified to reflect the net position of the contract as recommended by the SORP rather than the gross or legs of the contract. This has had the impact of decreasing total swap assets of £261.5m and decreasing total swap liabilities by the corresponding amount.
- Within the Statement of Net Assets and throughout the corresponding investment notes, there has been a reclassification of £8.6m from Pooled Investment Vehicles to Cash and other cash equivalents to reflect the substance of the investment.

4. Accounting policies

The principal accounting policies of the Fund are as follows:

a) Investments

i. Investments are included at fair value.
ii. Listed investments are stated at the bid price at the date of the statement of net assets, except as noted below.
iii. Fixed interest securities are stated at their clean prices (i.e. without accrued interest). Accrued interest is accounted for within investment income.
iv. Unquoted securities are included at fair value estimated by the Trustee based on advice from the investment managers.
v. Pooled investment vehicles are stated at bid price for funds with bid/offer spreads, or single price where there are no bid/offer spreads are provided by the investment manager.
vi. Annuities purchased in the name of the Trustee which fully provide the pension benefits for certain members are excluded in these financial statements on grounds of materiality.
vii. Derivatives are stated at fair value.
    - Exchange traded derivatives are stated at fair value determined using market quoted prices.
    - Swaps are valued taking the current value of future cash flows arising from the swap determined using discounted cash flow models and market data at the reporting date.
    - Over the counter (OTC) derivatives are stated at fair value using pricing models and relevant market data as at the reporting date.
    - Forward foreign exchange contracts are valued by determining the gain or loss that would arise from closing out the contract at the reporting date by entering into an equal and opposite contract at that date.
    - All gains and losses arising on derivative contracts are reported within change in market value in the fund account.
    - Receipts and payments arising from derivatives are reported as sale proceeds or purchases of investments.

viii. Repurchase and reverse repurchase agreements:
    - Under repurchase agreements, the Fund continues to recognise and value the securities that are delivered out as collateral and includes them in the financial statements. The cash received is recognised as an asset in the financial statements and the obligation to pay it back is recognised as a liability.

- Under reverse repurchase agreements, the Fund does not recognise the value of securities received as collateral in its financial statements. The cash delivered to the counterparty is recognised as a receivable in the financial statements.

b) Investment income

i. Income from fixed income securities is accounted for when it becomes payable.
ii. Interest is accrued on a daily basis.
iii. Investment income is reported net of attributable tax credits but gross of withholding taxes which are accrued in line with the associated investment income. Irrecoverable withholding taxes are reported separately as a tax charge.
iv. Investment income arising from the underlying investments of pooled investment vehicles is rolled up and reinvested within the pooled investment vehicles. This is reflected in the unit price and reported within change in market value.
v. Receipts from annuity policies held by the Trustee to fund benefits payable to members are included within investment income on an accruals basis.

c) Foreign currencies

i. The functional and presentational currency of the Fund is Sterling.
ii. Balances denominated in foreign currencies are translated into Sterling at the rate ruling at the reporting date. Asset and liability balances are translated at the bid and offer rates respectively.
iii. Transactions denominated in foreign currencies are translated at the rate ruling at the date of a transaction.
iv. Differences arising on investment balance translation are accounted for in the change in market value of investments during the year.

d) Contributions

i. Employee normal contributions are accounted for when deducted from pay. Employer normal contributions are accounted for in the period they are due under the Schedule of Contributions.
ii. Employer augmentation contributions are accounted for in accordance with the agreement under which they are being paid.
iii. If relevant, employer deficit funding contributions are accounted for on the due dates on which they are payable in accordance with the Schedule of Contributions and any recovery plan under which they are being paid.

e) Payments to members

i. Benefits are accounted for in the period in which they fall due for payment. Where there is a choice, benefits are accounted for in the period in which the member notifies the Trustee of his decision on the type or amount of benefit to be taken or, if there is no member choice, they are accounted for on the date of retirement or leaving.
ii. Opt outs are accounted for when the Trustee is notified of the opt out.
iii. Individual transfers in/out are accounted for when paid/received which is normally when member liability is accepted/discharged.

5. Contributions receivable

	2021	2020
	£'000	£'000
Employer:		
Normal	67,139	105,591
PaySave	16,281	27,220
Other	4,066	34,500
Sickness, maternity and career break absences, and disability benefits	1,028	1,411
	88,514	**168,722**
Members:		
Normal	1,622	2,491
	90,136	**171,213**

Following closure of the Fund to future accrual of benefits on 31 December 2020 no further regular contributions are payable. Employer normal contributions shown above were payable in accordance with the Schedules of Contributions certified by the Fund Actuary on 19 December 2017, 7 April 2020, 6 July 2020, 19 October 2020, 14 December 2020 and 18 December 2020.

PaySave contributions related to members participating in an employee salary sacrifice arrangement. Such members accepted a reduced salary, did not pay member pension contributions and instead, the Company paid the pension contributions that would otherwise have been due from the members.

Other contributions in 2021 related to members using voluntary severance payments to fund the Bridging Pension Option described on page 5. Other contributions in 2020 related to £34.5 million paid by the employer in 2019 to facilitate the purchase of a bulk annuity.

If the Fund is less than 107% funded at the 31 March 2023 on the Technical Provisions basis agreed between the Trustee and the Company for the formal actuarial valuation as at 31 March 2023, the employer will make additional contributions (capped at £145m) to the Fund over the period 1 January 2024 to 31 December 2026.

6. Transfers in

	2021	2020
	£'000	£'000
Individual transfers	1,188	981
	1,188	**981**

The individual transfers above relate to certain AVC's in the Rolls-Royce Retirement Savings Trust, which members can transfer back into the Fund to provide additional benefits at retirement.

7. Other income

	2021	2020
	£'000	£'000
Other income	-	500
	-	**500**

The other income in 2020 relates to a contribution towards legal fees from an annuity provider as part of the purchase of a bulk annuity in 2019.

8. Benefits payable

	2021	2020
	£'000	£'000
Pensions	(77,683)	(228,726)
Commutations and lump sum retirement benefits	(60,097)	(39,042)
Lump sum death benefits	(1,276)	(2,540)
Taxation where lifetime or annual allowance exceeded	(486)	(767)
	(139,542)	**(271,075)**

9. Payments to and on account of leavers

	2021	2020
	£'000	£'000
Refund of contributions	-	(1)
Individual transfers out to other schemes	(877,795)	(326,046)
Bulk annuity premium paid to annuity provider	-	(4,774,705)
	(877,795)	**(5,100,752)**

10. Other payments

	2021	2020
	£'000	£'000
PPF levies	(1,800)	(680)
	(1,800)	**(680)**

11. Administration expenses

	2021	2020
	£'000	£'000
Actuarial fees	(894)	(902)
Audit fee	(73)	(84)
Legal and other professional fees	(500)	(1,233)
Administration and processing	(3,286)	(3,194)
	(4,753)	**(5,413)**

12. Investment income

	2021	2020
	£'000	£'000
Income from bonds	167,901	168,776
Income from pooled investment vehicles	16,053	16,906
Annuity income	79	121,826
Interest on cash deposits	61	281
	184,094	**307,789**

Investment income in unit-linked insurance policies and other pooled investment vehicles where income is not distributed, is accumulated, reinvested and included under change in market value in these financial statements. Overseas investment income is stated gross of withholding taxes. Irrecoverable withholding taxes are reported under taxation in the fund account.

Annuity income relates to annuities provided by Clerical Medical, Prudential, Zurich Assurance, Aviva Life and Pensions UK, ReAssure, Rothesay Life and Legal & General Assurance Society.

The annuity income shown in the prior year reflects payments received from an annuity provider following the purchase of a bulk annuity by the Trustee (a buy-in), but before it was subsequently converted to individual annuity policies for the insured pensioners (a buy-out) in 2019.

13. Investment management expenses

	2021	2020
	£'000	£'000
Administration, management and custody fees	(7,833)	(9,049)
Performance measurement and advisory fees	(849)	(2,107)
Performance related fees	(159)	(18)
	(8,841)	**(11,174)**

In addition to the investment management expenses charged directly to the Fund and disclosed above, the Fund incurred indirect investment management expenses through pooled investment vehicles as follows:

	2021	2020
	£'000	£'000
Administration, management and custody	(3,539)	(3,478)
	(3,539)	**(3,478)**

14. Taxation

The Fund is a registered pension scheme for tax purposes under the *Finance Act 2004*. The Fund is therefore exempt from taxation except for certain withholding taxes relating to overseas income. Tax charges are accrued on the same basis as the investment income to which they relate (see note 4 (b) (iii) and note 12 above).

15. Investment reconciliation

	Market value as at 01/04/2020	Purchases at cost and derivative payments	Sales proceeds and derivative receipts	Change in market value	Market value at 31/03/2021
	£'000	£'000	£'000	£'000	**£'000**
Bonds	9,817,967	1,178,970	(1,528,269)	(471,288)	**8,997,380**
Pooled investment vehicles	1,087,431	2,804,524	(2,994,590)	126,065	**1,023,430**
Derivatives	(141,382)	8,129,409	(8,188,988)	301,619	**100,658**
	10,764,016	12,112,903	(12,711,847)	(43,604)	**10,121,468**
Cash deposits	154,732			6,327	**30,094**
Other investment balances	(1,601,178)				**(1,591,173)**
	9,317,570			**(37,277)**	**8,560,389**

16. Pooled investment vehicles

The Fund's investments in pooled investment vehicles is analysed below:

	2021	2020
	£'000	£'000
Unit linked insurance policies	-	257,334
Overseas open-ended investment companies	964,051	752,724
Shares in limited partnerships	59,379	77,373
	1,023,430	**1,087,431**

The asset classes for the pooled investment vehicles are summarised in the following table:

	2021	2020
	£'000	£'000
Credit	22,987	20,242
Equities	-	257,334
Private equity	59,379	77,373
Cash and liquidity	243,274	131,849
Sole-investor pooled investment vehicles	697,790	600,633
	1,023,430	**1,087,431**

The asset classes for the sole-investor pooled investment vehicles are summarised in the following table:

	2021	2020
	£'000	£'000
Credit	651,852	545,989
Futures	(9,952)	(10,623)
Cash and liquidity	55,890	65,267
	697,790	**600,633**

17. Derivatives

The Trustee has authorised the use of derivatives by its investment managers as part of the investment strategy described in the Trustee's report. Derivatives are primarily used to provide returns in line with changes in the value of the Fund's liabilities as a result of changes in interest rates and inflation – a strategy known as Liability Driven Investment (LDI). These assets include collateralised interest rate and inflation swap contracts.

(i) Total derivatives

The total derivatives in the Fund are summarised below:

	2021			2020		
	Assets	**Liabilities**	**Net**	**Assets**	**Liabilities**	**Net**
	£'000	£'000	£'000	£'000	£'000	£'000
Swaps	139,770	(62,158)	77,612	59,572	(135,130)	(75,558)
Futures	19,989	(159)	19,830	1,805	(31,173)	(29,368)
Foreign exchange forwards	7,836	(4,620)	3,216	2,485	(38,941)	(36,456)
	167,595	**(66,937)**	**100,658**	**63,862**	**(205,244)**	**(141,382)**

ii) Swaps

Swaps are used as part of the LDI strategy described in the Trustee's report. The swaps in the Fund are summarised below:

Nature	Latest maturity	Nominal amount	Asset value at year end	Liability value at year end
		£'000	£'000	£'000
Interest rate swap	20/07/2065	2,803,862	92,087	(38,067)
Inflation rate swap	15/01/2034	1,163,000	-	(24,091)
Total return swap	31/03/2022	338	47,683	-
Total 2021		**3,967,200**	**139,770**	**(62,158)**
Total 2020		3,576,306	59,572	(135,130)

(iii) Futures

Futures are used as part of the LDI strategy described in the Trustee's report. The futures in the Fund are summarised in the following table:

Nature	Notional Amount	Term	Asset value at year end	Liability value at year end
	£'000		£'000	£'000
Euro Bund – Euro	(300)	3 Months	8	-
Euro Buxl – Euro	(2,000)	3 Months	4	-
US 5 year note – USD	(101,000)	3 Months	1,174	-
US 10 year note – USD	(55,000)	3 Months	1,362	-
US 10 year ultra – USD	(40,200)	3 Months	1,564	-
US Ultra Bond – USD	(120,200)	3 Months	11,469	-
US Long Bond – USD	(98,400)	3 Months	4,408	-
Long Gilt – GBP	12,200	3 Months	-	(159)
Total 2021	**(404,900)**		**19,989**	**(159)**
Total 2020	(457,000)		1,805	(31,173)

The futures are structured as exchange traded contracts, are centrally cleared and require margin to be posted by the Fund.

iv) Foreign exchange (FX) forwards

FX forwards are used as part of the investment strategy described in the Trustee's report. The FX forwards in the Fund are summarised below:

Contract	Settlement date within	Currency bought	Currency sold	Asset value at year end	Liability value at year end
		000's	000's	£'000	£'000
FX Forward	1 to 3 months	5,923 GBP	10,659 AUD	43	(4)
FX Forward	1 to 3 months	11,033 GBP	19,243 CAD	3	(67)
FX Forward	1 to 3 months	8,107 GBP	10,056 CHF	355	-
FX Forward	1 to 3 months	1,983 GBP	16,814 DKK	56	-
FX Forward	1 to 3 months	79,822 GBP	91,669 EUR	1,662	-
FX Forward	1 to 3 months	13,102 GBP	139,319 HKD	165	(51)
FX Forward	1 to 3 months	23,129 GBP	3,361,700 JPY	1,072	-
FX Forward	1 to 3 months	1,157 GBP	13,670 NOK	3	(7)
FX Forward	1 to 3 months	3,540 GBP	41,052 SEK	125	-
FX Forward	1 to 3 months	999,206 GBP	1,379,039 USD	4,298	(4,469)
FX Forward	1 to 3 months	1,621 GBP	Various	28	(2)
FX Forward	1 to 3 months	4,187 USD	3,013 GBP	21	-
FX Forward	1 to 3 months	Various	1,098 GBP	5	(20)
Total 2021				**7,836**	**(4,620)**
Total 2020				2,485	(38,941)

The table above includes separate detail for FX forwards where the amount of GBP bought or sold is £1 million or more. All other FX forwards have been combined into two “various” lines.

v) Collateral and margin

The swaps and FX forwards are structured as “over the counter” contracts. Some of these contracts are “bilateral” agreements that require daily collateral to be posted by one of the counterparties to each swap. Collateral posted and received is summarised in the following table:

2021	Posted	Received	Net
	£'000	£'000	£'000
Cash	(7,510)	82,136	74,626
UK Government bonds	(12,891)	705	(12,186)
	(20,401)	**82,841**	**62,440**

2020	Posted	Received	Net
	£'000	£'000	£'000
Cash	(5,660)	12,850	7,190
UK Government bonds	(119,528)	3,721	(115,807)
	(125,188)	**16,571**	**(108,617)**

The Fund retains economic exposure to collateral posted to counterparties. Collateral received from counterparties is not reflected in the Fund's net asset statement.

The remaining contracts and futures are "cleared" agreements that require margin to be paid to a central clearing house to support changes in the valuation of the contracts. Margin is typically paid in cash. The Fund does not retain economic exposure to cash paid to a clearing house.

18. Transaction costs

Included within purchases and sales are direct transaction costs of £54,159 (2020: £53,414) comprising, commissions and stamp duty. These costs are summarised below and relate to equities.

				2021	2020
	Fees	**Commission**	**Stamp Duty**	**Total**	**Total**
	£'000	£'000	£'000	£'000	£'000
Equities	-	54	-	54	53
2021	-	**54**	-	**54**	-
2020	-	53	-	-	53

Transaction costs are also borne by the Fund in relation to transactions in pooled investment vehicles. These costs are taken into account in calculating the bid/offer spread of these investments and are not separately reported.

19. Repurchase and reverse repurchase agreements

The value of repurchase and reverse repurchase agreements are reported at the end of the year within other investment assets and liabilities. The amount payable under repurchase agreements as at 31 March 2021 was £1,604.3 million (£1,633.6 million as at 31 March 2020).

Repurchase and reverse repurchase agreements are structured as "over the counter" contracts and require daily collateral to be posted by one of the counterparties. Collateral posted and received is summarised in the following table:

2021	Posted	Received	Net
	£'000	£'000	£'000
UK Government bonds	(328,091)	-	(328,091)
	(328,091)	**-**	**(328,091)**

2020	Posted	Received	Net
	£'000	£'000	£'000
UK Government bonds	-	441,870	441,870
	-	**441,870**	**441,870**

The Fund retains economic exposure to collateral posted to counterparties. Collateral received from counterparties is not reflected in the Fund's net asset statement.

20. Concentration of investment

The Fund's investments in securities from a single issuer that represents 5% or more of the Fund's net assets are shown below:

Fund	2021	2020
UK Government bonds	68%	72%
Shares in the Insight Investments Secured Multi-Asset Credit Fund V	5.4%	4.7%

21. Investment fair value hierarchy

The fair value of the Fund's investment assets has been determined using the following fair value hierarchy:

- **Level 1** - the quoted price for an identical asset in an active market.
- **Level 2** - when quoted prices are unavailable, the price of a recent transaction for an identical asset adjusted if necessary or observable market data.
- **Level 3** - where a quoted price is not available and recent transactions of an identical asset on their own are not a good estimate of fair value, the fair value is determined by using a valuation technique which uses non-observable data.

The Fund's investment assets and liabilities have been allocated to the fair value hierarchy as follows:

2021	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Bonds	5,855,302	3,142,078	-	**8,997,380**
Pooled investment vehicles	-	964,051	59,379	**1,023,430**
Derivatives	19,830	80,828	-	**100,658**
Cash	30,094	-	-	**30,094**
Other investment balances	(1,591,173)	-	-	**(1,591,173)**
Total	**4,314,053**	**4,186,957**	**59,379**	**8,560,389**

2020	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Bonds	6,669,333	3,148,634	-	**9,817,967**
Pooled investment vehicles	-	1,010,058	77,373	**1,087,431**
Derivatives	(29,368)	(112,014)	-	**(141,382)**
Cash	154,732	-	-	**154,732**
Other investment balances	(1,601,178)	-	-	**(1,601,178)**
Total	**5,193,519**	**4,046,678**	**77,373**	**9,317,570**

22. 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 defaulting on 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 or 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 or 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 or 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.

The Fund has exposure to these risks because of the investments it makes to implement its investment strategy described in the Trustee’s report. The Trustee manages investment risks, including credit risk and other market risks, within agreed risk limits which are set taking into account the Fund’s strategic investment objectives relative to its liabilities. These investment objectives and risk limits are implemented and monitored through the agreements in place with the Trustee’s appointed investment managers, investment consultant and other professional advisors.

Further information about the Trustee’s approach to risk management and the Fund’s exposures to credit and market risks are set out below. This does not include annuity policies because these are not considered significant in relation to the Fund’s overall investments.

(i) Credit risk

The Fund is subject to credit risk as it invests in bonds, “over the counter” derivatives, money market instruments and cash deposits. The Fund also invests in pooled investment vehicles and is therefore directly exposed to credit risk in relation to the investment in the pooled investment vehicles and is indirectly exposed to credit risks arising on the financial instruments held by the pooled investment vehicles.

A summary of direct credit risk is shown in the following table (investments are categorised as rated or unrated based upon the rating of an issuer rather than a counterparty or deposit institution):

2021	Investment grade	Non-investment grade	Unrated	Total
	£'000	£'000	£'000	£'000
Bonds	10,177,954	26,917	(1,207,491)	**8,997,380**
Over the counter derivatives	-	-	100,658	**100,658**
Cash	-	-	30,094	**30,094**
Other investment balances	-	-	(1,591,173)	**(1,591,173)**
Pooled investment vehicles	-	-	1,023,430	**1,023,430**
	10,177,954	**26,917**	**(1,644,482)**	**8,560,389**

2020	Investment grade	Non-investment grade	Unrated	Total
	£'000	£'000	£'000	£'000
Bonds	10,744,111	20,561	(946,705)	**9,817,967**
Over the counter derivatives	-	-	(141,382)	**(141,382)**
Cash	-	-	154,732	**154,732**
Other investment balances	-	-	(1,601,178)	**(1,601,178)**
Pooled investment vehicles	-	-	1,087,431	**1,087,431**
	10,744,111	**20,561**	**(1,447,102)**	**9,317,570**

Credit risk arising on bonds is mitigated by investing in government bonds of developed countries (mainly the UK) where the risk of default is minimal or in non-government bonds that are mostly rated as "investment grade".

Credit risk arising on "over the counter" derivatives is mitigated by daily collateralisation (see note 17).

Credit risk arising on repurchase agreements is mitigated by daily collateralisation (see note 19).

Credit risk arising on cash deposits is mitigated by investing surplus cash in liquid and diversified pooled investment vehicles.

Credit risk on repurchase agreements is mitigated through collateral arrangements. Included in Other Investment Balances are amounts of £(1,604.3) million (£(1,663.6) million as at 31 March 2020) payable under repurchase agreements.

Direct credit risk arising from pooled investment vehicles is mitigated by the underlying assets of the vehicles being ring-fenced from those of the related investment managers and by the regulatory environments in which the vehicles are operated. Accordingly, the Trustee and its advisors undertake due diligence when investing in new pooled investment vehicles and then continue to monitor the position. Indirect credit risk arises in relation to the underlying assets in the pooled investment vehicles. These risks are mitigated as described above for direct credit risks. The pooled investment vehicles in the Fund are summarised in note 16.

(ii) Currency risk

The Fund is subject to currency risk because some of its assets are denominated in overseas currencies. Foreign exchange forwards are used to hedge currency risk where it is both desirable and practical. The Fund's exposure to currency risk at the year end is shown below:

2021	Gross Exposure	Hedged Exposure	Net Unhedged Exposure
	£'000	£'000	£'000
Bonds	749,340	749,340	-
Derivatives	97,442	97,442	-
Cash	(13,409)	(13,409)	-
Pooled investment vehicles	123,458	74,252	49,206
	956,831	**907,625**	**49,206**

2020	Gross Exposure	Hedged Exposure	Net Unhedged Exposure
	£'000	£'000	£'000
Bonds	836,585	836,585	-
Derivatives	(104,932)	(104,932)	-
Cash	(12,503)	(12,503)	-
Pooled investment vehicles	108,942	50,179	58,763
	828,092	**769,329**	**58,763**

The net unhedged exposure above is to USD.

(iii) Interest rate risk

The Fund maintains controlled exposure to interest rate risk through bonds and interest rate swaps as part of its LDI strategy. The assets in the Fund that are subject to interest rate risk as part of the LDI strategy are shown in the following tables:

2021	Segregated	Pooled investment vehicles	Total
	£'000	£'000	£'000
Bonds	8,997,380	-	8,997,380
Interest rate derivatives	97,442	-	97,442
	9,094,822	**-**	**9,094,822**

2020	Segregated	Pooled investment vehicles	Total
	£'000	£'000	£'000
Bonds	9,817,967	-	9,817,967
Interest rate derivatives	(104,926)	-	(104,926)
	9,713,041	**-**	**9,713,041**

(iv) Other price risk

Other price risk arises principally in relation to the Fund's return seeking assets, which includes publicly listed equity, private equity and a pooled, diversified growth fund. The Fund's exposure to other price risk is mitigated by constructing a diverse portfolio of investments across various markets. The Fund's exposure to other price risk is shown below:

2021	Segregated	Pooled investment vehicles	Total
	£'000	£'000	£'000
Publicly listed equity	-	-	-
Private equity	-	59,379	59,379
Other pooled funds	-	-	-
	-	**59,379**	**59,379**

2020	Segregated	Pooled investment vehicles	Total
	£'000	£'000	£'000
Publicly listed equity	-	257,334	257,334
Private equity	-	77,374	77,374
Other pooled funds	-	-	-
	-	**334,708**	**334,708**

23. Self-investment

The Fund's holding in employer-related investments at the end of the year was less than 0.01% of the Fund's net assets (less than 0.01% as at 31 March 2020).

24. Current assets

	2021	2020
	£'000	£'000
Contributions due from Employer	617	32,839
Cash held by the Trustees	561	6
Sundry debtors	313	983
	1,491	**33,828**

Contributions receivable from the employer are disclosed in note 5. The contributions due at the end of the year are shown above. Following closure of the Fund to future accrual of benefits on 31 December 2020 no further significant regular contributions are expected to be paid. Subject to the Fund's funding position additional contributions might be payable as described in note 5.

The accrued contributions above for 2021 related to backdated salary increases and contributions by members to fund the Bridging Pension Option described on page 5. They were paid in April 2021. The accrued contributions above for 2020 were to be paid in April 2020 in accordance with the Schedule of contributions certified by the Fund Actuary on 19 December 2017 but were deferred by agreement between the Company and Trustee as a result of the impact of Covid-19 on the Company. They were paid during the year to 31 March 2021.

25. Current liabilities

	2021	2020
	£'000	£'000
Amount due to Employer	(294)	(337)
Unpaid benefits	(16,158)	(10,004)
Sundry creditors	(916)	(884)
Investment manager expenses payable	(3,461)	(4,609)
	(20,829)	**(15,834)**

26. Related parties

At 31 March 2021 the companies participating in the Fund were:

- Rolls-Royce plc;
- Rolls-Royce Power Engineering plc;
- Rolls-Royce Submarines Limited (formerly Rolls-Royce Marine Power Operations Limited);
- Ross Ceramics Limited; and
- Vinters Engineering Limited.

At 31 March 2021 the directors of the Trustee included:

- 1 Trustee director who is a director of a trustee of another pension arrangement related to Rolls-Royce plc;
- 1 Trustee director who is in receipt of a pension from the Fund; and
- 7 Trustee directors who are deferred members of the Fund.

Contributions in respect of the Trustee directors were paid in accordance with the Schedules of Contributions.

In the year ended 31 March 2021 the following Trustee directors were paid fees for their services:

- Liz Airey - £58,000

The Fund is administered by the Pensions Department of Rolls-Royce plc. From 1 January 2018 all costs of managing and administering the Fund have been paid by the Fund.

Amounts due from and payable to the Company are included in notes 24 and 25. As at 31 March 2021 a net amount of £323,000 is due from the Company.

27. Commitments

The Fund has commitments in respect of private equity investments amounting to approximately £15.8m at 31 March 2021 (£18.7 million as at 31 March 2020).

28. Guaranteed Minimum Pensions

On 26 October 2018 the High Court handed down a judgment involving the Lloyds Banking Group's defined benefit pension schemes. The judgment concluded the schemes should be amended to equalise pension benefits for men and women in relation to Guaranteed Minimum Pension (GMP) benefits. The issues determined by the judgment arise in relation to many other defined benefit pension schemes. Under the judgement schemes are required to backdate benefit adjustments in relation to GMPs accrued between 17 May 1990 and 5 April 1997 and provide interest on the backdated amounts. The Trustee has obtained an estimate of the backdated benefit adjustments and related interest. The amount is £14m. This estimate is based on the Trustee's view of the most likely equalisation methodology to be adopted and a top down assessment of the likely impact on members. This has been recognised as a current liability in note 25 to the Fund's financial statements for the year ended 31 March 2020 (the prior year amount was £7m and has increased as a result of the High Court ruling on 20 November 2020 that GMP equalisation should also apply to cash equivalent transfer values paid since 17 May 1990).

Summary of contributions payable under the Schedule of Contributions in respect of the year ended 31 March 2021

This summary has been prepared on behalf of, and is the responsibility of, the Trustee. It sets out the employer and member contributions payable to the Fund under the Schedules of contributions certified by the Fund Actuary on 19 December 2017, 7 April 2020, 6 July 2020, 19 October 2020, 14 December 2020 and 18 December 2020.

The auditor reports on contributions payable under the Schedule of Contributions in the auditor's statement about contributions. The contributions payable under the Schedules of Contributions in respect of the Fund year are shown below:

	£'000
Employer:	
Normal contributions	67,139
PaySave contributions made by employee salary sacrifice	16,281
Employer contributions in respect of sickness absence, career breaks, maternity absences and disability benefits	1,028
Member:	
Normal contributions	1,622
Contributions payable under the Schedules of Contributions (as reported by the auditor)	**86,070**
Members' voluntary severance payments used to fund the Bridging Pension Option described on page 5.	4,066
Total contributions reported in the financial statements	**90,136**

An additional £32.6 million contribution was also paid during the Fund year, but that amount had been accrued in the Fund's financial statements for the previous year and so does not feature above. The payment of that amount was also deferred by agreement between the Trustee and the Company as described on page 5.

The option for active members to pay AVCs into the Fund was removed from 1 November 2016. Active members can pay AVCs outside of the Fund to a different Company pension arrangement, the Rolls-Royce Retirement Savings Trust.

Independent Auditor's Statement about Contributions

We have examined the summary of contributions to the Rolls-Royce UK Pension Fund for the Fund year ended 31 March 2021 which is set out on page 42.

Statement about contributions payable under the Schedules of Contributions

In our opinion contributions for the Fund year ended 31 March 2021 as reported in the summary of contributions and payable under the Schedules of Contributions have in all material respects been paid from 1 April 2020 to 6 April 2020 at least in accordance with the Schedule of Contributions certified by the Fund Actuary on 17 December 2017, from 7 April 2020 to 5 July 2020 at least in accordance with the Schedule of Contributions certified by the Fund Actuary on 7 April 2020, from 6 July 2020 to 18 October 2020 at least in accordance with the Schedule of Contributions certified by the Fund Actuary on 6 July 2020, from 19 October 2020 to 13 December 2020 at least in accordance with the Schedule of Contributions certified by the Fund Actuary on 19 October 2020, from 14 December to 17 December at least in accordance with the Schedule of Contributions certified by the Fund Actuary on 14 December 2020 and subsequently at least in accordance with the Schedule of Contributions certified by the Fund Actuary on 18 December 2020.

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 Fund and the timing of those payments under the Schedules of Contributions.

Respective responsibilities of Trustee and the auditor

As explained more fully in the Statement of Trustee's Responsibilities, the Fund'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 Fund by the employer in accordance with the Schedules 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

Deloitte LLP
Statutory Auditor
Birmingham, United Kingdom
Date: 14th September 2021

Actuarial certification of the Schedule of Contributions

Name of scheme: Rolls-Royce UK Pension Fund

Adequacy of rates of contributions

1. 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 March 2020 to continue to be met for the period for which the Schedule is to be in force.

I also certify that the rates of contributions shown in this Schedule are not lower than I would have provided for had I had responsibility for preparing or revising the Schedule, the statement of funding principles and any recovery plan.

Adherence to statement of funding principles

2. I hereby certify that, in my opinion, this Schedule of contributions is consistent with the Statement of Funding Principles dated 25 June 2021.

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 scheme's liabilities by the purchase of annuities, if the scheme were wound up.

Signature:	*A G McIntosh*	Date:	25 June 2021
Name:	Alastair McIntosh	Qualification:	Fellow of the Institute and Faculty of Actuaries
Address:	122 Leadenhall Street London EC3V 4AN	Name of Employer:	Aon Solutions UK Limited

Appendix 1 – Statement of Investment Principles

Rolls-Royce UK Pension Fund

Statement of Investment Principles – updated September 2021

1. Introduction

The Trustee of the Rolls-Royce UK Pension Fund ("the Trustee") has drawn up this Statement of Investment Principles ("the Statement") to comply with the requirements of the Pensions Act 1995 ("the Act") and subsequent legislation. The Pensions Act 1995 requires the Trustee to document the investment principles governing decisions about investments for the purposes of the Fund. These include the Trustee's policy on choosing investments, the kinds of investments to be held, the balance between different kinds of investments, risk, the expected return on investments, the realisation of investments, and such other matters as may be prescribed by legislation. The Trustee has consulted a suitably qualified person by obtaining written advice from the Trustee's appointed Investment Consultant (IC), currently Mercer. The Trustee, in preparing this Statement, has also consulted the Company, Rolls-Royce plc.

Overall investment policy falls into two parts: the Trustee is responsible for the strategic management of the assets, which it undertakes in accordance with advice from its appointed IC; and the Trustee delegates various operational activities in respect of the implementation of its agreed investment strategy to the Rolls-Royce pensions department and other professional service providers. The Trustee uses professional investment managers for the day-to-day management of the assets.

This Statement is consistent with the Trustee's investment powers, which are set out within the Fund's Trust Deed & Rules and are subject to applicable legislation. If necessary, the Trustee will take appropriate legal advice regarding the interpretation of these. The Trustee acknowledges that, according to the law, it has ultimate power and responsibility for the Fund's investment arrangements.

The Trustee refers to this Statement when making investment decisions to ensure that the decisions are consistent with the principles set out within. In addition, the Trustee will review this Statement in response to any material changes with respect to the Fund which it judges to have a bearing on this Statement. The Trustee will also review this Statement at least once every three years and without delay following any significant change in investment policy. Before any review or revision, the Trustee will obtain and consider written advice from an appropriate investment expert and will consult with the Company. Whilst it is normally expected that there will be general agreement, the Trustee's fiduciary obligation to Fund members will take precedence over the Company's wishes, should these ever conflict.

This Statement sets out the Trustee's investment beliefs and general principles underlying the investment policy.

2. **Investment Beliefs**

The Trustee holds the following investment beliefs (not in any particular order):

1. The Fund's assets should be invested at an appropriate level of risk relative to the Fund's liabilities and the strength of employer covenant.

2. Good stewardship of the Fund's investments is in the best interests of the beneficiaries, because it can contribute towards the generation of a sustainable long term return at an appropriate level of risk to meet the Fund's investment objective.

3. Integration of environmental, social and corporate governance (ESG), or sustainability, factors into investment management processes and stewardship practices has a positive impact on financial performance.

4. Long term sustainability issues, in particular climate risk, present risks and opportunities which increasingly require explicit consideration.

5. A "well-below 2ºC scenario" climate warming outcome in line with the Paris Agreement represents the best result for the economy and most investors as well as a lower risk outcome for the Fund than higher levels of warming. Therefore, the Trustee supports this outcome.

6. The primary risk to the Fund is a mismatch between its assets and liabilities.

7. Exposure to risks which might not reasonably be expected to be rewarded should be mitigated where the impact on overall risk is material and where it is practical and cost-effective to do so.

8. Exposure to credit risk is expected to be rewarded and contractual cash flows from credit investments are appropriate to match the liabilities, subject to adequate consideration of default risk.

9. Equity market exposure is expected to be rewarded through higher returns and diversification of risk versus other asset classes over the long term. However, equities are not a good match for the liabilities over the short term.

10. Exposure to specific risks of individual investments can be mitigated through diversification.

11. Investments which are liquid, transparent and simple are favoured, though a degree of illiquidity and complexity may be accepted where the expected rewards are sufficient and subject to having a very high probability of the remaining liquidity being sufficient (taking into account benefit payments including transfers and collateral requirements).

12. Risk cannot be captured effectively through a single measure and is best understood using a range of approaches.

13. Active management can add value and reduce risk, but its attractiveness depends on the style of active management and the associated additional costs must be justified.

Effectively controlling investment management costs can have a positive impact on overall investment returns.

14. The investment approach should reflect the ability to take a long-term view and to take advantage of a strong funding position. In particular, the Fund may benefit from being able to invest in a contrarian fashion, especially in times of heightened volatility, and efforts should be sought to control value leakage from the transaction costs associated with frequent switching between investments.

3. Investment Objective

The Trustee's overriding objective is to meet the Fund's liabilities as and when they fall due. In pursuit of this objective, the Trustee seeks to invest the Fund's assets at an appropriate level of risk relative to the Fund's liabilities.

In seeking to achieve the primary objective, the Trustee follows a low-risk investment strategy in pursuit of excess return relative to the Fund's liabilities by investing a proportion of assets in:

i) a Liability-Driven Investment ("LDI") portfolio, expected to match or "hedge" closely the interest rate and inflation risk profile of the Fund's liabilities;

ii) a Credit portfolio, expected to generate excess returns relative to the Fund's liabilities primarily by harvesting credit spreads above yields on "pure" hedging assets. The Credit portfolio may contribute to the LDI or liability-hedging strategy through investment in fixed interest assets, but may also hold floating rate or non-matching assets; and

iii) a Return-Seeking Asset ("RSA") portfolio, expected to generate excess returns relative to the Fund's liabilities through investment in other non-matching assets such as equities.

Under the Rules of the Fund, the Trustee will grant contingent increases to certain benefit tranches should certain parameters be met in respect of the funding position of the Fund and the investment strategy. From an investment perspective, the requirement for the granting of contingent increase is that the Trustee considers, having taken advice, that the Fund is invested prudently. The Trustee has adopted a strategy to invest the assets of the Fund in this way.

4. Strategic Asset Allocation

In order to achieve its investment objectives the Trustee has adopted the following broad strategic asset allocation ranges for the Fund. The Fund may deviate from this allocation due to market movements or due to strategic decisions and there is no requirement to rebalance back to these ranges. In addition, the asset allocation may be refined to take advantage of market opportunities.

Asset Class	Typical ranges %	
	Exposure	Allocation
LDI portfolio	36.0 – 86.0	36.0 – 66.0
Credit portfolio	33.0 - 53.0	33.0 – 53.0
RSA portfolio	3.5 – 8.5	0 – 8.5
Total	100.0	100.0

A modest degree of leverage is used within the investment strategy in order to maintain the interest rate and inflation hedge ratios within the rebalancing ranges below whilst also maintaining the asset class exposures within the typical ranges above. Leverage is expected be used within the LDI portfolio or to provide leveraged exposure to equity markets.

The table below sets out the typical liability hedge rebalancing ranges for interest rates and inflation as at the date on which this SIP has been updated. The hedge ratios are monitored by the Trustee on a regular basis and rebalancing may be undertaken if the ranges are breached, although there is no requirement for the hedge ratios to be automatically rebalanced back within these ranges. The Trustee expects to increase the rebalancing ranges as the funding level improves in future.

	Rebalancing ranges (%)
Interest rate hedge ratio *	90 – 100
Inflation hedge ratio *	85 – 100

*Measured on a gilts flat basis.

5. Expected Return and Risk

The Trustee expects to generate a return on total assets, over the long term, of circa gilts+ 0.7% to gilts + 1.0% p.a. (net of investment management expenses). It is recognised that over the short term, performance may deviate significantly from the long term target.

The Trustee regularly monitors the level of investment risk and aims to keep this to a prudent level.

6. Risk Management and Measurement

The primary risk upon which the Trustee focuses is that arising through a mismatch between the Fund’s assets and its liabilities.

The Trustee recognises that modern financial instruments make it possible to select assets with interest and inflation rate sensitivities that are similar to those of the estimated liability cash flows; a strategy known as liability-driven investment (“LDI”). The majority of the Fund’s assets have been invested in this way.

However, in order to meet the Fund's long-term objectives while controlling the level of contributions required from the Company, the Trustee has agreed to take a modest amount of investment risk relative to the liabilities. This is done in order to target a greater return than the LDI Portfolio would provide, whilst maintaining a prudent approach to meeting the Fund's liabilities.

In arriving at its chosen investment strategy and the production of this Statement, the Trustee has considered (amongst others) the following risks, which it believes may be financially material over the Fund's anticipated lifetime:

Risk	Description and mitigations
Market risk	Fluctuation in market prices and/or future cashflows of financial instruments. The Trustee adopts only a limited allocation to return seeking assets such as equities, and holdings are diversified by geography and sector. Currency risk is also monitored and, where appropriate, hedged.
Interest rate and inflation risk	Changes in market implied interest rates and inflation can affect the value of the Fund's assets and liabilities. The Trustee pays close attention to matching the interest rate and inflation exposures of its liabilities with those of its assets, maintaining high hedge ratios. A majority of assets are allocated to liability-matching asset classes.
Credit risk	Direct credit risk arising from pooled investment vehicles is mitigated by the underlying assets of the pooled arrangements being ring-fenced from the pooled managers. Credit risk arising from direct debt holdings such as corporate bonds is mitigated by diversification limits specified in the investment management guidelines, by requiring investment to be predominantly in investment grade rated or equivalent quality instruments, as well as the skill of the managers in instrument selection.
Counterparty risk	The risk of default by the counterparty to a derivative or similar transaction. The Trustee has set limits diversifying exposure across different counterparties and monitors the total exposure to counterparties across all holdings against aggregate risk limits. Derivative positions are predominantly collateralised daily to mitigate counterparty risk.
Investment manager risk	The risk inherent in the day-to-day running of the asset portfolio by investment managers, including underperformance of portfolios against the objectives set. The Trustee selects its managers carefully and, where appropriate, diversifies across a number of managers.
Concentration risk	The failure of any one of the Fund's investments could jeopardise the Trustee's ability to meet its objectives if it constituted a significant proposition of the assets. The Trustee aims to ensure that the Fund is not unduly exposed to asset class, market or manager specific risk. There is some concentration of the Fund's assets in holdings of government bonds held by the LDI investment manager. The Trustee is of the view that these assets are the best available matching assets for the Fund's liabilities, and this risk reduction more than offsets the concentration risk.

Cash flow and liquidity risk	Cash flow and liquidity risk relates to the realisation of investments in order to meet the benefit payments. The Trustee and its advisors manage the Fund's cash flow requirements over the short-term in order to minimise the possibility that this occurs. The Trustee mitigates liquidity risk by ensuring investment in illiquid assets is kept at an appropriate level, and a prudent approach is taken to maintaining suitable levels of collateral to support derivative programmes.
Custody risk	The Trustee has appointed a leading custodian bank which is independent of the investment managers to act as global custodian to the assets. The Trustee has satisfied itself that the financial security, procedures and controls available justify this as a prudent, efficient and cost effective procedure. Pooled funds will have their own custody arrangements and the global custodian's function in this regard is therefore limited to the safekeeping of any relevant unit certificates, the custodian designated by the pooled fund manager retaining the remaining responsibilities in respect of the underlying securities and cash of the pooled funds.
Leverage risk	The Trustee has considered the risks from the use of leverage, such as a potential need to raise additional collateral and roll risks, and has implemented controls to reduce these risks.
ESG factors	Environmental, social and corporate governance (ESG), or sustainability, factors can have an impact on financial performance. The Trustee's policy is that the Fund's investment managers should integrate ESG and sustainability factors into their investment processes, to assess the potential impact in deciding on the selection, retention and realisation of investments, and should engage in stewardship activity which complements this analysis.
Climate change	Climate change is a systemic risk that may materially affect the financial performance of investments. Since 2020, the Trustee has adopted the Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) framework recommendations and reports against them on an annual basis. The Fund's investment managers are expected to adopt these recommendations and since 2019 they have been required to provide portfolio carbon risk metrics consistent with the framework. In order to further mitigate climate change risk, the Fund's listed equity exposure tracks a low carbon equity index (subject to ongoing liquidity) and the Trustee monitors and engages with managers of other asset classes to ensure that the exposure to carbon is appropriate and to seek opportunities to reduce it.

7. **Rebalancing and Cashflow Policy**

The Trustee monitors the allocations to the LDI, Credit and RSA portfolios and the hedge ratios against the ranges set out in section 4 and considers rebalancing accordingly. Rebalancing is not automatic and the Trustee may choose not to rebalance if the limits of the ranges have been reached. The Trustee may also rebalance, if judged appropriate, where the limits of the ranges have not been reached.

The Trustee monitors leverage-related metrics and may rebalance the asset allocation if it deems that it is appropriate to do so in the context of these metrics. The Trustee may also make decisions about the realisation of assets based on the liquidity of an asset or class, its performance, and the extent to which investments must be in readily realisable form to meet the Fund's outgoing liabilities.

8. Day-to-Day Management of the Assets

The Trustee delegates the day-to-day management of the assets, including the realisation of assets, to a number of professional investment managers. The Trustee has taken advice from its appointed IC that the managers have the appropriate skill and experience for managing the Fund's investments and that they are carrying out their work competently.

The Trustee regularly reviews the continuing suitability of the Fund's investments, including the appointed managers, both of which may be adjusted from time to time. However, any such adjustments would be carried out with the aim of ensuring an overall level of risk that is consistent with the Fund's investment objective.

9. Appointment and Monitoring of Investment Managers

The Trustee looks to its appointed IC for a forward looking assessment of a manager's ability to meet its investment objectives over a full market cycle. This view will be based on the IC's assessment of the manager's idea generation, portfolio construction, implementation and business management, in relation to the particular investment fund that the scheme invests in. The IC's manager research ratings assist with due diligence and questioning managers during presentations to the Trustee and are used in decisions around selection, retention and realisation of manager appointments.

If the investment objective for a particular manager's fund changes, the Trustee will review the fund appointment to ensure it remains appropriate and consistent with the Trustee's wider investment objectives.

Some appointments, such as the private equity mandates, are for actively managed mandates and the managers are incentivised through remuneration (via performance related fees) and performance targets. The Trustee reviews the appropriateness of active management as part of its strategic management of the assets.

The documents governing the manager appointments include a number of guidelines which, among other things, are designed to ensure that only suitable investments are made by the Fund. The managers are prevented from investing in asset classes outside their mandate without the Trustee's prior consent. The Trustee restricts managers from investing in employer-related investments where possible.

Where the Trustee has invested in pooled investment vehicles (for example passive global equities), it accepts that it has no ability to specify the risk profile and return targets of the manager, but appropriate mandates can be selected to align with the overall investment strategy. Additionally, specific exclusions may not be possible to be included in pooled funds and limited employer-related investments may occur.

Arrangements are in place to monitor the Fund's investments to help the Trustee check that nothing has occurred that would bring into question the continuing suitability of the current investments. To facilitate this, the Trustee's appointed IC provides the Trustee with a quarterly investment monitoring report. The appointed investment managers provide quarterly investment reports. The Trustee also employs an independent performance measurer that reports on a quarterly basis. These reports support the production of the quarterly investment monitoring report.

The quarterly investment monitoring report allows the Trustee to review absolute performance, relative performance against a suitable comparator index used as the benchmark, and against the manager's stated target performance (over the relevant time period) on a net of fees basis. The Trustee's focus is on long term performance but it may put a manager 'on watch' if there are short term performance concerns. If a manager is not meeting performance objectives, or their investment objectives for the mandate have changed, the Trustee may ask the manager to review any element of their fees. The Trustee does not currently monitor portfolio turnover costs but is looking to do this in future. The Trustee will ask investment managers to include portfolio turnover and turnover costs in their presentations and reports to the Trustee. The Trustee will engage with a manager if portfolio turnover is higher than expected.

The safe custody of the Fund's assets is delegated to professional custodians (either directly or via the use of pooled vehicles).

Additionally, the Rolls-Royce pensions department holds regular meetings or calls with the IC, investment managers and other professional service providers to support implementation of the Trustee's investment strategy.

10. Responsible Investment

The Trustee has set out its responsible investment beliefs in relation to ESG integration, including climate change, and stewardship earlier in this statement.

The Trustee has considered how ESG factors should be integrated into the Fund's investment management processes and stewardship practices, taking into account the expected time horizon of the Fund. The Trustee's policy is that the Fund's investment managers have full discretion in integrating ESG and sustainability factors into their investment processes to assess the potential impact on financial performance in deciding on the selection, retention and realisation of investments.

The Trustee supports the UK Stewardship Code (the "Code"). The Trustee has given the appointed investment managers, both segregated and pooled, full discretion when undertaking engagement activities in accordance with their own corporate governance policies and current best practice.

The Trustee is open to engaging directly through written communication with debt or equity issuers on a range of issues including, but not limited to, performance, strategy, risks, ESG and sustainability factors. This might take place if the manager requests the engagement and if the Trustee believes that this may be more effective than the investment manager's stewardship engagement activity on its own. Before engaging the Trustee will seek advice from its appointed IC and other appointed advisers.

The Trustee produces an Engagement Policy Implementation Statement on an annual basis which documents how the Trustee has adhered to its policies with respect to engagement over the prior year. This statement provides detail on the voting activity of the investment managers, as well as examples of how they have engaged with the investee companies over the period.

The Trustee's IC produces an annual responsible investment monitoring report for the Trustee covering ESG integration, carbon footprinting analysis and stewardship activities including investment managers' adherence to the UK Stewardship Code.. The Trustee engages with its investment managers on the key findings as necessary, particularly where a manager is judged to be lagging its peers. The Trustee uses this assessment and the IC's ESG ratings in decisions around selection, retention and realisation of manager appointments.

The Trustee supports the recommendations of the TCFD as a best-practice framework to manage and report on the actions being taken to identify climate change related risks and incorporate climate change risk management into investment processes. Therefore, since 2020, the Trustee has adopted the TCFD framework recommendations and reports against them on an annual basis via its TCFD Statement. The Fund's investment managers are also expected to adopt these recommendations. Since 2019 the investment managers have been required to provide portfolio carbon risk metrics consistent with the framework and the Trustee reports these metrics on an annual basis.

In addition to requiring all managers to adhere to the UK Stewardship Code all managers are expected to be signatories to the UN supported Principles for Responsible Investment (PRI).

The Trustee does not currently have a policy of taking into account "non-financial matters" when considering the selection, retention and realisation of assets. For this purpose "non-financial matters" means the views of the members and beneficiaries, including their ethical views and views in relation to social and environmental impact and their present and future quality of life.

11. **Compliance with this Statement**

The Trustee will monitor compliance with this Statement regularly, and in any event will review this Statement at least once every three years or sooner if there is any significant change in investment strategy. The Statement will also be reviewed in response to any material changes to any aspects of the Fund and its liabilities, finances and attitude to risk of the Trustee and Company which they judge to have a bearing on the stated investment policy. Any such review will be based on written expert investment advice and will be in consultation with the Company.

Approved by the Trustee on 13 September 2021

Appendix 2 – Taskforce on Climate-related Financial Disclosures report

1

TCFD Statement

This report outlines how the Trustee has established and maintains oversight and processes to satisfy itself that the climate-related risks and opportunities which are relevant to the Fund are a considered appropriately by all stakeholders involved in the day-to-day management of the Fund.

The Trustee supports the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) as a best-practice framework to manage and report on the actions being taken to identify climate change related risks and incorporate climate change risk management into investment processes.

The Trustee is, on behalf of its members, a long-term investor. It is therefore in the interests of members that the market is able to effectively price climate-related risks and that policy makers, and other market participants, are able to address these risks and avoid market failure. The Trustee believes that TCFD-aligned disclosure from asset owners, asset managers, and companies, is in the best interest of the Fund's members.

2

Governance

The Trustee's governance oversight with respect to climate change-related risks and opportunities

Policy approach

The Trustee maintains a Statement of Investment Principles (SIP), which details the key beliefs, risks and approach to responsible investment and climate change. This is reviewed on an annual basis or more frequently as required.

Oversight of climate change risks

The Trustee meets at least quarterly and receives quarterly performance reports from its investment consultant, which include Environmental, Social and Corporate Governance (ESG) ratings for relevant investment mandates. These assess the degree to which managers integrate ESG considerations, including climate change, into their investment processes and active ownership activities.

The Trustee has commissioned an annual ESG monitoring framework covering ESG integration, stewardship and carbon foot-printing analysis. This reporting identifies and assesses key climate change risks within the Fund's strategies. In order to manage these risks the Trustee will engage with its investment managers on the key findings as necessary and monitor progress on at least an annual basis.

In June 2020 the Trustee considered a climate change scenario analysis report from its investment consultant. More detail on the results is provided below under the 'Strategy' section.

Training and climate competency

The Trustee receives relevant training on responsible investment, including climate change, as required. Responsible investment topics may also form stand-alone agenda items at meetings. The Trustee's investment managers are also asked to explicitly cover ESG and climate issues when presenting to the Trustee. In the year under review, the Trustees received a presentation from Insight Investment including a section on ESG.

The investment consultant's approach to climate change and how these are integrated into its advice and services is assessed as part of the selection and monitoring process. The Trustee sets its investment consultant annual objectives, including ones related to ESG and climate change competency. The investment consultant is formally assessed against its objectives annually.

Day-to-day implementation

The implementation of the management of climate change-related risk with respect to specific securities is delegated to third party portfolio managers. Each manager's approach to ESG issues and how these are integrated into their investment process is assessed as part of the manager selection and monitoring process. The terms of reference forming part of the contracts with the Fund’s listed corporate bond and equity portfolio managers reflect their agreement to integrate ESG and sustainability factors into their investment processes and adhere to the UK Stewardship Code. In addition, the Fund’s investment managers are expected to adopt TCFD recommendations.

From this year onward, the Trustee will publish its Engagement Policy Implementation Statement detailing how it has implemented its approach to climate change as laid out in the SIP.

3 Strategy

The Trustee’s approach to managing strategic climate change risks and opportunities

Climate change related-investment risks and opportunities over the short, medium and long term

The Trustee believes that sustainability issues, in particular climate change, present risks and opportunities which increasingly require explicit consideration. Climate change is identified and described as a systemic risk which may materially affect the financial performance of the Fund’s investments. More specifically, the Trustee supports a “well-below 2ºC scenario” climate warming outcome in line with the Paris Agreement as it represents the best result for the economy and most investors as well as a lower risk outcome for the Fund than higher levels of warming.

As a long-term investor the Trustee recognises the risks and opportunities arising from climate change are diverse and continuously evolving.

The Trustee has considered the following short (next 3-5 years), medium (5-20 years) and long-term (20+ years) drivers of investment risk:

- Short term risks may present themselves through rapid market re-pricing as:
  - Scenario pathways become clearer. For example a change in the likelihood of a 2°C scenario occurring.
  - Market awareness grows. For example, the implications of the physical impacts of climate change become clearer to markets.
  - If policy changes catch markets by surprise. For example, if a carbon price is introduced across key markets to which the portfolio is exposed, at a sufficiently high price to impact behaviour.
- Over the medium term, risks associated with the transition to a low carbon economy are likely to dominate. These include the development of technology and low carbon solutions. Policy, legislation and regulation are likely to also play a key role at the international, national and subnational level. Technology and policy changes are likely to produce winners and losers both between and within sectors and lead to stranded asset risks.
- Over the long term, physical risks are expected to come to the fore. This includes the impact of natural catastrophes leading to physical damages through extreme weather events. Availability of resources is expected to become more important if changes in weather patterns (e.g. temperature or precipitation) affect the availability of natural resources such as water.

Strategic actions undertaken to manage climate risk

The Trustee has invested all of the Fund's c.5% target allocation to listed equities in low carbon passive equities using derivatives. This has significantly reduced the equity portfolio's weighted average carbon intensity and fossil fuel reserve exposure (see below).

The Trustee will continue to consider approaches to further manage climate change risks and opportunities in its investment strategy.

Investment strategy climate change scenario analysis

In 2020 the Trustee commissioned a strategic climate change scenario analysis on the Fund's strategic asset allocation to assess the potential implications of climate change. This allowed for the now completed change to low carbon equities.

Key findings from the analysis were as follows:

- The Fund demonstrates robustness with respect to the potential impact of climate change, with muted modelled impacts in terms of annualised return impacts and stress testing under 2ºC, 3ºC and 4ºC scenarios. The Trustee noted, however, that the modelling may understate the true level of risk and uncertainty is likely to be greater for higher warming scenarios.
- The decision to move to low carbon equities is expected to modestly improve outcomes under a 2ºC scenario.
- The impact at the sector level is expected to be more significant and the Trustee will monitor sector allocations in its annual ESG monitoring.

Funding Level Scenario Modelling and Integrated Risk Management

Over the next 12 months the Trustee expects to consider in more detail the potential impact of climate change scenarios on its funding strategy. This will explore the potential impact of climate change on the funding level as a result of potential changes in government interest rates and on longevity. In addition, it will consider the potential impact of climate change on the covenant to allow the Trustee to integrate funding, investment and covenant risk considerations.

The Trustee is pleased that the Fund's sponsor, Rolls-Royce plc, reports in line with TCFD in its own right. As part of this reporting the sponsor has highlighted the risk of climate change to future revenue growth as a principal risk following its own scenario analysis.

4

Risk Management

The processes used by the Trustee to identify, assess and manage climate change-related risks and integrate them within the overall risk management approach

Processes for identifying and assessing climate change related risks

The Trustee seeks to identify and assess climate change related risks from both a top down and bottom up perspective. The climate change scenario modelling (described above) provides a top down strategic assessment of climate change risks at the total Fund, asset class and sector level.

From a bottom up perspective the Fund's equity and corporate bond managers have been asked to provide carbon foot-printing metrics consistent with TCFD recommendations. This analysis helps identify key sources of company and sector-level carbon risks.

As the Trustee relies on third party investment managers to manage its assets, the day-to-day assessment of climate change related risks has been delegated to them. They in turn are regularly assessed using the investment consultant's ESG ratings and as part of the annual ESG monitoring framework.

Where relevant, managers are invited to present to the Trustee to explain their approach to climate change risk management, amongst other topics.

The Trustee will engage with managers where they are perceived to be lagging their peers in terms of ESG integration or active ownership, including where this relates to climate change risks.

Processes for managing climate-related risks

The Trustee manages risk by prioritising those risks that it believes may be most financially material over the Fund's anticipated lifetime. These risks are identified in the Statement of Investment Principles and include climate change.

The Trustee's approach to climate change risk management is guided by climate change scenario modelling, carbon foot-printing and an assessment of managers' ability to integrate ESG issues, including climate change considerations, into their investment processes using the investment consultant's ESG ratings.

The Trustee recognises that active ownership by the investment managers will continue to be a very important part of the Fund's approach to managing these risks. The Trustee has agreed to assess investment managers' approaches to stewardship and engagement on an annual basis and summarises its findings in the Engagement Policy Implementation Statement. The Trustee expects companies in its portfolio to manage climate change risks. Stewardship activities can help hold companies to account and ensure they are taking a meaningful approach in this area.

The Trustee delegates stewardship engagement activity to the underlying investment managers.

The Trustee recognises the challenges with various metrics, tools and modelling techniques used to assess climate change risks. The Trustee aims to work with its investment consultant and investment managers to improve its approach to assessing and managing risks over time.

Integration of climate change related risks into the overall risk management approach

Both climate change-related risks and wider investment risks are considered by the Trustee. Where possible, climate change and wider investment risks are treated in a holistic manner by recognising they are often interrelated. Climate change and ESG risks are included alongside other material risks in the Statement of Investment Principles.

The climate change scenario analysis is strategic in nature and has therefore been incorporated into wider investment strategy discussions and considerations. As detailed above, over the next 12 months the Trustee expects to consider further the potential impact of climate change on the funding strategy and covenant.

5

Metrics and Targets

The metrics and targets used to assess and manage relevant climate change-related risks and opportunities, in line with strategy and risk management

Key metrics for climate change related risks

For the listed equity and corporate bond portfolios, together representing around 40% of the Fund's total asset exposure (the majority of the remaining assets being UK government bonds), the Trustee has initially focused on carbon foot-printing analysis as a key metric for assessing risk and has compared this against a relevant benchmark or other comparator. This is a way of assessing historical carbon emissions volume/intensity, which is an indicator for the relative risk of carbon pricing increases as part of the transition to a low-carbon economy.

Different methodologies can be used to calculate a portfolio's carbon footprint. The key methodology applied is the Weighted Average Carbon Intensity (WACI), which is the preferred method of the TCFD and measures the number of tonnes of carbon dioxide equivalent per USD million in revenues. In future, the Trustee is looking to report on additional metrics and has requested information from the managers to assess their ability to report on other metrics.

Carbon foot-printing metrics aid the Trustee in assessing the potential climate change related risks to which the Fund is exposed, and identifying areas for further risk management, including company engagement and investment manager monitoring.

The ability to determine appropriate and reliable climate change risk metrics is limited by the availability of consistent and comparable data. Currently data coverage is most complete for listed equities, representing around 5% of the Fund's total remaining economic exposure. Market practices, tools and datasets will need to improve to gain a more complete understanding of risks for corporate bonds. The Trustee will consider whether to extend carbon metrics analysis to additional asset classes over the next 12 months.

Carbon foot-printing summary

Carbon foot-printing analysis was first undertaken in 2019 and is now an annual exercise.

In summary:

- The corporate bond mandates are in aggregate more carbon intensive than the comparator indexes. This is largely due to the utility exposure that forms a significant portion of the portfolios managed by LGIM and Insight. However, in absolute terms carbon intensity has significantly decreased year-on-year.
- LGIM's carbon footprint is driven by the utilities exposure which is significantly greater than the comparator index and contributes c.87% to the overall carbon intensity. Despite this, the

mandate's carbon intensity has reduced over the year in question with LGIM proactively meeting their target to reduce the carbon intensity by 33% by 31 December 2020.

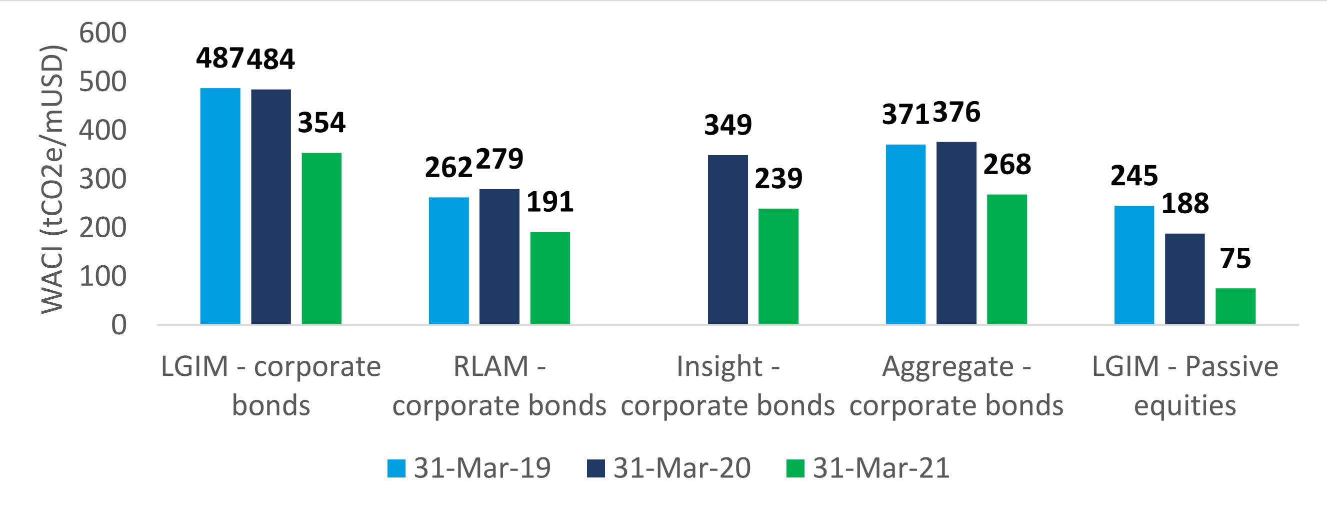
- Insight's carbon footprint is dominated by its exposure to utilities and energy.
- RLAM's portfolio is more carbon efficient than the comparator index primarily due to its underweight to utilities (c.3% vs. benchmark) and its choice of more carbon efficient utility companies within the sector. Ten issuers make up nearly half of portfolio WACI.
- Over the year the Fund shifted from passive equity to a synthetic equity portfolio replicating the MSCI ACWI Low Carbon Target index. As a holder of derivatives there is no carbon data available, however an equivalent exposure in physical equities would have a notably lower carbon footprint compared to the equities actually held a year prior. Compared to the MSCI ACWI Index, the synthetic equity portfolio has significantly lower exposures to carbon intensive sectors including utilities and materials.

Figure 3: Comparison of Weighted Average Carbon Intensity – equity and corporate bonds

Mandate	WACI ($tCO_2e/mUSD$)			Carbon intensity coverage	
	Fund	Benchmark	Relative	Fund	Benchmark
LGIM corporate bonds	354	189	+87%	65%	89%
RLAM corporate bonds	191	217	-12%	85%	88%
Insight corporate bonds	239	229	+4%	94%	96%
Aggregate corporate bonds	268	207	+29%	77%	90%
LGIM - Passive equities [1]	75	169	-56%	98%	98%

Source: Rolls-Royce UK Pension Fund investment managers.
Notes: All data as at 31 March 2021. WACI is measured in tonnes of CO_2 (or equivalent "greenhouse gas" emissions, e.g. methane) per million USD of revenue. Carbon intensity coverage is the proportion of a mandate for which carbon intensity data is available; this is limited for the corporate bond portfolios.
[1] Benchmark used is MSCI ACWI, for illustrative purposes.

Figure 4: Weighted Average Carbon Intensity Progression Over Time



Source: Investment managers, Rolls-Royce

The underlying portfolio weights used in the total credit portfolio's Weighted Average Carbon Intensity ("WACI") calculations are based on 31 March 2021 values.
Asset valuation provided by Rolls-Royce and includes cash & accruals, government bonds, FX and derivatives and corporate bonds' accrued interest.
WACI figure provided by investment managers based on 31 March 2021 data.
RLAM 2019 WACI figure calculated using holding data as at 30 September 2018.
RLAM WACI figure converted from £ to USD using the spot FX rate at 31 March 2019, 2020 and 2021.
Carbon intensity coverage is limited for credit portfolios.

Targets used to manage climate change-related risks and opportunities

The Trustee has not set specific climate change targets for the Fund but this remains an area for ongoing review in conjunction with the new regulatory requirements due to come into force. Over the year in question LGIM achieved its 33% carbon intensity reduction commitment within the corporate bond mandate by 31 December 2020.

The Trustee will explore target setting covering its corporate bond portfolio over the next 12 months.

Suitability of additional metrics

The Trustee has undertaken education on the proposed climate change metrics forming part of upcoming regulations. It will assess the suitability of these metrics and incorporate them into next year's report. In addition its investment consultant requested the availability of the recommended metrics as they stood and was not able to get all desired metrics from the corporate bond investment managers at that time. The Trustee will work on improving disclosure with its investment managers.

Appendix 3 – Annual engagement policy implementation statement

Annual Engagement Policy Implementation Statement

Rolls-Royce UK Pension Fund ('the Fund')

Introduction

This statement sets out how, and the extent to which, the Engagement Policy in the Statement of Investment Principles ('SIP') produced by the Trustee, has been followed during the year to 31 March 2021. This statement has been produced in accordance with the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013, as amended, and the guidance published by the Pensions Regulator.

Investment Objectives of the Fund

The Trustee believes that it is important to consider the policies in place in the context of the investment objectives is has set. The Trustee's overriding objective is to meet the Fund's liabilities as and when they fall due. In pursuit of this objective, the Trustee seeks to invest the Fund's assets at an appropriate level of risk relative to the Fund's liabilities. The objectives of the Fund are included in Section 3 of the SIP.

Policy on ESG, Stewardship and Climate Change

Section 9 of the SIP sets out the Trustee's policy on Environmental, Social and Governance ("ESG") factors, stewardship and climate change. This policy sets out the Trustee's beliefs on ESG and climate change and the processes followed by the Trustee in relation to voting rights and stewardship.

In order to establish these beliefs and produce this policy, the Trustee undertook investment training in March 2020, provided by its investment advisors, on responsible investment which covered ESG factors, stewardship, climate change and non-financially driven, beliefs-based ethical investing (which can be referred to as "ethical" investment). Following this training, the policies in the SIP were updated in July 2020.

The following sections set out how the Trustee's engagement and voting policies were followed and implemented during the year.

Engagement

The Trustee requested that the investment managers confirm compliance with the principles of the UK Stewardship Code. All managers confirmed that they are signatories of the current UK Stewardship Code (2012 version) and fully intend to become a signatory to the new 2020 code when available.

As part of its quarterly review of investment performance, the Trustee receives reporting from its investment consultant including ratings (both general and specific ESG) for its investment managers. In addition, the Trustee receives an annual report on the responsible investment activities of its managers, which includes a comparison of manager ESG ratings against their peer group and a review of each manager's engagement activities. On average, the Fund's investment managers had better ESG ratings (as determined by the investment consultant) than the average of their respective peer groups.

The Trustee expects its fund managers to engage regularly with the companies in which they invest on the Fund's behalf. Whilst this is more commonplace amongst equity mandates where the investor has voting rights, there are still elements of engagement practices which can be incorporated by fixed income managers. A summary of the Trustee's review of the managers' engagement activity is set out below.

Legal and General Investment Management (LGIM) – equity and corporate bond mandates

Active ownership is embedded in the way LGIM manages its passive equity portfolios and LGIM has been successful at applying its reach across global markets. In the 1 year period to 30 September 2020, LGIM voted on 99% of eligible resolutions within the passive equity portfolio, which was fully redeemed on 15 October 2020. LGIM voted against management on 17% of resolutions.

The firm has developed a proprietary ESG rating approach relevant to equities and corporate bonds. This is made publicly available to companies along with the methodology, with a clear method of linking these ratings to the engagement agenda and voting policies.

Royal London Asset Management (RLAM) – corporate bond mandate

RLAM have increased the Responsible Investment team from three to eight over 2019 and expanded the team to nine in 2020. This had led to a 59% increase in engagement activities as well as participation in a growing number of initiatives such as Climate Action 100+ and the Just Transition.

RLAM is developing a thematic approach to engagement across a range of E, S and G issues with the following 2020 engagement themes: climate risk, financial & social inclusion, innovation, technology & society, circular economy, governance and diversity. These have been a priority over the last two years and will continue to be an area of focus for future engagement in 2021.

Insight Investment– corporate bond and secured finance mandates

Insight engage with companies on broad topics, using the Quarterly Risk Review for potential ideas. This is typically done when the team believes the outcome could have a potential impact on the method in which they analyse issuers. For example, Insight has previously engaged with several European banks to address the role of boards in banks.

Insight's credit analysts and ESG specialists routinely and frequently engage with senior management representatives of issuing companies globally with the objective of shaping the nature of bond issuance and improving investment outcomes. On such occasions they aim to discuss their existing and future funding needs, corporate strategy and performance, as well as any ESG-specific issues. This includes a meaningful focus on environmental issues including climate change.

M&G – secured finance mandate

Over 2020 M&G engaged on a number of Environmental, Social and Governance issues considered systemically important including affordable credit during the COVID-19 pandemic and promoting ESG disclosure. M&G have also acted collaboratively with other investors on key ESG issues through initiatives such as the Investor Forum and Climate Action 100+.

Voting activity during the Scheme year

The Trustee has delegated its voting rights to the investment managers. The SIP states *"The Trustee has given the appointed investment managers, both segregated and pooled, full discretion when undertaking engagement activities in accordance with their own corporate governance policies and current best practice".* It is the Trustee's view that the policy has been followed during the Scheme year.

Over the prior 12 months, the Trustee has not actively challenged the managers on their voting activity. The Trustee does not use the direct services of a proxy voter.

The majority of voting activity will arise in public equity funds. However, voting opportunities may arise in other asset classes such as certain bonds, property, private equity and multi-asset funds. During the period, voting information relating only to public equity was appliable.

Over the year ending 31 March 2021, the Trustee was only invested in one physical equity mandate, the All World Equity Index Fund managed by Legal & General Investment Management ('LGIM'). The Trustee fully redeemed from the mandate on 15 October 2020.

Overview of LGIM's approach to voting and engagement

All decisions are made by LGIM's Investment Stewardship team and in accordance with their relevant Corporate Governance & Responsible Investment and Conflicts of Interest policy documents which are reviewed annually. The Investment Stewardship team is supported by LGIM's Global Research and Engagement Group who monitor a wide range of emerging ESG issues across a range of sectors. They employ both a top-down approach with macro and thematic views as well as a bottom-up analysis of corporate and sector fundamentals.

LGIM's Investment Stewardship team uses ISS's 'ProxyExchange' electronic voting platform to electronically vote clients' shares. All voting decisions are made by LGIM and they do not outsource any part of the strategic decisions. To ensure their proxy provider votes in accordance with their position on ESG, they have put in place a custom voting policy with specific voting instructions.

Overview of voting activity, on behalf of the Trustee, for the LGIM equity funds

The Trustee has been provided with the voting disclosures relating to the All World Equity Index Fund. LGIM provide annual voting disclosures on a quarter end basis only; since the Fund redeemed all holdings in the LGIM equity fund on 15 October 2020, the information below is in respect of the year ending 30 September 2020.

Fund	All World Equity Index Fund
Number of meetings eligible to vote at over year to 30 September 2020	4,711
Number of resolutions eligible to vote on over year to 30 September 2020	51,989
Percentage of resolutions voted on where eligible	99.1%
Of the resolutions voted on, percentage voted with management	81.8%
Of the resolutions voted on, percentage voted against management	17.3%
Of the resolutions voted on, percentage abstained	0.9%

Source: LGIM

Sample of significant votes undertaken in the LGIM equity funds

There is no official definition of what constitutes a significant vote; managers have adopted a variety of interpretations such as:

- There is a particular interest in a specific vote relating to an issue,
- The potential impact on the financial outcome,
- Size of the holding in the fund / mandate, and
- Whether to vote was high-profile or controversial.

The table on the next page summarises a sample of signifincat votes highlighted by LGIM.

Issuer	Date	Vote Category	Proposal	Vote by L&G	Proposal by management	Rationale
International Consolidated Airlines Group	7/9/20	Governance	Approve Remuneration Report	☒	☑	LGIM were concerned about the level of bonus payments, which are 80% to 90% of salary for executives and 100% of salary for the departing CEO.
Lagardere	5/5/20	Governance	Proposed appointment and removal of directors	☑	☒	Proposals by Amber Capital were due to the opinion that the company strategy was not creating value for shareholders, that the board members were not sufficiently challenging management on strategic decisions, and for various governance failures.
Barclays	7/5/20	Environmental	Approve Barclays' Commitment in Tackling Climate Change	☑	☑	The resolution proposed by Barclays sets out its long-term plans in respect of tackling climate change and has the backing of ShareAction and co-filers.
ExxonMobil	27/5/20	Environmental	Elect Director Darren W. Woods	☒	☑	In June 2019, under LGIM's annual 'Climate Impact Pledge' ranking of corporate climate leaders and laggards, LGIM announced that they will be removing ExxonMobil from their Future World fund range, and will be voting against the chair of the board. LGIM also separately voted in favour of shareholder proposals for an independent chair.
Amazon	27/5/20	Social & Governance	Various resolutions	☑	☒	Of 12 proposals, LGIM voted to support 10, looking into the individual merits of each proposal. Resolutions included the separation of CEO and board chair roles, details of data transparency in Amazon's 'climate pledge' and employee health and safety.