



**KATHLEEN
O'DONOVAN**

CHAIRMAN OF
THE TRUSTEE
OF THE INVENSYS
PENSION SCHEME

We are publishing this newsletter a little later than normal in order to provide you with a more informative update on two key issues. I hope that you will accept my apologies for the delay but also realise the value of the postponement once you have read through the next few pages.

The two issues in question were our discussions with the Company regarding funding and investment policy, and the government's new Pensions Bill. I will deal with our own discussions below – the new Pensions Bill is covered in more detail on page seven.

Funding

As you will know from our previous newsletter, we had agreed a three-pronged funding approach with Invensys in the light of our Pension Scheme deficit. This deficit was 11% (or £450m) in March 2003, but had reduced to approximately 7% (£250m) by the end of 2003 and at March 2004.

The agreement required:

- Company Scheme contributions to be started again at a rate of 20% of pensionable earnings – resulting in approximately £19m per year.
- Special Company contributions of £15m to be made each half year for the next two-and-a-half years – a total of £75m.
- A lump sum to be paid by Invensys from its disposal programme amounting to 15% of proceeds received above an initial £1bn. The sum was not fixed as it depended on the success of the disposal programme. Indications by Invensys suggested it was likely to be in the region of £120m.

These amounts would have enabled the Scheme to eliminate its deficit over a relatively short period – as long as the equity markets did not take a turn for the worse.

In February 2004 Invensys announced a major refinancing, giving a significant improvement in the financial stability of the Group. The trustees welcome this improved stability. As a consequence of the refinancing, Invensys also announced that it was ending its disposal programme. At that point the programme had not reached the trigger level of £1bn, which meant that there was no lump sum payment available for the Scheme.

Discussions on funding levels with the Company have been ongoing for some time. In the light of the refinancing Invensys has indicated that it would wish to discuss any changes in future funding arrangements in the context of;

- any changes in the Scheme's investment policy (see below).
- a review being undertaken by the Company of its global pension arrangements (Invensys has pension schemes in several countries, including the US).

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This delay in a full solution to the funding deficit is not, at this stage critical.

Based on reasonable future investment returns, our actuary has recently estimated that the Scheme's deficit is currently running at about 7%. That deficit needs to be addressed by Invensys since it has an obligation to meet the costs of the benefits that have been built up within the Scheme.

In the ordinary course of events we would expect to have time to resolve the underfunding in the Scheme. The average length of time before 'actives' – those still working and contributing to the fund – come to draw a pension is 11 years. Without further funding the current fund is sufficient to pay the present level of benefits for many years beyond that time. In the extreme situation that Invensys was unable to make any further contributions to the Scheme we would still expect there to be sufficient assets to pay ALL PENSIONERS THEIR CURRENT LEVEL OF PENSION IN FULL AND THEIR SPOUSE'S PENSION. It would also be able to pay most of the benefits due to other members.

In the unlikely event that Invensys was unable to make further contributions, the trustee is of the view that 'actives' would get no further build up in benefits or any linkage to salary in the future, and for all members there would be an end to the annual increase in pensions that is

intended to keep the payments broadly in line with inflation.

The Company is aware of the trustees concerns regarding the Scheme's funding. The Company has said: 'the trustees have quite properly, indicated to members what might happen if there was no further funding. However the Company has been making the regular and special contributions since October 2003 and these will continue. We will continue to work with the trustees to establish what further funds may be required to safeguard members benefits'.

Investment policy

Our Scheme is very mature with over 95% of members being pensioners or deferred pensioners. As a result we already know what the majority of our liabilities are and, approximately, when they need to be paid. For that reason we believe we should invest in instruments that match those liabilities as best as possible and have low risk.

However, if we were to take no risk we would not be able to meet all the benefit payments. Eventually the money would run out and the demands for cash on Invensys would be very large. It is therefore important that we continue to invest in instruments that give the chance of a higher return. Obviously this comes with greater risk but that is

what we, together with our advisers, have to manage.

Given this background, we are planning some revisions to our investment policy to more specifically identify the risk and reward limits for our Scheme. It will continue with our existing approach of 70% invested in Government bonds and corporate bonds and 30% in other higher yielding investments. However, it will also split the investments into very low risk, low risk and higher risk categories and set clear requirements of the managers in each of these sub-categories. Due to the limits of the trust deed that governs our Scheme we believe that we cannot fully implement this change until the deed is changed.

We have been discussing this with Invensys and its advisers. Elements have been refined, and the Company is reviewing whether an amendment to the trust deed will be needed. We intend to implement the revised approach in stages, and we are currently reviewing the steps that we can set in train now so as to get moving on the strategy that we believe is in the best interests of our members.

We have added a lot of new information into this newsletter – I urge you to read all that you can. Pensions are an important subject for you as an individual, for us as a group, and for society as a whole.

Role of the trustees

The 'trustee' of the Scheme is a limited company – Invensys Pension Trustee Ltd – that is governed by a legal trust deed arrangement with Invensys.

The trustee Company is managed by a board of directors who are nominated by Invensys and the UK Pensions Consultative Committee (see Pension Scheme structure page 3). The trustee

board also nominates two directors who are pensioners of the Scheme. Together, these directors are known as the 'trustees' of the Pension Scheme.

The trustees' role is to administer the Scheme in accordance with the Scheme rules in the interests of the contributors, and all other members.

This includes:

- Receiving contributions from Invensys and active members
- Investing the Scheme's assets
- Paying the beneficiaries of the Scheme

The rules of the Scheme state that Invensys determines its level of contributions after considering the advice of an actuary. The actuary also ensures that these contributions at least meet

the minimum requirements of the Pensions Act 1995.

The trustees must also make decisions about individual cases. These include the payment of benefits, such as lump sum payments after the death of a pension fund member, children's pensions and ill-health pensions.

Trustees are also responsible for setting out the key elements of the Scheme's investment policy. This is produced after consultation with Invensys and appropriate advice from advisers. The trustees then appoint investment managers to deal with day-to-day investment decisions in line with their investment policy and any other restrictions on investments contained in the Scheme rules.

Pension Scheme structure

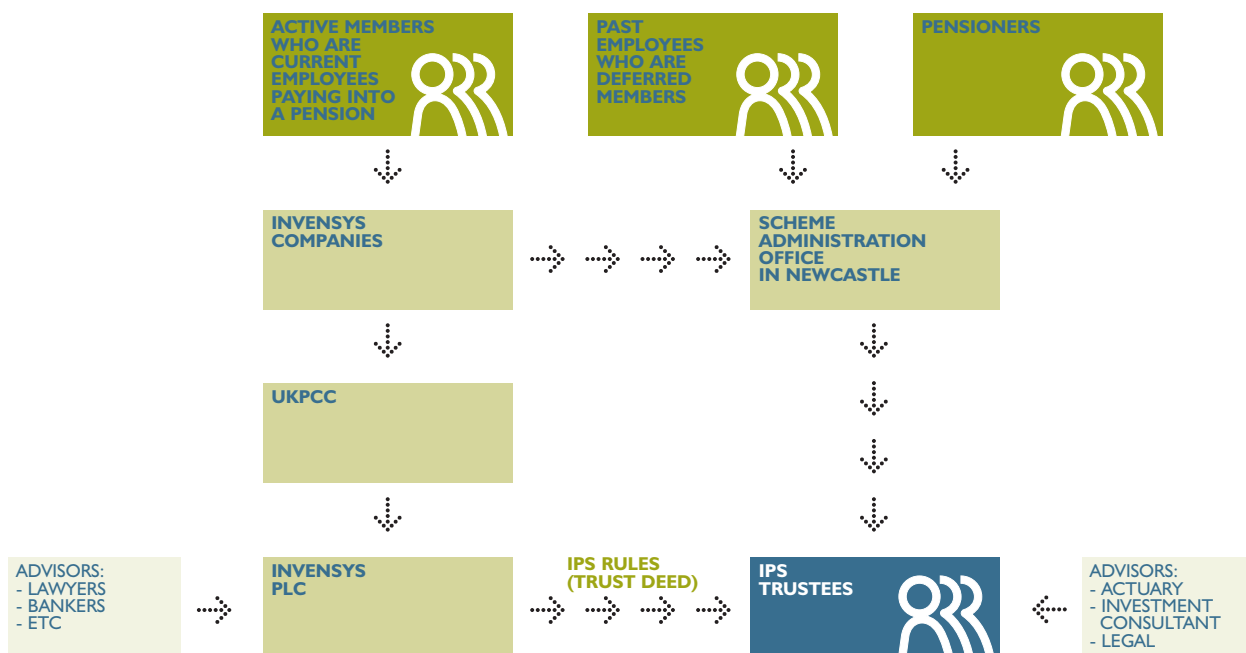
The Invensys Pension Scheme is governed by a trust deed between the Company (Invensys plc) and the trustee (Invensys Pension Trustee Ltd).

The rules of the Scheme are laid down by the Company in a trust deed. The trustees – the directors of Invensys Pension Trustee Ltd – must operate the Scheme in accordance with those rules. The trustees are required to act in the best interests of all individuals who may benefit from the Scheme.

Active members contact the Scheme through local HR departments and are represented on a Pensions Consultative

Committee (UKPCC). This committee meets quarterly to discuss pension policy and issues with the Company. The UKPCC nominates the Pension Scheme members in order to provide four directors for the trustee company.

Deferred members and pensioners contact the Scheme directly through the Scheme's administration office based in Newcastle.



Balance of power

The key powers in a pension fund are the powers to set contribution rates, amend rules and to wind-up the fund.

Each pension scheme has different powers, some of which are affected by overriding legislation. The Company largely controls all of these key powers in the Invensys Pension Scheme. The trust deed between the Company and the Scheme restricts the ability to amend benefits that have already been set.

From time to time the UKPCC and the trustees may propose amendments to the Company about the way in which the Scheme is operated. It is then up to the Company to consider whether those amendments should be implemented. Aside from this, the trustees may only operate the Pension Scheme in line with the Scheme's rules.

The world of pensions is going through massive change. New legislation is being introduced and there is a growing recognition of the importance of pension funds. That implies a healthy focus on how pension funds operate and how they are governed.

Pension fund governance

The last 12 years have seen a real attempt to improve the way that public companies are governed. You may, for example, have heard of the Cadbury Report or other reviews of the governance structure of UK companies. The governance of pension funds has not been quite so much in the limelight but, in recent years, there have also been a number of government-backed reports that require trustees to carefully review the way in which their pension fund is governed.

Here is a quick Q&A to update you on some of the major governance issues.

How does corporate governance apply to pension funds?

Pension funds governance covers the structures and processes for operating and controlling the fund. It also includes the ways in which trustees take their decisions.

What is the current state of affairs on pension fund governance?

2004 Pensions Bill	Will promote trustee knowledge and understanding
New Pensions Regulator	Will promote good fund administration and issue Codes of Practice
2001 Myners Report	Primarily reviewed investment management and currently due for legislative review
1995 Pensions Act OPRA	Trustees rights and duties Guidelines for trustees on their role and responsibilities

Why is governance important?

Because pension funds need to be properly managed. It is growing in importance for a number of reasons:

- Risks have increased. Funds can encounter a variety of risks, for example, investment risk, demographic risk, compliance risk, financial risks, and so on. These all need to be identified and managed.

- Regulation and legal liability are increasing as governments and courts seek to protect pension fund members.
- Life expectancy is increasing while length of work life is decreasing. Pensions need to adapt to these changes.
- Pension investment is becoming more complicated. These are financial products for life and require a sophisticated and modern investment approach.

What are the key areas of pension fund governance?

We have identified ten areas that the trustees will be monitoring on your behalf to ensure best practice in your pension fund:

- i* **Compliance** Trustees and administrators have to act in accordance with the rules and regulations of the pension fund.
- ii* **Role and responsibilities** All involved in the operations of the fund must have a clearly identified and understood role.
- iii* **Knowledge and understanding** Trustees should have the right balance of knowledge and skills.
- iv* **Decision-making process** Trustees must have clear processes to follow so that they can properly discharge their responsibilities.
- v* **Use of advisers/delegates** Their roles and responsibilities need to be identified and understood.
- vi* **Management of risk** The risk environment must be regularly reviewed, major issues highlighted and then managed correctly.
- vii* **Assessment of performance** The performance of advisers/delegates and trustees must be properly assessed and acted upon.
- viii* **Conflicts of interest** Any conflicts that arise need to be identified, discussed and managed appropriately.
- ix* **Fund administration** Processes must be adequately documented and regularly reviewed.
- x* **Communication** Member communication and feedback should be measured and refined accordingly.

Over the next year the trustees will be reviewing your Scheme in the light of the above.

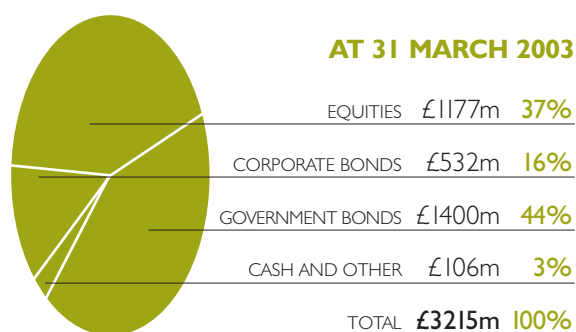
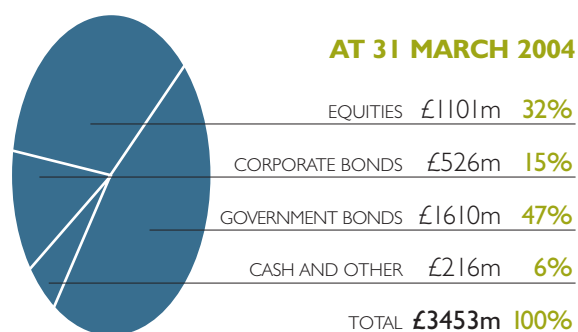
Investment review

The fund outperformed its benchmark and generated substantial positive returns in the year. In the 12 months to 31 March 2004, the return from Invensys Pension Scheme investments was 13.1%. Since 1 January 2002 the investments have returned 1.9% per annum.

The trustees measure the investment performance against benchmark indices for each type of investment set out in the investment policy. As you can see from the table, the fund outperformed its benchmarks in both of these periods.

	ACTUAL RETURN (per annum)	BENCHMARK RETURN (per annum)
12 MONTHS TO 31 MARCH 2004	13.1%	12.4%
1 JANUARY 2002 TO 31 MARCH 2004	1.9%	1.6%

The Scheme's assets continue to be invested in both bonds and equities. At 31 March 2004 our investments were split as follows:



Over the last year we have increased our investment in bonds. This has been done in order to improve the security of the Scheme's assets and to reduce volatility as a result of lower exposure to global equity markets.

We have also reduced the number of equity investment managers. The Scheme's assets are now managed by the following managers and invested in various markets as shown.

MANAGER	MARKETS	AMOUNT £m
PUTNAM	GLOBAL EQUITY	276
UBS	GLOBAL EQUITY	292
UBS	UK EQUITY	225
SCHRODER	UK EQUITY	147
DEUTSCHE	UK EQUITY	161
SCHRODER	GOVERNMENT BONDS	1610
MERRILL LYNCH	CORPORATE BONDS	526
MERRILL LYNCH	ABSOLUTE RETURN	111
SCHRODER	CASH AND OTHERS	105
TOTAL		3453

The Invensys Pension Scheme is valued by a specialist actuary every three years. In the review, the actuary estimates the benefits to be paid to members over the remaining life of the Scheme and compares these with the funds available.

Funding levels

In the past, the fund's assets have been expected to meet the outgoings, but in recent years this has not been the case – largely as a result of the poor equities market in the wake of the dotcom crash.

Of course, these decisions do not just come down to one actuarial measurement every three years. The trustees keep an estimated track of the current funding so that decisions can be made in between full valuations.

Funding Levels	Valuation	Funding Level
	March 2003 (Full Triennial)	89%
	March 2004 (Estimated)	93%

The funding of a scheme can be measured in several different ways. Some methods are prescribed by regulation, such as the 'Minimum Funding Requirement (MFR)' valuation and FRS17 as laid down by accounting standards. The actuary may also value the scheme using other methods and assumptions. For example, the actuary may include an allowance for some reasonable future investment returns, or, where a pension scheme is closed, the actuary will take into account the cost of securing benefits through buying an annuity with an insurance company.

Funding objective

The trustees' objective is to target a sensible plan aimed at ensuring a funding level of 100%. That means there are enough assets within the scheme to meet all the likely payments of members' pensions in the future. If, as at present with the Invensys Pension Scheme, the scheme does not have sufficient assets, the trustees must ask the company for more contributions. It can also review its investments and its funding plan to anticipate increased expected returns – bearing in mind that

by taking greater investment risk the scheme may not achieve the necessary returns and so all benefits may not be paid.

Valuation of the Scheme

The full valuation of the Invensys Pension Scheme in March 2003 indicated a funding level of 89%. This was a result of negative returns from the Scheme's equity investments since 2000, and recent increases in the expected lifespan of pension fund members. Therefore, the trustees entered into discussions with Invensys in order to review its contributions. This is covered in the chairman's statement in this and the previous ipsnews and resulted in an agreement whereby the Company pays several lump sums into the Scheme up to March 2005. As detailed on page one, this agreement is now subject to further discussion in the wake of the Company's decision to change its strategy.

Investment policy

The trustees have also proposed an investment policy designed to improve its funding position over the coming years. This will result in over 50% of the Scheme being invested in very secure assets to meet known future expenditure. A further 20% will be invested in low risk assets, and around 30% into a broad diversification of investments intended to give the Scheme a higher level of return. As detailed in the chairman's statement, this revised investment policy is currently being discussed with the Company and may require a change in the trust deed before being implemented.

When possible the trustees intend to revise the investment policy to reduce the risk level while still having a funding plan that anticipates the payment of all the Scheme's benefits. The trustees expect this to be achieved by gradually transferring assets from the broadly diversified portion of the Scheme into the lower risk and very secure sections.

New legislation

As mentioned in the chairman's statement on page one, the UK parliament is discussing a new pensions bill. It is currently expected to come into force from 6 April 2005. The new legislation is designed to provide more protection for pension fund members. You may already have heard it being discussed on the news.

The main provisions of the Bill are:

- Establishing a Pension Protection Fund to provide some compensation to scheme members who lose benefits when their employers go out of business and their pension schemes do not have sufficient funds to provide benefits.
- A new Pension's Regulator will replace the Occupational Pensions Regulatory Authority.
- Each pension scheme will have to establish its own funding objectives and agree the funding of the scheme with the company. If the company cannot agree with those objectives then the new Regulator has the power to determine contribution levels from the company.
- Employees will have more protection of their pension rights when businesses are sold or transferred.
- If an employer winds up a scheme but remains in business it will have to ensure that the scheme is left fully funded in order to meet members' benefits.

The regulations have also been published that change the priority of different groups when schemes are wound up and a funding deficit becomes clear.

The main change is that the increases paid to pensioners will now have a lower priority than the basic pension of members who are currently active or deferred. This is intended to represent a fairer distribution of the funds' assets.

The Finance Act 2004 will introduce a new and very different method of tax allowances on pension contributions from 6 April 2006. Effectively, each individual will be able to contribute untaxed income to a regulated pension scheme. Tax will only become payable once the individual's pension fund from all sources reaches a certain level.

We believe that these proposals will simplify the taxation of pensions and contributions for the vast majority of pension scheme members. We will provide more precise details on all of the new legislation as it is finalised.

Frequently asked questions

What do the recently announced changes in legislation mean to me?

The new legislation is designed to ensure that your pension benefits are more secure in the future. This increased security arises in two ways. New requirements have already been placed on all UK companies meaning that they cannot initiate a winding-up of a pension scheme without securing all benefits built up prior to that date. Secondly, should a company go out of business on or after 6 April 2005, then the new Pensions Bill should mean that members will receive a guaranteed level of benefits, defined by the legislation, regardless of the assets of their pension scheme. As detailed earlier, the Pensions Bill is still under discussion and may be subject to change prior to coming into effect.

Will I always receive a pension?

You should continue to receive your pension in line with the rules of the Scheme

during your lifetime. In the unlikely event that the Scheme is wound-up, your pension would be provided by a third party. That pension provision would then be dependent upon the funds available at the time the Scheme was terminated and the priority orders made upon winding it up.

Will the Invensys Pension Scheme continue?

The Scheme will continue until either Invensys goes out of business or decides that its Pension Scheme should be terminated. The Scheme would become the responsibility of the trustees who would decide whether to wind-up the Scheme or to continue to pay pensions and other benefits from the fund. As long as Invensys does not go out of business it will remain responsible to meet all of the benefits built up to date.

What happens if Invensys is taken over?

The effect on the Scheme will depend on the intentions of any company that purchases Invensys. In principle, all benefits accrued in the Scheme up until the date of the sale would remain.

What is the difference between a scheme closing and a scheme terminating?

A scheme is closed when no new entrants are allowed to join and, sometimes, when benefits stop building up. A scheme is terminated when its sponsoring company terminates its responsibility to pay contributions.

Information about your pension Scheme

The directors of Invensys Pension Trustee (the 'trustees') are:

Kathleen O'Donovan (Chairman)	
Geoff Campion	Westinghouse Rail Systems, Chippenham
Anthony Gajadharsingh	IMServ, Milton Keynes
Regina Hitchery	Invensys plc, London
Vic Legg	Invensys Climate Controls, Bodmin
Caroline Parker	Invensys Climate Controls Europe, Slough
Peter Tompkins	Eurotherm Ltd, Worthing
Russell Walker	Westinghouse Rail Systems, Chippenham
Bill Weighill	APV Baker, Peterborough
Martin Barker	Pensioner
Ian Fyfe	Pensioner

The only recent change follows the retirement of Cyril West after over eight years service to the Scheme. We warmly thank Cyril for his contribution as a director. We are pleased to welcome Martin Barker as Cyril's replacement. Martin retired from Westinghouse some three years ago and has extensive pensions experience. He is Chairman of the Westinghouse section of the Railways Pension Scheme and the pensioner representative on the UK Pensions Consultative Committee.

IMPORTANT NOTICE FOR PENSIONERS

Would you please note that all changes to your address or banking details should be advised to us as quickly as possible in writing, with YOUR SIGNATURE authorising the amendment. PLEASE NOTE that we are unable to take down details over the telephone. Any delay in notifying us of these important changes, particularly banking details, may result in the misdirection or temporary suspension of your pension, which we want to avoid if at all possible.

In order to assist you in this we have enclosed notification forms for future use. Please ensure to add your PAYROLL REFERENCE NUMBER as this will make identification and amendment that much quicker and easier.

Blind or Partially Sighted?

Are you, or do you know an Invensys Pension Scheme member who is blind or partially sighted and might be interested in receiving pension communications on an audio cassette? If we have not already been informed, then please contact our payroll manager who will be pleased to make the necessary arrangements.

You can telephone (local rate):

0845 300 0549

or send a fax to:
0191 206 1011

or send e-mails to:
enquiries@invensyspensions.co.uk

Death benefit nominations

Members nominations are essential to help the trustees decide who should receive a lump sum death benefit. Often we have no nomination. Members who have not previously made a nomination, or whose circumstances have changed, are urged to consider making a nomination now on the enclosed form.

Pensioners **who retired less than five years ago**, or on grounds of ill-health, and are in this position, are invited to contact the payroll manager at Invensys Pensions.

Change of address

Please keep the Scheme informed if you change your address. If you are a pensioner or a deferred member a form is included for you to complete, and reply paid envelope for your convenience. For active members please contact your HR department.

How can I get more information about the Scheme?

The trustees produce detailed annual report and accounts, which are available on request. Other scheme documentation can also be obtained from the Scheme's administration offices in Newcastle.

Scheme administration

The Scheme is administered through the Newcastle office. Please contact us at:

Invensys Pensions
Higham House
New Bridge Street West
Newcastle upon Tyne
NE99 1TG

Telephone (local rate):
0845 300 0549

e-mail:
enquiries@invensyspensions.co.uk