

Directors' remuneration policy

for approval at the 2017 Annual General Meeting

This Directors' remuneration policy (the Policy) will take legal effect from the conclusion of the 2017 Annual General Meeting (AGM) subject to shareholder approval at the 2017 AGM.

The Remuneration Committee (the Committee) considers remuneration policy annually to ensure that it remains aligned with business needs and is appropriately positioned relative to the market. However, in the absence of exceptional or unexpected circumstances which may necessitate a change to the Policy, there is currently no intention to revise the Policy more frequently than every three years. We use target performance to estimate the total potential reward and benchmark it against reward packages paid by BAE Systems' competitors.

The Policy is to set base salary with reference to the relevant market-competitive level. Actual total direct reward reflects the performance of the individual and the Company as a whole. The aim is to deliver an overall remuneration package for executive directors which provides an appropriate balance between short-term and long-term reward and between fixed and variable reward as described in the table below.

Whilst our Long-Term Incentive Plan provides the Committee with discretion in respect of vesting outcomes that affect the actual level of reward payable to individuals, as explained on page 102, such discretion would only be used in exceptional circumstances and, if exercised, disclosed at the latest in the report on implementation of the Policy (i.e. the Annual remuneration report) for the year in question.

Changes compared to the policy approved at the 2014 AGM

The Policy contains no components which were not in the remuneration policy approved at the 2014 AGM. However, the material changes from the policy approved in 2014 are summarised below with the supporting rationale provided in the Remuneration Committee Chairman's letter on pages 79 to 81:

Salary

- Clarity on cap on salary increases.

Annual incentive

- Introduction of separate maximum for Chief Operating Officer.
- Introduction of limits for new executive director role.
- Incorporation of malus and clawback mechanisms.

Long-Term Incentives (LTI)

- Introduction of reasonableness discretion.
- Introduction of separate maximum for Chief Operating Officer.
- Introduction of limits for new executive director role.
- Clarity on flexibility to vary weightings of different award types and the associated impact on opportunity levels subject to the parameters set out.
- Incorporation of malus and clawback mechanisms.
- Introduction of two-year holding period for shares acquired on vesting of awards to non-US directors.
- Introduction of Earnings per Share (EPS) alongside Total Shareholder Return (TSR) on share options with equal weighting.
- Removal of Share Options for US executive director and redistribution into Performance Shares and Restricted Shares to maintain current Expected Value.
- Increase in Minimum Shareholding Requirement for US executive director.

Pension

- Participation in executive defined contribution retirement plan (or cash equivalent) introduced as default pension vehicle for new directors.
- Inclusion of salary supplement as vehicle to offset impact of Lifetime Allowance and/or Annual Allowance.

Non-executive directors' fees

- Introduction of maximum for Chairman's fees and benefits.

Directors' remuneration policy

continued

Executive directors' policy table

Base salary

Purpose and link to strategy

Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.

Operation

Salaries are reviewed annually. Business and individual performance, skills, the scope of the role and the individual's time in the role are taken into account when setting and assessing salaries, as is market data for similar roles in the relevant market comparator group.

The comparator group for UK executive directors is comprised of selected companies from the FTSE 100 and is constructed to position BAE Systems around the median in terms of market capitalisation. For the President and Chief Executive Officer of BAE Systems, Inc., the comparator group is drawn from companies in the US aerospace and defence sectors, together with similar organisations in the general industry sector where BAE Systems, Inc. is positioned at the median of the comparator group by reference to revenue size.

Maximum opportunity

When considering salary increases for the executive directors in their current roles, the Committee considers the general level of salary increase across the Group and in the relevant external market.

Actual increases for the executive directors in their current roles will generally not exceed the average percentage increase for employees as a whole, taking account of the level of movement within the relevant UK/US comparator group.

As a maximum, in exceptional circumstances (such as a material increase in job size or complexity while performing the same role, or a recently appointed executive director where the salary is positioned low against the market), the increase will not exceed 10% in any single year for executive directors performing the same role. If an individual's role changes then a salary increase above 10% may be awarded in any single year to position their salary appropriately in accordance with the base salary principles described under 'Operation' above. As a matter of policy, no new executive director role will have a salary greater than the Chief Executive at that time.

Performance metrics used, weighting and time period applicable

None.

Annual incentive

Purpose and link to strategy

Drive and reward annual performance of individuals and teams on both financial and non-financial metrics, including leadership behaviours in order to deliver sustainable growth in shareholder value.

Compulsory deferral into shares increases alignment with shareholder interests.

Operation

The annual incentive is driven off in-year financial performance, corporate responsibility and other non-financial objectives measured at the Group and individual level.

One-third of the total annual incentive amount is subject to compulsory deferral for three years in BAE Systems shares without any matching.

A malus mechanism may be applied to any bonus, and a clawback mechanism may be applied to the deferred bonus shares until up to the end of the three-year deferral period, in respect of 2015 or subsequent years where:

- the Company is entitled to terminate employment for cause or the participant has engaged in misconduct (including breach of policy) which gives rise to other disciplinary sanction;
- the results of the Company and/or relevant business or businesses for any period have been restated or subsequently appear materially inaccurate or misleading; and/or
- any Group company or business unit has made a material financial loss.

Cash dividends are payable to the participants on the shares during this three-year deferral period.

Executive directors' policy table continued

Annual incentive continued

Maximum opportunity

Chief Executive and the President and Chief Executive Officer of BAE Systems, Inc.: 225% of salary

Chief Operating Officer: 200% of salary

Group Finance Director: 160% of salary

Where a new executive director role is established, the maximum opportunity will not exceed that of the Chief Operating Officer role as set out above.

The pay-out for maximum performance is double the payout for on-target performance. The pay-out for target performance is half of the respective maximum percentages above. The pay-out for achieving a threshold performance is 40% of the payout for on-target performance (i.e. 20% of maximum), with no pay-out for achieving less than this. Pay-out for performance between targets is calculated on a straight-line basis.

Performance metrics used, weighting and time period applicable

Performance is assessed on an annual basis, using a combination of the Group's main performance indicators for the year and other objectives designed to support the Group's strategy. Metrics, which will include financial and non-financial metrics as well as the achievement of personal objectives, will be determined and weighted each year according to business priorities. 75-80% will relate to financial metrics.

Metrics and weightings to be determined annually. Proposed metrics and weightings applicable in 2017:

Group EPS – 40%

Group cash – 25%

Order intake – 15%

Safety – 5%

Personal objectives designed to support the Group's strategy – 15%

See notes 4 and 5 on page 106 regarding the selection and weighting of performance metrics.

Notwithstanding performance against the applicable metrics, all bonus payments are at the discretion of the Committee, which will be based on an assessment of the individual's personal contribution to business performance over the relevant year and leadership behaviours demonstrated in making that contribution, relative to others.

Long-Term Incentives (LTI)

Operation

Long-term incentives will operate under the BAE Systems Long-Term Incentive Plan approved by shareholders at the 2014 AGM.

The size of awards granted is based on a percentage of salary, which is divided by the share price to determine the number of shares subject to the award.

Dividend equivalents in respect of vested shares may be paid at the time of vesting (or exercise, in the case of options) and are not taken into account when determining individual limits.

A malus and clawback mechanism may be applied, until two years after vesting, or if sooner, the fifth anniversary of grant, or the occurrence of certain corporate events, to all awards granted on or after 25 March 2015 where:

- the Company is entitled to terminate employment for cause or the participant has engaged in misconduct (including breach of policy) which gives rise to other disciplinary sanction;
- the results of the Company and/or relevant business or businesses for any period have been restated or subsequently appear materially inaccurate or misleading;
- any Group company or business unit has made a material financial loss; and/or
- the measurement of any performance condition does not reflect the actual performance of the Company over the performance period.

The Committee will establish the targets for each measure at the start of each performance period based on Group projections and market expectations for the business. The performance conditions for previous awards are described in the Annual remuneration report.

Awards and performance conditions can be adjusted to take account of variations of share capital and other transactions or events.

On a change of control or similar transaction, awards generally will vest to the extent performance conditions are then satisfied (if applicable) and then be pro-rated to reflect the acceleration of vesting unless the Committee decides otherwise. Alternatively, awards may be exchanged for equivalent awards over shares in the acquiring company.

The share plan rules may be amended from time-to-time by the Committee in certain circumstances including minor changes for administrative, tax or other regulatory purposes.

Subject to this Policy, performance conditions of awards already granted may be amended in accordance with their terms or if anything happens which causes the Committee reasonably to consider it appropriate to do so.

Performance metrics used, weighting and time period applicable

See notes 4 and 5 on page 106 regarding the selection and weighting of performance metrics.

Directors' remuneration policy continued

Executive directors' policy table continued

Long-Term Incentives (LTI) continued

Maximum opportunity

Over the lifetime of this Policy, the Committee will have discretion to vary the weighting of different types of awards within the framework set out below, but the overall LTI Expected Value (EV) will remain the same (assuming the LTI EV is calculated as 50% of face value for Performance Shares, 20% of face value for Share Options and 100% of face value for Restricted Shares):

- UK executive directors' awards will consist of a mix of Performance Shares and Share Options (with Share Options comprising no more than 50% of overall LTI EV).
- US executive directors' awards will consist of a mix of Performance Shares and Restricted Shares (with Restricted Shares comprising no more than 50% of overall LTI EV).

Performance metrics used, weighting and time period applicable

See below in relation to Performance Shares and Share Options.

In addition to the primary performance tests set out below, the Committee confirms and recognises its obligation to judge the overall reasonableness of the rewards received relative to the overall business actions and results achieved. When determining the final performance condition outcome under Performance Share and Share Option awards, the Committee will have discretion over the number of awards vesting in light of other important factors in the business (reasonable discretion). The discretion may result in vesting of awards going upwards (subject to maximum 100% vesting of awards) as well as downwards. Any factors will be properly considered as they arise and any discretion to the calculated results will be applied in a highly disciplined manner and the rationale and impact will be reported transparently. The use of reasonableness discretion would apply to LTI awards granted to executive directors after the commencement of this Policy.

See notes 4 and 5 on page 106.

Long-Term Incentives – Performance Shares

Purpose and link to strategy

Drive and reward delivery of sustained long-term EPS and TSR performance aligned to the interests of shareholders.

Operation

For non-US executive directors, awards, typically in the form of nil-cost options, will vest subject to performance and service conditions on the fifth anniversary of grant. These will be exercisable between the fifth and tenth anniversary of grant or such shorter period as may be specified by the Committee.

For US executive directors, awards are delivered as conditional share awards (RSUs). To maintain the competitiveness of the LTI offering in the US, awards will vest automatically on the third, fourth and fifth anniversary of grant, subject to performance conditions.

Policy maximum opportunity

Award levels applicable to UK executive directors for normal annual grants (assuming the current LTI EV weightings in Performance Shares and Share Options) are as follows:

Chief Executive: 250% of salary

Chief Operating Officer: 230% of salary

Group Finance Director: 215% of salary

Award levels applicable to US executive directors for normal annual grants (assuming the current LTI EV weightings in Performance Shares and Restricted Shares) are as follows:

President and Chief Executive Officer of BAE Systems, Inc.: 298% of salary

Note the percentages above could be exceeded if the LTI EV weightings were to be varied (see above).

Where a new executive director role is established, the maximum opportunity will not exceed that of the Chief Operating Officer role as set out above.

Executive directors' policy table continued

Long-Term Incentives – Performance Shares continued

Performance metrics used, weighting and time period applicable

Metrics and weightings will be as follows (subject to the Committee's ability to adjust as set out below):

- 50% of award based on TSR relative to one or more appropriate comparator groups over the three-year performance period as selected by the Committee at the time of grant:
 - Vesting of each comparator group is determined as: nil vesting if TSR ranked below median in the peer group; 25% vesting if TSR ranked at the median; 100% vesting if TSR ranked in the upper quintile; pro-rata vesting for performance between median and upper quintile.
 - If more than one comparator group is used, vesting of the TSR portion of the award will be determined by the average of the vesting outcomes from each comparator group.
 - Award subject to a secondary financial measure as set out on page 93.
- 50% of award based on average annual EPS growth over the three financial years starting with that in which the award is granted, with 25% vesting for threshold performance, 50% vesting for target performance and 100% vesting for stretch performance. Pro-rata vesting for intermediate performance.

The metrics and weightings applicable in 2017 are as follows:

- 50% of award based on TSR relative to the following two comparator groups over the three-year performance period:
 - At least ten other international defence companies selected by the Committee at the time of grant.
 - All companies in the FTSE 100 index.
- 50% of award based on average annual EPS growth over the three financial years starting with that in which the award is granted, with threshold performance requirement as average annual EPS growth of 3%, target performance requirement as average annual EPS growth of 5% and stretch performance requirement as average annual EPS growth of 7%.

Note that awards granted to executive directors from the date of the 2017 AGM would be subject to application of reasonableness discretion in light of other important factors in the business as described earlier.

The Committee can adjust the weighting of the EPS and TSR conditions and, if considered appropriate, the Committee may introduce an alternate performance condition aligned to the Company's strategy.

See notes 4 and 5 on page 106.

Long-Term Incentives – Share Options

Purpose and link to strategy

Drive and reward delivery of sustained long-term EPS and TSR performance and sustained improvement in the Company's share price.

Operation

Share Options have an exercise price set at market value at grant.

For non-US executive directors, awards vest subject to performance and service conditions on the fifth anniversary of grant and will be exercisable between the fifth and tenth anniversary of grant.

US executive directors are not eligible.

Policy maximum opportunity

Award levels applicable to UK executive directors for normal annual grants (assuming the current LTI EV weightings in Performance Shares and Share Options) are as follows:

Chief Executive: 300% of salary

Chief Operating Officer: 300% of salary

Group Finance Director: 300% of salary

Note the percentages above could be exceeded if the LTI EV weightings were to be varied (see page 102).

Where a new executive director role is established, the maximum opportunity will not exceed that of the Chief Operating Officer role as set out above.

Performance metrics used, weighting and time period applicable

For Share Option awards made to the executive directors, exercise is subject to the TSR and EPS performance conditions (subject to any adjustment described above) and application of reasonableness discretion as set out above.

Note that for Share Option awards granted to the executive directors prior to the 2017 AGM, exercise is subject to the TSR performance conditions as set out in our policy approved at the 2014 AGM.

See notes 4 and 5 on page 106.

Directors' remuneration policy continued

Executive directors' policy table continued

Long-Term Incentives – Restricted Shares

Purpose and link to strategy

Provide long-term reward through time-vesting awards principally in the Company's US market.

Operation

The shares are subject only to the condition that the participant remains employed by the Group on the vesting date (three years after the award date). These awards are not subject to a performance condition as it is designed to address competitive market practice and retention issues principally in the US. Non-US executive directors are not eligible.

Policy maximum opportunity

Award levels applicable to US executive directors for normal annual grants (assuming the current LTI EV weightings in Performance Shares and Restricted Shares) are as follows:

President and Chief Executive Officer of BAE Systems, Inc.: 150% of salary

Performance metrics used, weighting and time period applicable

None.

See notes 4 and 5 on page 106.

Benefits

Purpose and link to strategy

Provide employment benefits which ensure that the overall package is market competitive when these elements are taken into account.

Operation

Benefits include provision of a company car (or cash equivalent), life assurance and ill-health benefit cover which are provided directly or through membership of the Company's pension schemes. The main benefits in the UK include a car allowance (currently £16,000 per annum), private use of a chauffeur-driven car and annual medical screening, plus life assurance and ill-health benefit cover provided through membership of the Company's pension schemes.

Opportunity for UK executive directors to participate in the Share Incentive Plan, a tax approved all-employee plan.

In the US, benefits include a cash allowance for car and parking (currently \$20,900 per annum) and private use of a chauffeur-driven car, medical and dental benefits, and insured life and disability benefits.

Additional benefits, such as relocation assistance, may also be provided in certain circumstances if considered reasonable and appropriate by the Committee. Relocation assistance comprises reimbursement for direct items of expenditure, such as legal, estate agency, removals and temporary accommodation.

Directors' and Officers' insurance cover is also provided for all executive directors.

Maximum opportunity

Benefits are set at a level which the Committee considers to be appropriate against comparable roles in companies of similar size in the relevant market.

Benefits are as reported and itemised within the single total figure shown as part of the Annual remuneration report on page 85. The maximum cost of such benefits will reflect the associated market-competitive cost of provision. Relocation assistance is based on actual costs incurred which are linked to the size and value of the property, plus a maximum relocation allowance of £2,500.

Participation limits for the Share Incentive Plan are those set by the UK tax authorities from time-to-time.

Performance metrics used, weighting and time period applicable

None.

Executive directors' policy table continued

Pension**Purpose and link to strategy**

Provide competitive post-retirement benefits or cash allowance equivalent.

Operation

The current Chief Executive and Group Finance Director as at 22 February 2017 are members of the BAE Systems Executive Pension Scheme and members of an underlying employee pension plan, which together provide a target benefit for executive directors payable at normal retirement age (62) of 1/30th of final pensionable earnings (FPE) for each year of service up to a maximum of two-thirds of FPE. Member contributions are currently 8% of salary. Further detail is provided on page 90 as part of the Annual remuneration report.

The current Chief Operating Officer as at 22 February 2017 is a member of the defined contribution section of the BAE Systems Executive Pension Scheme (EPS DCRP). In line with our policy, Company contributions are 19% of salary and member contributions are 6% of salary. Where the Annual Allowance (AA) is breached, as is the case with the Chief Operating Officer, he will pay member contributions up to the AA limit and the Company contributions will be paid as a salary supplement.

For any new externally-appointed UK executive directors, or internally appointed UK executive directors who are not members of a BAE Systems defined benefit scheme, membership of the BAE Systems EPS DCRP is offered with contribution requirements set as a percentage of base salary dependent on grading. Individuals may elect to receive some or all of their Company contributions as a cash allowance. For any internally-appointed UK executive directors who are already members of a BAE Systems defined benefit scheme, the Company may offer to maintain their membership in that pension arrangement (with the contribution rates appropriate to that arrangement), or the choice of membership of the BAE Systems EPS DCRP as set out above.

Where UK executive directors' pension entitlement or accrual is restricted to the Lifetime Allowance (LTA) and/or the AA, the Company may offer an unfunded pension promise or salary supplement to offset the impact of these restrictions.

The current President and Chief Executive Officer of BAE Systems, Inc. as at 22 February 2017 participates in a Section 401(k) defined contribution arrangement in which the company matches his contributions up to a maximum of 6% of salary, subject to US regulatory limits.

Any new externally-appointed US executive directors, or internally-appointed US executive directors who are not members of a pension plan, would be offered membership of the US Section 401(k) defined contribution plan. For any internally-appointed US executive directors who are members of the 2006 Plan and Non-Qualified Plan, these plans provide a cash sum at retirement equal to the sum of the annual accruals, currently set at \$1,000 from the 2006 Plan and \$500 from the Non-Qualified Plan. The Company may offer to maintain membership of the 2006 Plan and Non-Qualified Plan, in addition to membership of the US Section 401(k) defined contribution plan.

Maximum opportunity

The BAE Systems EPS DCRP provides a maximum Company contribution of 19% (in addition to employee contribution of 6%) of base salary.

Under the existing executive defined benefit scheme, a maximum of two-thirds of FPE is accrued at 1/30th for each year of service.

Where UK executive directors' pension entitlement or accrual is restricted to the LTA and/or the AA, the Company may offer an unfunded pension promise or salary supplement to offset the impact of these restrictions.

The US Section 401(k) defined contribution plan provides 100% company matching contributions up to a maximum of 6% of base salary, subject to US statutory limits.

For US executive directors who are members of the 2006 Plan and Non-Qualified Plan, these plans provide a cash sum at retirement equal to the sum of the annual accruals, currently set at \$1,000 from the 2006 Plan and \$500 from the Non-Qualified Plan.

Directors' remuneration policy

continued

Notes to the executive directors' policy table

Remuneration policy for other employees

1. The Company's approach to annual salary reviews is consistent across the Group, with consideration given to the scope of the role, level of experience, performance and market data for similar roles in other companies.
2. All leaders may participate in an annual bonus scheme with similar metrics to those used for the executive directors. Other employees may participate in performance-based incentive plans which vary by organisational level and with relevant metrics for the particular area of the business.
3. LTI grants may be made to the most senior managers in the business (approximately 400 individuals globally). The nature of the awards depends on the individual's location, roles and responsibilities, in particular:
 - performance conditions and targets for performance share grants made to UK and Rest of World participants are made in line with those applying to executive directors;
 - for US participants below Executive Committee level, performance share grants are normally subject to BAE Systems, Inc. operating cash flow and EPS performance conditions and targets;
 - Performance Shares applicable to participants below executive director level vest on the third anniversary subject to performance conditions and are exercisable (or released in the case of US participants) in equal tranches on the third, fourth and fifth anniversary of grant;
 - Share Options are granted to participants below executive director level; there are no performance conditions attached and they vest and are exercisable after three years; and
 - Restricted Share grants are currently made to the most senior managers in the US businesses reflecting competitive market practice and vest after three years.

Performance measures and targets

4. The Committee selected the performance conditions because these are central to the Company's overall strategy and are the key metrics used by the executive directors to oversee the operation of the business. Any non-financial performance targets are determined by the Committee in consultation with the Corporate Responsibility Committee.
5. The performance conditions and targets are determined annually by the Committee (within the parameters set out above), taking account of the Group's strategic objectives, the internal business plan and budgets, as well as external market expectations and general economic conditions. The Committee is of the view that the performance targets for the annual bonus are commercially sensitive and that it would be detrimental to the interests of the Company to disclose them before the start of the financial year. The targets will be disclosed retrospectively after the end of the relevant financial year.

Minimum Shareholding Requirement (MSR)

6. The Committee has agreed a policy whereby the executive directors are required to establish and maintain a minimum personal shareholding equal to a set percentage of base salary. An Initial Value must be achieved as quickly as possible using shares vesting or options exercised through the executive share option schemes and other LTI schemes by retaining 50% of the net value (i.e. the value after deduction of exercise costs and tax) of shares acquired under these schemes. Once the Initial Value is achieved, a Subsequent Value must be achieved in the same way, except that a minimum of 25% of the net value must be retained on each exercise or acquisition. The Committee has discretion to increase the Initial Value and/or Subsequent Value (see below). Shares owned beneficially by the director and his/her spouse count towards the MSR. The MSR does not apply after the individual has ceased to be a director. Any case of non-compliance would be dealt with by the Committee.

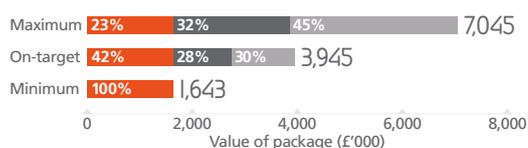
The following table sets out MSR Initial Value and Subsequent Value applicable from 2018:

	Initial Value	Subsequent Value
Chief Executive	150%	300%
Chief Operating Officer	100%	200%
Group Finance Director	100%	200%
President and Chief Executive Officer of BAE Systems, Inc.	212.5%	425%

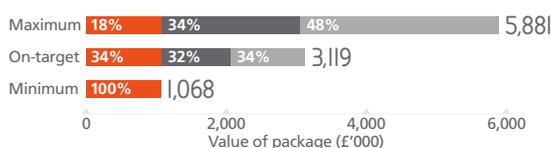
Illustration of application of remuneration policy

The charts below show the value of the package each of the executive directors would receive in the first year of operation of the Policy. The values are based on 2017 levels for base salaries, benefits and pension and assume that the office-holders at the date of this Policy coming into effect are employed throughout the first year of operation of the Policy. Annual and long-term incentives are based on awards applying in 2018. The charts assume the following scenarios: minimum fixed pay (including salary, benefits and pension as provided in the single figure table on page 85); pay receivable assuming on-target performance is met; and maximum pay assuming variable elements pay out in full. The scenarios below exclude any share price appreciation and dividends.

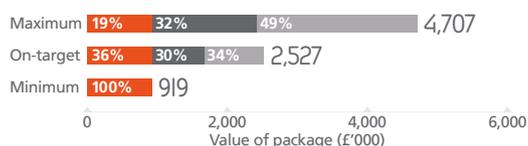
Chief Executive (£'000)



Chief Executive designate (£'000)



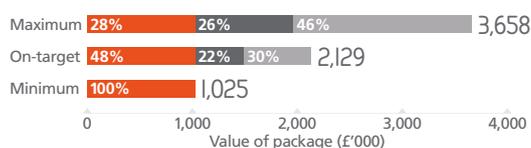
Chief Operating Officer (£'000)



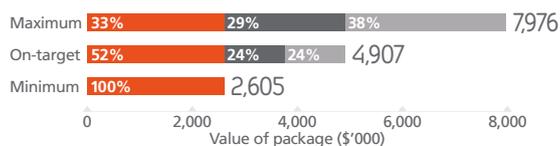
Executive directorship changes

As announced on 22 February 2017, Ian King will retire as Chief Executive on 30 June 2017 and Charles Woodburn, Chief Operating Officer, will be appointed as Chief Executive on 1 July 2017. The left hand chart above illustrates Ian King's remuneration if he were Chief Executive throughout the year, and the right hand chart above illustrates Charles Woodburn's remuneration if he were Chief Executive throughout the year. The chart to the left illustrates Charles Woodburn's remuneration if he were Chief Operating Officer throughout the year.

Group Finance Director (£'000)



President and Chief Executive Officer of BAE Systems, Inc. (\$'000)



- Fixed elements of remuneration
- Annual bonus
- Performance Shares and Share Options

Directors' remuneration policy

continued

Non-executive directors' (NEDs) policy table

Fees

Purpose and link to strategy

To attract NEDs who have a broad range of experience and skills to provide independent judgement on issues of strategy, performance, resources and standards of conduct.

Operation

NEDs' fees are set by the Non-Executive Directors' Fees Committee.

NEDs receive a basic fee with an additional fee for those who are chairmen of committees and/or undertake the role of Senior Independent Director.

NEDs also receive a travel allowance per meeting on each occasion that a scheduled Board meeting necessitates air travel of more than five hours (one way) to the meeting location, subject to a maximum of six travel allowances per year.

Fees are typically reviewed annually, taking into account time commitment requirements and responsibility of the individual roles, and after reviewing practice in other comparable companies.

The Chairman's fees are set by the Remuneration Committee on a three-year basis and not normally subject to review during that period.

Maximum opportunity

Actual fee levels are disclosed in the Annual remuneration report for the relevant financial year.

The current Chairman's fee has been set at £700,000 from 1 February 2017 and is fixed at this level for three years.

The aggregate cost of fees and benefits paid to NEDs (including the Chairman) will not exceed an annual limit of £2.5m and the cost of fees and benefits paid to the Chairman will not exceed £1.25m annually.

Performance metrics used, weighting and time period applicable

None.

Benefits

Purpose and link to strategy

Reimbursement for reasonable and documented expenses incurred in the performance of duties.

Operation

NEDs are not eligible to participate in any pension benefits provided by the Company, nor do they participate in any performance-related incentives.

The Chairman is provided with a chauffeur-driven car. This may be used for non-Company business, but the cost of the benefit of such usage shall be paid by the Chairman.

Reimbursement of travel and subsistence costs (including payment of the associated tax cost) incurred by the director or his/her spouse whilst undertaking duties on behalf of the Company that may be assessed as a benefit for tax purposes. Directors' and Officers' insurance cover is also provided for all directors.

Maximum opportunity

See the aggregate limit under 'Fees' above.

Prior commitments

For the duration of this Policy, the Company will honour any commitments made in respect of executive director and non-executive director remuneration and benefits before the date on which either: (i) the Directors' remuneration policy becomes effective; or (ii) an individual becomes a director, even where such commitments are not consistent with the policy set out in this report or prevailing at the time any such commitment is fulfilled. This includes (without limitation) all existing share awards as detailed on page 102 of the 2013 Annual Report under the PSP, SMP, RSP, ExSOP and ExSOP²⁰¹² that remain outstanding, Peter Lynas' second residence allowance as detailed on page 93 of the 2013 Annual Report, and any commitments entered into (such as grants of share awards) consistent with a previously approved Directors' remuneration policy that was applicable at the relevant time.

Approach to recruitment remuneration

The recruitment policy provides an appropriate framework within which to attract individuals of the required calibre to lead a company of BAE Systems' size, scale and complexity. The Remuneration Committee determines the remuneration package for any appointment to an executive director position, either from within or outside BAE Systems.

Operation

The Remuneration Committee will take into consideration all relevant factors, including overall total remuneration, the type of remuneration being offered and the jurisdiction from which the candidate was recruited, and will operate in order to ensure that arrangements are in the best interests of the Company and its shareholders without paying more than is necessary to secure the individual of the required calibre.

The fees and benefits applicable to the appointment of any new non-executive directors will be in accordance with the policy table on page 108.

Opportunity

The Committee seeks to align the remuneration package offered with the policy set out in the executive directors' policy table above recognising that participation under the policy above varies by geography.

- For UK and other non-US executive director appointments, participation in annual incentive plans will not exceed 225% of annual salary and long-term awards under this Policy will not exceed 550% of annual salary.
- For US executive director appointments, participation in annual incentive plans will not exceed 225% of annual salary and long-term awards under this Policy will not exceed 500% of annual salary.

The Committee may make awards on hiring an external candidate to 'buy-out' existing equity or, in exceptional circumstances, other elements of remuneration forfeited on leaving the previous employer. In doing so, the Committee will take account of relevant factors including any performance conditions attached to these awards, the form in which they were granted (e.g. cash or shares) and the time over which they would have vested. Buy-out awards would be capped to be no higher, on recruitment, than the fair value of those forfeited. Full details will be disclosed in the next Annual remuneration report following recruitment which will include details of the need to grant a buy-out award.

Fixed elements (base salary, retirement and other benefits)

The salary level will be set in accordance with the principles for setting base salary described in the executive directors' policy table above.

The executive director shall be eligible to participate in applicable BAE Systems' employee benefit plans, including coverage under applicable executive and employee pension and benefit programmes in accordance with the terms and conditions of such plans, as may be amended by the Company in its sole discretion from time to time.

In the case of promotion of an existing Group employee to an executive directorship on the Board, commitments made before such promotion will continue to be honoured whether or not they are consistent with the remainder of this Policy.

Annual Incentive Plan

The appointed executive director will be eligible to earn a discretionary annual bonus in accordance with the annual incentive framework as described in the executive directors' policy table above.

The level of opportunity will be consistent with the policy disclosed in the executive directors' policy table in this report and subject to the maximums referred to therein and under 'Opportunity' above.

Long-Term Incentive Plan

The executive director will be eligible for equity awards in such amounts as the Committee may determine in its sole discretion, subject to this Policy and the rules of the Long-Term Incentive Plan.

The level of opportunity will be consistent with the policy set out in the executive directors' policy table above and subject to the maximums referred to therein and under 'Opportunity' above.

Other

For internal and external appointments, the Committee may agree that the Company will meet certain relocation expenses in accordance with the provisions described under the Benefits section of the policy table on page 104.

Directors' remuneration policy

continued

Service contracts

Executive directors

Operation

In accordance with long-established policy, all executive directors have rolling service agreements which may be terminated in accordance with the terms of these agreements.

Dates of appointment for executive directors

Name	Date of appointment	Notice period
Ian King	1 September 2008 ¹	12 months either party
Charles Woodburn	9 May 2016	12 months either party
Peter Lynas	1 April 2011	12 months either party
Jerry DeMuro	1 February 2014	90 days either party ²

1. Contract dated 27 June 2008, effective 1 September 2008.

2. Jerry DeMuro's contract of employment automatically renews for one-year periods from 31 December each year, unless one party gives at least 90 days' notice of non-renewal.

Notice period

The Committee's policy is that the service contracts of executive directors will not exceed 12 months. In exceptional circumstances, in relation to newly recruiting an executive director operating in a US environment, the notice period may be extended to a maximum of 24 months and structured such that it reduces to no more than 12 months by no later than the end of the first complete year of service.

Change of control

No executive director has provisions in his service contract that relate to a change of control of the Company.

Chairman

The Chairman's appointment is documented in a letter of appointment and he is required to devote no fewer than two days a week to his duties as Chairman. His appointment as Chairman (which commenced on 1 February 2014) will automatically terminate if he ceases to be a director of the Company. The Chairman's appointment was reviewed by the Nominations Committee prior to the end of his initial three-year term and has been extended until February 2020, unless it is terminated earlier in accordance with the Company's Articles of Association or by the Company or the Chairman giving not less than six months' notice.

Non-executive directors

The non-executive directors do not have service contracts but do have letters of appointment detailing the basis of their appointment. The dates of their original appointment are shown below:

Name	Date of appointment	Expiry of current term
Elizabeth Corley	01.02.2016	31.01.2019
Harriet Green	01.11.2010	31.10.2019
Chris Grigg	01.07.2013	30.06.2019
Paula Rosput Reynolds	01.04.2011	31.03.2020
Nick Rose	08.02.2010	07.02.2019
Ian Tyler	08.05.2013	07.05.2019

The non-executive directors are normally appointed for an initial three-year term that, subject to review, may be extended subsequently for further such terms. Any third term of three years is subject to rigorous review, taking into account the need progressively to refresh the Board. Non-executive directors do not have periods of notice.

In accordance with the UK Corporate Governance Code, all directors are subject to annual election or re-election at the Company's AGM.

Policy on payment for loss of office

Operation

The policy on payment for loss of office provides a clear set of principles that govern the payments that will be made for loss of office, and take account of the need to ensure a smooth transition for leadership roles during times of change. The policy that will apply for a specific executive director's payments for loss of office will be the policy that was in place at the point when the payments for loss of office were agreed for the executive director in question.

Any termination payment made in connection with the departure of an executive director will be subject to approval by the Committee, having regard to the terms of the service contract or other legal obligations and the specific circumstances surrounding the termination, including whether the scenario aligns to an example under the approved leaver criteria, performance, service and health or other circumstances that may be relevant.

In addition to payments described below, the Committee may pay such amounts as are necessary to settle or compromise any claim or by way of damages, where the Committee views it as in the best interests of the Company to do so. In the event of the termination of an executive director's contract, it is the Committee's policy to seek to limit any payment to not more than one year's base salary.

Notice and pay in lieu of notice

Executive directors' contracts allow for termination with contractual notice from either party or termination by way of payment of base salary in lieu of notice, at the Company's discretion. Neither notice nor a payment in lieu of notice will be given in the event of gross misconduct. Any new executive director contracts since 2016 (including the Chief Operating Officer) concerning payment in lieu of notice provisions allow for the Committee to exercise discretion to apply phased payments and mitigation on that executive director securing alternative employment.

Jerry DeMuro's contract of employment automatically renews for one-year periods from 31 December each year, unless one party gives at least 90 days' notice of non-renewal. If the employment is (a) terminated by the Company (other than for cause as defined in the contract) or (b) he resigned for a 'Good Reason' (as defined in his contract), he is entitled to a termination payment equal to (i) one year's base salary and (ii) a bonus payable at target level pro-rated for service for the relevant financial year. He will also be entitled to a continuation of medical benefits for 18 months (or a cash payment in lieu).

Other than notice payments, the Company has no obligation to make any termination payments when the Chairman's appointment terminates. Non-executive directors do not have periods of notice and the Company has no obligation to make any termination payments when their appointment terminates, other than to pay fees in accordance with the appointment letters.

Retirement benefits

As governed by the rules of the relevant pension plan. No enhancement for leavers will be made.

Annual Incentive Plan

Where an executive director's employment is terminated after the end of a performance year but before the payment is made, the executive director will remain eligible for an annual incentive award for that performance year subject to an assessment based on performance achieved over the period. No award will be made in the event of gross misconduct.

The Committee may, as set out below, exercise its discretion to allow an annual incentive payment for the year of cessation as part of the termination package for executive directors. Where it does so, the exercise of the discretion and reason why the Committee considered such action appropriate will be disclosed.

Where an executive director leaves during the relevant performance year by reason of death, ill-health, disability, retirement, a transfer of business or redundancy, the Committee may use its discretion to determine that an executive director will remain entitled to receive a bonus (subject to an assessment based on performance over the performance year and pro-rated for time) in respect of the financial year in which the individual ceased employment. One third of the bonus will be subject to compulsory deferral as set out previously, unless the Committee decides otherwise.

The Committee's policy is not to award an annual incentive for any portion of the notice period not served.

The treatment set out above does not apply to the President and Chief Executive Officer of BAE Systems, Inc.

Long-Term Incentive Plans

The treatment of outstanding share awards in the event that an executive director leaves is governed by the relevant share plan rules.

Under the Long-Term Incentive Plan, where an executive director leaves the Group by reason of ill-health, injury, disability, retirement with the agreement of the Company, sale of a business or employing company, redundancy or leaving in such circumstances as the Committee determines (each an 'approved leaver'), unvested awards and options generally continue and vest on the normal vesting date (or, in the case of Performance Shares held by US executive directors, the first normal vesting date or, if later, cessation), unless the Committee determines that the awards should vest on cessation. Any performance conditions will be applied at the time of vesting.

On vesting, the number of shares under award will, unless the Committee decides otherwise, be reduced pro-rata to reflect the period in which the executive director was in employment as a proportion of the relevant vesting period (or in the case of Performance Shares held by US executive directors or Performance Shares granted prior to the 2017 AGM, as a proportion of the initial three-year vesting period).

In the event of death, awards generally vest at the time of death subject to the satisfaction of any performance conditions at that time. Awards are then pro-rated as set out above.

Where an executive director's employment is terminated for any other reason, his unvested awards and options will lapse. Options normally remain exercisable for six months after cessation (or vesting, if later) and 12 months after death.

If the Committee exercises its discretion to treat a director as an approved leaver as permissible under the leaver provisions of the share plan rules, the exercise of the discretion and reason why the Committee considered such action appropriate will be disclosed.

Where an executive director's employment is terminated or an executive director is under notice of termination for any reason at the date of award of any Long-Term Incentive awards, no Long-Term Incentive awards will be made.

Consideration of employment conditions elsewhere in the Company

The Committee does not consult directly with employees as part of the process for reviewing executive pay. When considering salary increases for the executive directors, the Committee considers the general level of salary increase across the Group and in the external market.

Stakeholder considerations

The Committee conducts an annual programme of consultation with major shareholders in order to seek their input to the development of remuneration policy or plans.