



Funding Update

Every year we produce a funding update to let you know how the Scheme is performing. This update summarises the results of the most recent interim financial health check of the Scheme as at 31 March 2023. Inside you can find out more about how the funding situation has changed since the last interim funding update as at 31 March 2022, included in last year's Pension Update, and since the last formal financial health check of the Scheme ('actuarial valuation') as at 31 March 2021.

IN BRIEF

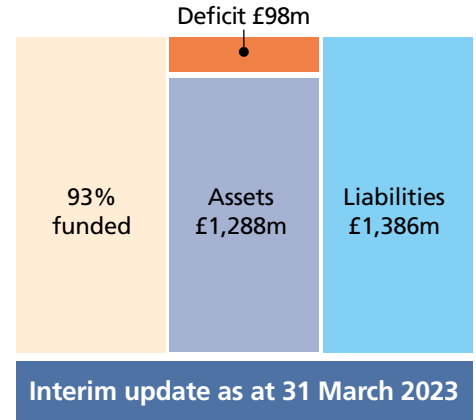
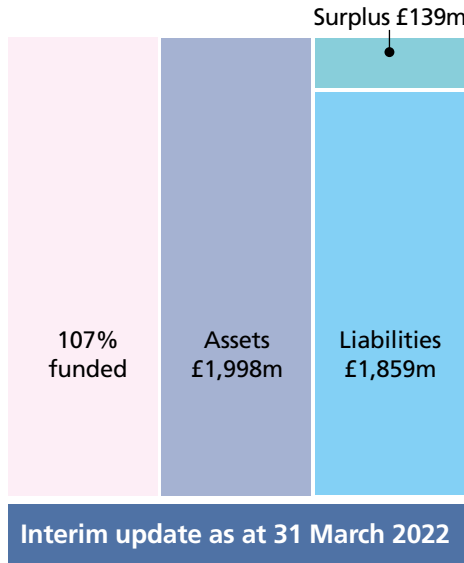
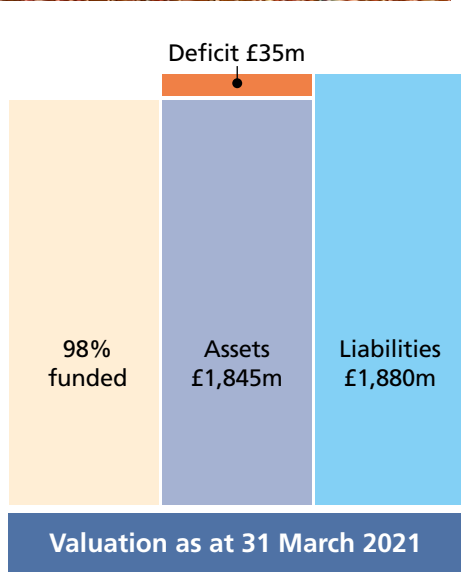
The Scheme's funding situation has deteriorated since the last formal valuation and the last interim funding update, with an estimated deficit of £98m as at 31 March 2023. However, this should not be of any concern due to the existence of the Crown Guarantee.

Work has begun on the next formal valuation of the Scheme as at 31 March 2024. If the Scheme is revealed to still be in shortfall at that date, the Trustee, AWE and MoD will discuss a recovery plan to make good on the deficit.

In March 2024, AWE made a one-off contribution of £30m to improve Scheme funding.

HOW IS THE SCHEME DOING?

As at 31 March 2023, the Scheme was 93% funded, with a deficit of £98 million. The diagrams below show how the funding situation has changed since the last valuation in 2021 and the last interim funding update in 2022.



Funding updates and valuations are very much 'snapshots in time', which reflect the situation on a given date. Due to a number of factors, which are explained in detail on the next page, the funding situation has deteriorated since both 31 March 2021 and 31 March 2022. However, this should not be of any concern due to the existence of the Crown Guarantee. We expect the situation to change from year to year because the Scheme's finances depend partly on changes in global financial markets. We will provide you with more information on the 2024 actuarial valuation in our next funding update.

Crown Guarantee

A Crown Guarantee is a special legal agreement whereby the Secretary of State for Defence (backed by HM Treasury) agrees to stand behind AWE's funding obligations to the Scheme to ensure that the Scheme always has sufficient monies to cover all of its benefits payable in full.



HOW HAS THE FUNDING SITUATION CHANGED?

The funding situation has deteriorated since the last valuation as at 31 March 2021 due to a number of factors which have both positively and negatively impacted on the funding situation. These included:

- The deficit recovery contributions that AWE paid in the year to March 2022 had a positive impact on funding.
- Changes to market conditions over the period, which have impacted the value of the liabilities.
- Lower than expected investment returns.

Material changes to market conditions in the year since 31 March 2022 have resulted in a reduction to the funding level as at 31 March 2023. The key drivers have been:

- Significant increase to interest rates.
- High short-term inflation offset to an extent by lower long-term inflation expectations.
- Unprecedented gilt market volatility in September and October 2022 following the September 2022 mini-budget.

Since 31 March 2023, the £30m one-off contribution paid in March 2024 will have had a positive impact on funding. As the assumptions used to assess the funding level as at 31 March 2024 will change as a result of the valuation discussions, it's hard to predict what the outcome will be as there are a number of factors to take into account. We'll let you know more in our next funding update, which will be issued once work on the formal valuation as at 31 March 2024 has been completed. Valuations can take up to 15 months to complete, so depending on how work and discussions progress, we may not be able to update you until sometime next summer. You can find out more about valuations starting on the next page.

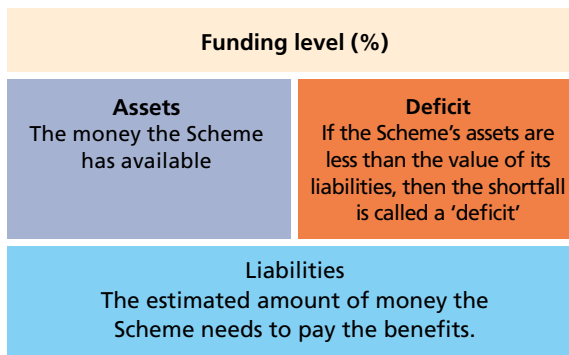


WHAT IS A VALUATION?

A valuation compares the value of the Scheme's assets (the money it has available) against its liabilities (the estimated amount of money that it needs to ensure that in future it can pay the benefits members have already earned).

Valuations are normally carried out at least every three years, although they can be carried out more frequently. The last valuation of the Scheme was at 31 March 2021. Work on the next valuation as at 31 March 2024 is in progress. In the years between valuations, the Trustee receives annual interim updates on the funding situation.

Comparing the assets with the liabilities gives a funding level which indicates if the Scheme has a surplus (more money than it needs to pay members' benefits) or a deficit (less money than it needs to pay the benefits). For example ...



If there is a deficit, the Trustee, AWE and MoD have to agree a plan to remove the deficit over a reasonable period. The valuation also shows the contributions needed to provide the benefits that current active members will build up in the future.

When carrying out a valuation, the Trustee has to consider:

- the Employer covenant – AWE’s financial strength and its ability to support the Scheme both now and in the future, also taking account of the Crown Guarantee;
- the Scheme investment strategy – the risks being taken and how this is expected to change over time; and
- the assumptions to be used to calculate the future value of the Scheme’s benefits – these include demographic assumptions such as how long members might live and financial assumptions such as the rate of future investment returns. When setting assumptions, the Trustee receives advice from the Scheme Actuary, but also takes into account its view of the Employer covenant. In general, the assumptions could be very different depending on whether the Employer covenant is considered to be weak or strong. As the Scheme now has the security of the Crown Guarantee, AWE’s covenant is considered strong.

How are the liabilities calculated?

The Scheme’s Actuary, a qualified professional who is independent from the Scheme, AWE and the MoD, calculates the value of the liabilities using assumptions from a Statement of Funding Principles. The Statement of Funding Principles is drawn up by the Trustee and agreed with both AWE and the MoD.

Eliminating the deficit

As a result of the 2021 valuation, the Trustee, AWE and the MoD agreed a recovery plan to eliminate the funding shortfall at that point. Under the terms of the recovery plan, whilst the valuation discussions were ongoing, AWE continued to make monthly deficit recovery contributions of £2,722,100, due under the previous recovery plan, to 31 March 2022. AWE made a one-off contribution of £34.4 million in advance in March 2022 for the period from 1 April 2022 to 31 March 2023. This had the effect of eliminating the funding deficit as at the last valuation date, so that no further recovery payments are currently formally due.

In March 2024 AWE made a one-off contribution of £30 million to the Scheme to further improve the funding. The situation will be reviewed again as part of the work on the valuation as at 31 March 2024.

Other things we need to tell you

As part of the valuation, the Scheme Actuary also estimates how much an insurance company might charge to take on the responsibility of paying members' benefits (the 'solvency position'). All defined benefit pension schemes are required to carry out this calculation, but in practice it has limited relevance for the Scheme given the security that is now provided by the Crown Guarantee.

If the Scheme had discontinued and transferred to an insurance company at 31 March 2021, the estimated deficit would have been £1,266 million, and so the Scheme assets would have secured around 59% of benefits at that date.

Regulations additionally require us to confirm that AWE has not taken any money out of the Scheme since our last funding update. We can confirm this. We can also confirm that the Scheme has not had any directions imposed on it by The Pensions Regulator.



GOING DIGITAL

We are taking the opportunity to remind you again of a change we are planning to make to how we communicate with you. Within the next 12 to 18 months we are aiming to 'go digital' – in other words, we want to move away from sending you printed documents such as this funding update or Pension Update (due to be issued in Q4 this year to give you the most up-to-date accounts information) and supply them electronically instead.

Rather than sending you a printed copy, we will put a copy of the document on the Scheme website and we will email you to let you know it's there. It's therefore important that we have your current email address. If you have not already done so, you can provide us with your email address by registering on the Scheme website (details below right).

We recognise that not all Scheme members will be comfortable with, or able to receive electronic communications, so there will always be the opportunity to 'opt out' and receive printed versions again. We'll give you more details about this nearer the time.

Are your contact details up to date?

Please remember to let us know if you move house during the year so that we can stay in touch with you and make sure you receive all necessary information about the Scheme and your benefits. Please contact Aon, using the details below, to let us know of any changes.

CONTACT US

For questions about your pension benefits, contact the Scheme's administrators:

Email: **awepension.scheme@aonconsulting.co.uk**

Phone: **0345 601 5903**

Write to: **AWE Pension Scheme, Aon, PO Box 196, Huddersfield, HD8 1EG**

Find us online at:

The Scheme's website: **<http://www.mypensionline.com/awe>**

