

This announcement is issued for UK works & staff employees who were active members of Rolls-Royce UK Pension Fund (RRUKPF) on 31 December 2020

Dear member,

Following the closure of the defined benefit ('final salary') pension scheme on 31 December 2020 and consultation with Employee Representatives over the last 6 months, we can now confirm the final enhancements that have been agreed between the Company and the Trustee of the RRUKPF.

In brief

The detail of the enhancements is complex, but in summary include:

- Enhancements worth £120m for Works and Staff members
- Uplifts to deferred pensions of 1.33% a year over the next three years (total 4% increase), subject to certain tests being satisfied
- Continuation of the availability of the good-leaver 'with consent' early retirement factors beyond 2023
- Availability of share of fund transfer values (SOFTV) until at least 31 December 2024
- Core life assurance cover of 4 x pensionable earnings
- Protection for Works and Staff members transferred under TUPE

To help understand what this means for you, we have provided a Q&A with more detail at the bottom of this message.

What do I need to do?

You don't need to do anything. These benefit improvements have all been agreed and our pension team is currently re-programming the pension administration system to give you more visibility of your transfer figures and these enhancements.

We'll contact you again in August when the new self-serve functionality is planned to be available on-line. We'll also produce a video and some guidance notes to help you navigate your figures and explain what quotes and support are available.

You can find out more information on the RRUKPF by logging into the pension website at <https://www.rolls-roycepensions.com/Homepage>

We respectfully ask that you do not contact the pension team for further details as we will be back

in touch – the team needs to prioritise colleagues who will be leaving the business in the next few months, and other urgent cases.

Joel Griffin
People Director – Performance & Reward

Fiona Brown
Head of Pensions

Your questions answered

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Disclaimer: All pension benefits are payable in accordance with the Rules of the Rolls-Royce UK Pension Fund and the following note is intended as a summary of changes that have been agreed to the Rules. A copy of the Rules is available upon request to pensions.mail@rolls-royce.com

UPLIFTS TO RRUUKPF PENSIONS

Why are extra benefits being granted?

These are final benefit improvements to recognise the impact of the closure of the RRUUKPF to future accrual on Works and Staff members who were active members of the RRUUKPF up to 31 December 2020. All of the improvements will be delivered from the money held in the RRUUKPF and will not involve the payment of any cash by the Company. The Company remains liable to continue to support the RRUUKPF if it requires additional funding in the future. It has taken some time to ensure that all parties are confident that the RRUUKPF can deliver these enhancements and to agree checks and balances on how they enhancements will be delivered in case the Company's or the RRUUKPF fund's financial position deteriorates.

When will the uplifts apply?

Uplifts totalling 4% will apply over 3 years as follows:

- 1.33% on 31 December 2021
- 1.33% on 31 December 2022

- 1.33% on 31 December 2023

The uplifts are dependent on some tests being met – see the explanation of the tests below.

What about the standard increases to my deferred pension?

The uplifts of 1.33% a year will be applied in addition to standard deferred increases (as detailed in the Closure Statement that was issued to you earlier this year). For example, if the standard deferred increases in one year is 2%, the total increase applied for that period will be 3.33%.

Why are the tests needed?

Because of the weakened strength of Rolls-Royce's finances. It has not been possible to guarantee the full uplift now or deliver them in a single step. The only way in which these £120m of enhancements for Works & Staff members have been possible is because they will be funded from the RRUKEPF and spread over a period of time.

What tests will apply?

Before each uplift is granted, the funding of the RRUKEPF and Rolls-Royce's liquidity position will need to exceed thresholds agreed between the Company and the Trustee. This is to ensure that the extra benefits can be delivered without risking the security of the existing benefits for all RRUKEPF members and beneficiaries.

The tests for the uplifts are that the funding of the RRUKEPF stays at least at 107% on an agreed funding basis, and that Rolls-Royce liquidity stays above £2.5bn. As at June 2021 both these tests are currently being met.

What if the tests aren't passed?

We are confident that these enhancements will be delivered. However, if any of the tests are not met, we will review whether any missed uplifts can be applied retrospectively.

What is the eligibility for the uplifts?

- You must have been an active member of the RRUKEPF on 31 December 2020, stayed in the same employment and not have been TUPE transferred, at each 31 December to receive the uplift for that year
- If you leave employment part way through the year you will not receive a pro-rata uplift
- If you are TUPE transferred to another employer before 1 January 2024, you will receive all of the uplifts granted for remaining employees as long as you stay with your new employer up to that date. If you leave employment before 1 January 2024 you will keep any uplifts already granted to you.

If you leave employment before all the uplifts have been granted, you will keep the uplifts that have already been granted for you, but you will not receive any further full or partial uplifts. For example, if you leave before 31 December in a year, you will keep any uplifts granted up to and including 31 December of the previous year.

EARLY RETIREMENT

How long will 'with consent' early retirement factors be available?

You are already eligible (if you are of retirement age) to apply for 'with consent' early retirement factors if you retire and take your pension before 31 December 2023, assuming that you have continuous service with the Rolls-Royce employer that participated in the RRUKPF on 31 December 2020. If the RRUKPF funding levels remain strong, then we will endeavour to extend availability beyond 2023 and our intention is that these factors will remain in place permanently.

What does 'with consent' mean?

If you are unfamiliar with the term 'with consent' this is the terminology in the pension rules and aligns broadly with being a 'good leaver' from the business.

Do I have to take my pension or transfer value when I leave?

No – you can take your pension or a transfer value at a later date, but different terms may apply to the early retirement factors (if you retire early) or transfer value calculation and you should check that out before you make any final decisions.

SHARE OF FUND TRANSFER VALUES

How long will SOFTV be available?

The SOFTV will remain available until at least 31 December 2024 if you remain in Rolls-Royce employment and are 55 or over when you leave.

Will the availability of SOFTV be extended any further?

At time of writing, we anticipate that this option will continue in some form for a further 3-years until 31 December 2027, but we can't guarantee that now. An extension will be considered during the second half of 2023 in the next formal three-year funding valuation. If you are TUPE transferred to another employer before 31 December 2023 you will be eligible for a SOFTV until 31 December 2023 as long as you remain with your new employer up to the time you ask to take a SOFTV, or 31 December 2023 if later.

Why can't we guarantee SOFTV eligibility permanently?

Paying transfer payments for certain members that are more than the statutory Cash Equivalent Transfer Value that they are entitled to means that more funds are removed from the RRUKPF than

would ordinarily be the case and could potentially reduce the security of other members' benefits. We always need to test that SOFTVs do not reduce the security of other members' pensions and that they continue to be appropriate. We also need to be mindful of the legal and regulatory framework around defined benefit pension transfers which is continuing to develop.

Are the new uplifts included the SOFTV (share of fund transfer value) calculation?

Yes. From 1 January 2022 the SOFTVs will include full allowance for the new uplifts.

Will the SOFTV calculation basis be the same as it is now?

No, but the changes will be minimal in the vast majority of cases. The Company and the Trustee have reviewed the terms that will apply for the SOFTV calculation from 1 January 2022, to ensure those terms are fair for eligible members across all sections of the RRUKPF as well as ensuring the RRUKPF remains adequately funded for members who don't transfer but draw their pension when they retire.

For the vast majority of members, the new basis will provide values that are very similar to the values provided on the current basis; depending on age and service the values may be slightly higher or slightly lower but the difference will be within the range seen currently when applying the normal monthly market adjustment changes. It is possible that for a very small group of eligible members, the new transfer basis will provide a SOFTV that could be around 10% lower than the current value. We stress that this will affect a very small number of members. The pensions team plan to analyse who is affected by the changes over the summer and will write to the small number of people who will see a material reduction to their SOFTV on the new basis that is applicable from 1 January 2022. In addition, the team is working to re-programme the pension system so that all eligible members will be able to model their own SOFTVs on the new basis from sometime during August onwards.

LIFE ASSURANCE

What changes are being implemented to life assurance benefits?

The most common level of life assurance cover for Works and Staff employees who were active members of the RRUKPF was a lump sum of 3x pensionable earnings. This lump sum is increasing to 4x pensionable earnings for all employees who were active members of the RRUKPF up to 31 December 2020. The transition arrangements for survivor's death in service pensions are unaffected by this change and will continue to apply until 31 December 2023. From 1 January 2024 lump sum death in service benefits will align to 6x pensionable earnings and dependents' pensions will be paid based on deferred pension rules rather than active member rules. Any funds in the RRRST will be paid out in addition in all cases.

GENERAL

How are the extra benefits affordable given the financial circumstances of the Group?

Assuming the funding and liquidity tests are met, the additional benefits will be funded from the RRUKPF and will not require any cash from Rolls-Royce. The tests for the uplifts are that the funding of the RRUKPF stays at least at 107% on an agreed basis, and that Rolls-Royce liquidity stays above £2.5bn. As at June 2021 both these tests are currently being met.

Are Works & Staff employees receiving the same enhancements as managers?

No. The Works & Staff uplifts are higher as both groups were starting from different positions. In total, Works & Staff enhancements will cost around £120m and managers enhancements will cost around £20m. The average total uplift for each manager will be 1.4% if granted in full. Works & Staff members will receive an extra 2.6% to reflect the fact that managers received a 5% uplift to their pensions in March 2020, whilst Works & Staff received a 2.4% pay rise. Works & Staff will also receive eligibility for with-consent early retirement factors, but subject to ongoing affordability tests as explained above. These tests won't apply to managers as early retirement factors were guaranteed following the benefit changes implemented for managers last year. The benefit changes implemented in 2020 for managers were designed in 2019 before anyone knew about the pandemic and were given in exchange for managers' individual contractual agreement to future pension benefit reductions.

Does the CNC endorse these enhancements?

We've had an open dialogue with both the CNC and Manager Representatives throughout this whole process and they helped to shape the final proposals that were subsequently agreed between the Company and the Trustee.

The CNC continues to seek further RRUKPF benefit improvements for employees with benefits in RRUKPF in addition to the package of £120m set out above, however, we have very limited expectations of reaching any agreement on any further improvements. Discussions have been on-going for a long time and there is no clear timeframe for concluding these, therefore, we wanted to write to you now to let you know what has been agreed with the Trustee and is no longer subject to any ongoing consultation.

Are these improvements subject to a Pensions Ballot?

No. They are already agreed.

Will there be more benefit improvements in the future?

This is exceptionally unlikely. We expect the future priority for the RRUKPF will be to increase security of members' existing pension benefits rather than adding to them. Going forward we intend to focus on the benefit and reward packages for all our employees as we re-build our business together.

Will you review the TotalReward package in future?

Yes - of course. We will always keep our TotalReward arrangements under regular review to ensure that our TotalReward is competitive to allow us to attract, retain and reward our people. We will continue to work with employee representatives (including the CNC) to ensure the transparency of any reviews. However, many of our benefits are already in the upper quartile versus the wider market whilst as a Group we are continuing to lose more cash than we generate. Consequently, please do not anticipate any further benefit improvements to be implemented in the near term.

What happens to the enhancements if I am TUPE transferred?

If you are TUPE transferred to another employer before 31 December 2023, the following enhancements will continue to apply:

- SOFTV will apply until 31 December 2023 for eligible members as long as you remain with your new employer up to the time you ask to take a SOFTV.
- 'With consent' early retirement factors will apply if you take your pension when leaving your new employer before 31 December 2023.
- You will receive all the uplifts granted for remaining employees as long as you stay with your new employer up to 31 December 2023. If you leave your new employer before 1 January 2024 you will keep any uplifts already granted to you.