GOVERNANCE REPORT

GOVERNANCE REPORT

COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE 2018

The Company is subject to the principles and provisions of the UK Corporate Governance Code 2018 (the Code), a copy of which is available at www.frc.org.uk.

For the year ended 31 December 2020, the Board considers that it has complied in full with the provisions of the Code, with the exception of provision 38 regarding pension contribution rates for Executive Directors and those of the wider workforce, as these were not aligned throughout 2020. As we previously reported, we committed to reduce the rates over a period of time for our existing Executive Directors to ensure alignment by 2022. However, to ensure compliance in 2021, existing and new Executive Directors will now receive a pension contribution rate aligned with the wider workforce from 1 January 2021 (see pages 82, 86 and 90).

BOARD LEADERSHIP AND COMPANY PURPOSE

The Board has delivered a heightened degree of oversight and scrutiny during the pandemic to ensure the long-term sustainable success of the Company. Our Governance report provides examples of our leadership and engagement with our stakeholders (see page 72).

•

We refined our corporate narrative as we are determined to play a fundamental role in pioneering a resilient, inclusive, net zero carbon future (see page 70).

•

To ensure we have the right resources and skills to execute our strategy, we have undertaken a number of significant actions to mitigate the impact of COVID-19 (see pages 7 and 8).

•

Our Code and associated policies ensure our workforce can meet our expected values and behaviours. We encourage our people to speak up (see pages 45 and 70).

DIVISION OF RESPONSIBILITIES

We clearly define the roles of the Chairman and the Chief Executive and fully support the separation of the two roles.

•

The Board believes it operates effectively with the appropriate balance of independent Non-Executive Directors (NEDs) and Executive Directors (see pages 64 to 66).

•

The Board regularly considers time commitments of Directors. Prior Board approval is required for Directors' external appointments to ensure there is no compromise on time commitment (see page 75).

•

The quality of information and resources available to the Board has enabled us to operate effectively and efficiently during a year in which we held a considerable number of additional Board and Committee meetings and calls.

COMPOSITION, SUCCESSION AND EVALUATION

We have a clear process when considering appointments to the Board and operate effective succession planning (see pages 75 and 76).

•

Our Board demonstrates a combination of skills, experience and knowledge (see pages 64 to 66 and 68).

•

In 2020, Belinda Hudson Limited carried out an annual evaluation of the Board. The methodology and progress can be found on page 74.

AUDIT, RISK AND INTERNAL CONTROL

We recognise the importance and benefits of ensuring the internal audit function and the external auditors remain independent (see pages 79 to 80).

•

The Board presents a fair, balanced and understandable (FBU) assessment of the Company's position and prospects (see page 78).

•

Our risk and control environment is reviewed by the Audit Committee. The Board considered both emerging and principal risks during the year (see page 70).

REMUNERATION

Our remuneration policy has been revised this year and will be put to the shareholders for approval at our 2021 AGM. Key changes are set out on page 81 and clear links to our KPIs can be found on page 84.

•

The Remuneration Committee, comprising only NEDs, is responsible for developing the policy and determining executive and senior management remuneration (see page 82).

•

No Director is involved when deciding their own remuneration outcome.

CHAIRMAN'S INTRODUCTION

As a Board, we very quickly changed the way we worked in response to the COVID-19 environment. We still have a lot to achieve and deliver in 2021 but your Board is as committed as I am to see us through the current period.

In previous years, I have stated here that our approach is to have innovative governance that fits the needs of the business and ensures that we add value in all that we do. This stood us in good stead for 2020 as we flexed our governance structures to meet our needs as a Board and as a business and found they stood up well under pressure. As a Board we very quickly changed the way we worked as we moved to weekly Board calls and management updates on key metrics, particularly for Civil Aerospace, and impacts on our people, customers, partners & suppliers and other stakeholders. As with much of the rest of the world, all our meetings since March 2020 have been virtual, including our AGM and the General Meeting held in October to approve our rights issue.

I would like to thank the Board for all the time they have given during the course of the year. As you can see on page 69, not only did we hold a high number of additional Board meetings and calls but each of the Committees also held additional meetings to ensure focus on specific areas such as product safety; wellbeing; diversity & inclusion and talent retention throughout the significant restructure; and financial resilience in a time of cost pressure and macroeconomic uncertainty. The Non-Executive Directors also reduced their fees by 10% in line with the senior management team for nine months of the year and the impact of COVID-19 on the aerospace sector led the Remuneration Committee to review our remuneration policy. A revised, bespoke policy which is tailored to our specific challenges is set out on pages 85 to 91 and will be put to shareholders at our AGM in May 2021.

Culture

Our Employee Champions, Irene Dorner and Beverly Goulet, were joined by Lee Hsien Yang who was appointed this year as the Board's Employee Champion for the Asia Pacific region, and together they reached out to all our people to hear what was on their minds. The Board noted progress against our 2020 diversity & inclusion targets and agreed targets for 2025. These are detailed on page 44. We recognise that there is still significant work to do, particularly at Executive Team level. We ensured that there were females on the shortlist for the CFO role and that the succession pools for all Executive Team roles have increasing representation both from females and from non-British nationalities.

We took time to understand the impact of COVID-19 on employee resilience and noted good progress with our injury rates. We continued to receive feedback on the anti-bullying and harassment programme as well as other training.

Board developments

In February 2020, we announced extensions to the terms for both Lewis Booth and Sir Frank Chapman as Non-Executive Directors, until the 2021 AGM at the latest. In light of the COVID-19 pandemic, Lewis remained as the Chair of the Audit Committee during the year with his intended replacement, Nick Luff, continuing as a Non-Executive Director and member of the Audit Committee. I would like to thank Lewis for his continuing support through a challenging time. He has continued in his role to see us through the 2020 financial year and will step down as Chair of the Audit Committee with effect from the date of this report when Nick Luff will take over as we had previously planned. Sir Frank has been a tremendous support and source of advice for our product safety team in particular during his tenure and has also been a guiding voice as we have developed our sustainability agenda to this point. Jasmin Staiblin will also stand down from the Board at the 2021 AGM, along with Lewis and Sir Frank, as she will have served nine years on the Board at that time. I would like to thank all of them for their tremendous support during their tenure. Dame Angela Strank, who joined the Board in May 2020, will take over as chair of the Safety, Ethics & Sustainability Committee following Sir Frank's departure – a role we had in mind for her when she was recruited to the Board.

I would also like to welcome Paul Adams who will join the Board on 11 March 2021 and will also join the Nominations & Governance Committee, Safety, Ethics & Sustainability Committee and the Science & Technology Committee. Paul's biography can be found on page 64.

I would also like to thank Stephen Daintith who has been a highly valued member of the Board and the management team. He has made a huge contribution to the business, not least in response to the pandemic by taking rapid action to strengthen our liquidity. On behalf of the Board, I would like to thank him for his hard work, resilience and energy. I am delighted to welcome Panos Kakoullis who will join the Board in May as our Chief Financial Officer.

Looking forward

I will look to Sir Kevin Smith, as Senior Independent Director, to start to look for my successor during 2021 as I approach the end of my tenure as Chairman. However, we still have a lot to achieve and deliver and I know that your Board is as committed as I am to see us through the current period.

Sir Ian Davis
Chairman

CORPORATE GOVERNANCE

THE BOARD

THE ROLE OF THE BOARD

The Board is ultimately responsible to shareholders for the direction, management, performance and long-term sustainable success of the Company. It sets the Group's strategy and objectives and oversees and monitors internal controls, risk management, principal risks, governance and viability of the Company. In doing so, the Directors comply with their duties under section 172 of the Companies Act 2006 (see pages 56 to 57).

The Board has established certain principal committees to assist it in fulfilling its oversight responsibilities, providing dedicated focus on particular areas, as set out below. The chair of each committee reports to the Board on the committee's activities after each meeting.

In addition to the Board's principal committees, it has established a sub-committee of Directors who each hold an appropriate level of UK national security clearance for the purpose of receiving and considering, on behalf of the Board, any UK classified information relating to the Group's programmes and activities. Beverly Goulet, a US national and independent Non-Executive Director, also sits on the board of Rolls-Royce North America Holdings, Inc. to create a link between the Board and the Group's North American governance structure.

KEY MATTERS RESERVED FOR THE BOARD

- The Group's long-term objectives, strategy and risk appetite
- Changes to the corporate or capital structure of the Company
- The Group's organisation and capability
- Annual Report and financial and regulatory announcements
- Stakeholder engagement
- Significant changes in accounting policies or practices
- Overall corporate governance arrangements including Board and Committee composition, committee terms of reference, Directors' independence and conflicts of interest
- Annual budgets and financial expenditure and commitments above levels set by the Board
- Internal controls, governance and risk management frameworks
- Overview of speak up programme and cases reported through the Ethics Line

THE BOARD COMMITTEES

NOMINATIONS & GOVERNANCE COMMITTEE	AUDIT COMMITTEE	REMUNERATION COMMITTEE	SAFETY, ETHICS & SUSTAINABILITY COMMITTEE	SCIENCE & TECHNOLOGY COMMITTEE
See page 75	See page 77	See page 81	See page 101	See page 102

Roles and responsibilities

The roles of the Chairman and Chief Executive are clearly defined and the Board supports the separation of the two roles. The Chairman is responsible for the leadership and effectiveness of the Board. The Chief Executive is responsible for the running of the Group's business and leads the Executive Team which comes together to communicate, review and agree on issues and actions of Group-wide significance.

Non-Executive Directors support the Chairman and provide objective and constructive challenge to management. The Senior Independent Director (SID) provides a sounding board for the Chairman and serves as an intermediary for the Chief Executive, other Directors and shareholders when required.

The Company Secretary makes sure that appropriate and timely information is provided to the Board and its Committees and is responsible for advising and supporting the Chairman and Board on all governance matters. All Directors have access to the Company Secretary and may take independent professional advice at the Company's expense in conducting their duties.

Directors' independence

We continue to monitor and note potential conflicts of interest that each Director may have and recommend to the Board whether these should be authorised and if any conditions should be attached to such authorisations. The Directors are regularly reminded of their continuing obligations in relation to conflicts and are required to review and confirm their external interests at least annually. This helps us to determine whether each of them continues to be considered independent.

In 2020, the Board considered the independence of both Lewis Booth and Sir Frank Chapman who both completed their nine years as Non-Executive Directors in May and November 2020 respectively, and recommended their re-election at the 2020 AGM. Further information can be found on page 75.

Following due consideration, the Board determined that all Non-Executive Directors continued to be independent in both character and judgement.

Freedom within a framework

The Executive Team has defined the framework in which the businesses have the maximum freedom, responsibility and accountability for their performance.

The framework sets out how we are organised as a Group. Having the framework in place enables us to manage risk, drive critical business decisions and maintain standards across the Group. It means we can act with pace and confidence in a way that meets the expectations of our stakeholders.

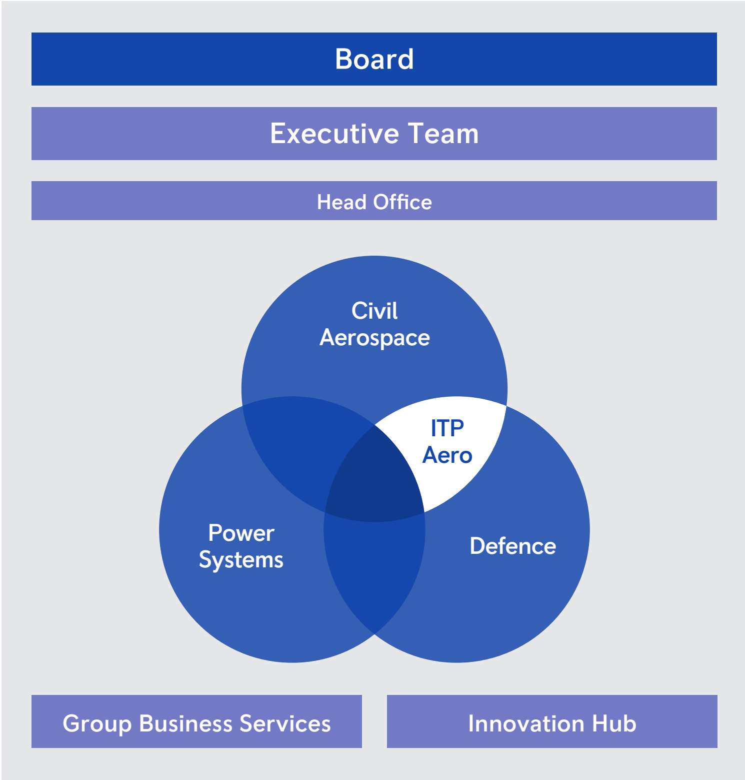
The framework sets out the roles of the businesses, as well as head office, group business services and the innovation hub and defines what we mean by empowered businesses.

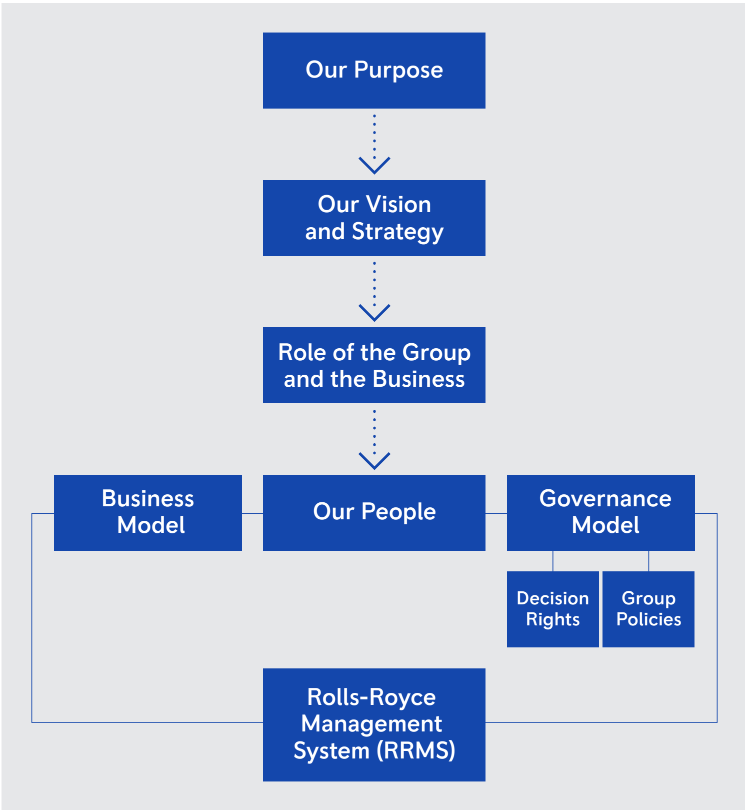
Our people section sets out the capabilities, behaviours, competencies and values which enable us to deliver our strategy.

The governance model clarifies decision-making rights and points of accountability and includes an online support tool for all key decision-makers. It includes details of all governance bodies and decision-making committees within the Group that the decision-makers may need to consult or seek approval from. It also provides access and an overview of our mandatory Group policies which define the requirements for all our people when they are carrying out their day-to-day activities as well as sets out our risk management and internal control systems and assurance activities.

The Rolls-Royce management system (RRMS) promotes end-to-end value stream processes that standardise and simplify the way we deliver products and services across the Group. It is an important strand in our governance of product safety.

Together, these are set within the context of our vision and strategy and also link to our business model. All our people can see how everything joins together and how they are contributing to one of the world's leading industrial technology companies, connecting, powering and protecting society.





BOARD OF DIRECTORS

	Position	Board skills and competencies	Key external appointments
	**SIR IAN DAVIS** Chairman of the Board Chair, Nominations & Governance Committee Appointed to the Board on 1 March 2013 and as Chairman on 2 May 2013	Sir Ian brings tremendous financial and strategic experience. He has worked widely with global organisations and companies, enabling him to draw on his knowledge of diverse issues and outcomes. Sir Ian's wealth of business knowledge as well as his global experience means that he makes a considerable contribution to the Board, the Company's stakeholders and its future.	**Current** – Johnson & Johnson Inc., non-executive director – McInsey & Company, senior partner emeritus **Past** – BP p.l.c., senior independent director (2010 to 2020) – Cabinet Office, non-executive board member (2015 to 2016) – McKinsey & Company, various executive roles (1979 to 2010)
	**WARREN EAST CBE** Chief Executive Appointed to the Board on 1 January 2014 and as Chief Executive on 3 July 2015	Warren is a chartered engineer and has an outstanding record as a chief executive officer. He has a deep understanding of technology and developing long-term partnerships. He has proven strategic and leadership skills in a global business and a strong record of value creation. Warren harnesses the Company's world-class engineering skills and its proud record of innovation and delivery.	**Current** – ASML Holdings N.V., member of the supervisory board **Past** – ARM Holdings plc, chief executive (2001 to 2013)
	**STEPHEN DAINTITH** Chief Financial Officer Appointed to the Board on 7 April 2017 Resignation announced on 27 August 2020. To step down from the Board on 19 March 2021	Stephen has a deep understanding of international business across various sectors and an appreciation for looking beyond the numbers to help improve performance. His change management experience allows him to make a significant contribution to the long-term growth of the business and the increasing demand for its technology.	**Current** – 3i Group plc, non-executive director **Past** – Daily Mail and General Trust plc, CFO (2011 to 2017) – British American Tobacco plc, various executive roles (1996 to 2005)
	**PANOS KAKOULLIS** Chief Financial Officer To be appointed to the Board on 3 May 2021	Panos has over 30 years of experience working with a wide range of significant multinational corporations, leading audits and advising on M&A transactions and turnarounds. He has been credited as one of the most highly regarded Big Four audit partners globally. Delivering significant transformation programmes throughout his career at Deloitte, he brings strong leadership and an appetite for innovation, collaboration and simplification.	**Past** – Deloitte LLP, various partner and leadership director roles (1989 to 2019)
	**PAUL ADAMS** Independent Non-Executive Director Appointed to the Board on 11 March 2021	Paul has deep experience across the aerospace industry and in engine manufacturing in particular, gained from over 30 years of leadership experience in the aviation industry. He has a passion for engineering and broad, sector-specific operational experience. His industry focus is undoubtedly a great asset to both our Safety, Ethics & Sustainability Committee and our Science & Technology Committee.	**Current** – OC Oerlikon Corporation AG, Pfäffikon, board member – Aerion Corporation, board member **Past** – Precision Castparts, chief operating officer (2016 to 2018) – Pratt & Whitney, various executive roles (1999 to 2016)
	**LEWIS BOOTH CBE** Independent Non-Executive Director Chair, Audit Committee Appointed to the Board on 25 May 2011. To step down from the Board on 13 May 2021	Lewis has considerable financial expertise with a strong international perspective having worked in Europe, Asia, Africa and the US. He has been credited as one of the strongest and most experienced international leaders within the motor industry and as such makes a significant contribution to the Board and to his role as Chairman of the Audit Committee.	**Current** – Mondelez International, Inc., director – Ford Innovation Fund Advisory Board, chair **Past** – Gentherm, Inc., director (2013 to 2018) – Ford Motor Company, various executive roles (1978 to 2012)

Full biographies of our Directors can be found at rolls-royce.com

	Position	Board skills and competencies	Key external appointments
	**SIR FRANK CHAPMAN** Independent Non-Executive Director Chair, Safety, Ethics & Sustainability Committee Appointed to the Board on 10 November 2011. To step down from the Board on 13 May 2021	Sir Frank has a life-long passion for engineering and innovation and a deep understanding of technology, together with an outstanding record of business achievement. His significant industrial and safety experience, gained through his distinguished career, have proved invaluable to Rolls-Royce and particularly in his role as Chairman of the Safety, Ethics & Sustainability Committee.	**Current** – NextDecade Corporation, non-executive director – Myeloma UK, vice-chair – Zap Energy, Inc., independent director **Past** – Golar LNG Limited, chairman (2014 to 2015) – BG Group plc, chief executive (2000 to 2013)
	**GEORGE CULMER** Independent Non-Executive Director Appointed to the Board on 2 January 2020	George has a strong track record as a senior finance professional with significant experience gained in large, international, highly regulated groups and has proven business leadership credentials. With this experience, together with his strengths in change leadership and transformation gained from within complex groups, George makes a significant contribution to the Board.	**Current** – Aviva plc, chairman **Past** – Lloyds Banking Group plc, chief financial officer (2012 to 2019) – RSA Insurance Group plc, group financial officer (2004 to 2012)
	**IRENE DORNER** Independent Non-Executive Director Chair, Remuneration Committee Employee Champion Appointed to the Board on 27 July 2015	Irene has held a number of varied international roles during her career, including risk management and human resources, and draws on her considerable experience as Chairman of the Remuneration Committee. As a passionate advocate of diversity and inclusion, Irene has embraced the role of Employee Champion and ensures the views of the workforce are properly reflected in the Board's discussions.	**Current** – AXA SA, director – Taylor Wimpey plc, chair – Control Risks Group, chair **Past** – HSBC, various executive roles (1986 to 2014)
	**BEVERLY GOULET** Independent Non-Executive Director Rolls-Royce North America Holdings, Inc., board member Employee Champion, North America Appointed to the Board on 3 July 2017	Having spent a considerable amount of her career in the airline industry, Bev brings valuable knowledge and operational experience to the Board. She has significant expertise in finance, treasury, strategy, legal and governance matters. She has the expertise and experience to be able to confidently contribute to decision-making and actively take part in developing and strengthening our businesses.	**Current** – Xenia Hotels & Resorts, Inc., director – American Airlines Federal Credit Union, chair **Past** – American Airlines, Inc., various executive roles (1993 to 2017)
	**LEE HSIEN YANG** Independent Non-Executive Director Employee Champion, Asia Pacific Appointed to the Board on 1 January 2014	A Singaporean national, Hsien Yang combines a strong background in engineering with extensive international business and management experience in our most important growth markets. Through his varied career history, Hsien Yang has gained significant industrial and financial skills which have proved invaluable in his current committee memberships.	**Current** – INSEAD South East Asia Council, president **Past** – Civil Aviation Authority of Singapore, chairman (2009 to 2018)
	**NICK LUFF** Independent Non-Executive Director Appointed to the Board on 3 May 2018	Nick is an experienced finance executive having been CFO of a number of listed companies across a variety of industries. He has broad financial skills and a track record of driving business performance. His extensive non-executive and audit committee experience, together with both financial and accounting expertise and a passion for engineering, is invaluable to the Board.	**Current** – RELX plc, chief financial officer **Past** – Lloyds Banking Group plc, non-executive director (2013 to 2017) – QuinetiQ Group plc, non-executive director (2004 to 2010)

	Position	Board skills and competencies	Key external appointments
	**SIR KEVIN SMITH CBE** Senior Independent Director Chair, Science & Technology Committee Appointed to the Board on 1 November 2015	Sir Kevin has extensive industrial leadership experience and a deep knowledge of global engineering and manufacturing businesses, as well as the aerospace industry. As Chairman of the Science & Technology Committee, Sir Kevin has been able to draw on his extensive experience and make a significant contribution to development and growth of key strategies.	**Current** – L.E.K. Consulting LLC, european advisory board member **Past** – Unitas Capital PTE LTD, partner & chairman (2012 to 2015) – GKN plc, group chief executive (2003 to 2011)
	**JASMIN STAIBLIN** Independent Non-Executive Director Appointed to the Board on 21 May 2012. To step down from the Board on 13 May 2021	Jasmin combines a strong background in advanced engineering and a deep understanding of technology with extensive international business experience. She has a track record in leading strategic repositioning and growth, restructuring and major transformations. Her background is dominated by science and technology and Jasmin is able to make a significant contribution to the Board and Science & Technology Committee.	**Current** – George Fischer AG, board member – Zurich Insurance Group Ltd, non-executive director – NXP Semiconductors N.V., non-executive director **Past** – Alpiq Holding AG, chief executive officer (2013 to 2018) – ABB Switzerland Ltd, CEO (2006–2012)
	**DAME ANGELA STRANK** Independent Non-Executive Director Appointed to the Board on 1 May 2020	Dame Angela brings a proven track record in managing engineering operations and driving technology, digital research and sustainability programmes. She brings a wealth of corporate experience to the Board, having served on the executive team at BP and being one of the most senior female executives in the energy industry, as well as having non-executive experience.	**Current** – Severn Trent plc, non-executive director – SSE plc, non-executive director **Past** – BP p.l.c., various executive roles (1982 to 2020)
	**PAMELA COLES** Chief Governance Officer/ Company Secretary Appointed as Company Secretary on 1 October 2014	Pamela is an expert in corporate governance and company law with a pragmatic approach to how the Governance Team supports the business. Pamela is instrumental in supporting the Chairman and the Non-Executive Directors to build strong relationships with the management team and has been able to offer advice and guidance on a wide range of topics.	**Current** – E-Act, non-executive director

Board committee membership (as at 11 March 2021)

	Nominations & Governance	Audit	Remuneration	Safety, Ethics & Sustainability	Science & Technology
Sir Ian Davis	Chairman				
Paul Adams	Member			Member	Member
Lewis Booth	Member	Member	Member		
Sir Frank Chapman	Member			Chairman	Member
George Culmer	Member	Member		Member	
Irene Dorner	Member		Chairman	Member	
Beverly Goulet	Member	Member	Member		
Lee Hsien Yang	Member	Member		Member	
Nick Luff	Member	Chairman			
Sir Kevin Smith	Member		Member		Chairman
Jasmin Staiblin	Member				Member
Dame Angela Strank	Member			Member	Member

Member Chairman

Board induction and development

The Chairman and Company Secretary arrange a comprehensive, tailored induction programme for newly-appointed Non-Executive Directors, which includes dedicated time with the Executive Team and senior management and scheduled trips to business operations. The programme is tailored based on experience and background and the requirements of the role.

All Directors visit the Group's main operating sites as part of their induction and are encouraged to make at least one visit to other sites each year throughout their tenure. However, as a result of COVID-19, all visits were postponed during 2020. These will resume as soon as possible as we regard these site visits as an important part of the induction process as well as for continuing education. They help Directors understand the Group's activities through direct experience of seeing processes in operation and by having discussions with a range of employees.

Dame Angela Strank was appointed to the Board in May 2020 and at that time joined the Nominations & Governance, Safety, Ethics & Sustainability and Science & Technology Committees. Since her appointment, she has embarked on her induction programme and met virtually with members of the Executive Team. Angela will be visiting Civil Aerospace in Derby, UK, Defence in Bristol, UK, and Power Systems in Friedrichshafen, Germany, as soon as it is possible.

It is important that the Directors continue to develop and refresh their understanding of the Group's activities. More detail of the Board's engagement with its stakeholders is set out on pages 72 to 73.

It is also important that the Directors regularly refresh and update their skills and knowledge and receive relevant training when necessary. Members of the Board also attend relevant seminars, conferences and training events to keep up-to-date on developments in key areas.

BOARD INDUCTION PROGRAMME FOR DAME ANGELA STRANK

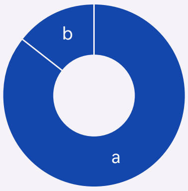
TIMING	PEOPLE TO MEET	KEY TOPICS COVERED
Within first three months	Chairman	— Overview of the Board — Nominations & Governance Committee
	Chairs of the Committees	— Overview of Committees — Plan of work for the year — Current issues
	Chief Executive	— Business model — Current strategic priorities — Opportunities/risks — Current issues
	Chief Financial Officer	— Finance, treasury, M&A and tax overviews — Budget — Accounting issues
	Chief Governance Officer	— UK Corporate Governance Code and directors' duties — UK listed company requirements — Rolls-Royce framework — Board arrangements and meeting dates
	Executive Team members and senior management	Overview of each area of responsibility and current priorities, including: — markets and competition — operational and financial performance including KPIs — functional leadership — employee engagement — culture and diversity — sustainability strategy
	Internal and external auditors	— Audit report and findings — Financial and non-financial controls — Accounting judgements

BOARD COMPOSITION

The Board brings a wide range of experience, skills and backgrounds which complement the Group's strategy.

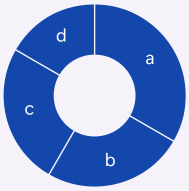
COMPOSITION OF THE BOARD AS AT 11 MARCH 2021

BALANCE OF THE BOARD



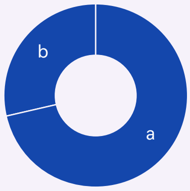
a. Non-Executive Directors	12
b. Executive Directors	2

NON-EXECUTIVE DIRECTORS' TENURE



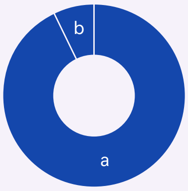
a. 0–3 years	4
b. 3–6 years	3
c. 6–9 years	3
d. 9+ years	2

BOARD MEMBERS BY GENDER



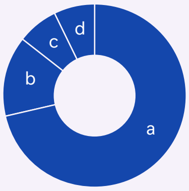
a. Male	10
b. Female	4

BOARD MEMBERS BY ETHNICITY



a. White	13
b. Asian	1

BOARD MEMBERS BY NATIONALITY *



a. British	10
b. American	2
c. German	1
d. Singaporean	1

* According to the Company's Articles, at least 50% of our Directors must be British citizens.

Non-Executive Directors' skills and experience

	Business experience										Global experience		
Non-Executive Director	Health & Safety	Sustainability & Environment	Engineering, Science & Technology	Company Leadership	Finance	Audit & Risk Management	Remuneration	Transformation	Legal & Regulation	Sector Specific	Europe	USA	Asia & Middle East
Sir Ian Davis		▪		▪	▪						▪		▪
Paul Adams	▪	▪	▪	▪						▪	▪	▪	▪
Lewis Booth	▪	▪	▪	▪	▪	▪	▪	▪			▪	▪	▪
Sir Frank Chapman	▪	▪	▪	▪				▪			▪	▪	▪
George Culmer				▪	▪	▪		▪	▪		▪		
Irene Dorner		▪		▪	▪	▪	▪		▪		▪	▪	▪
Beverly Goulet					▪	▪	▪	▪	▪	▪		▪	
Lee Hsien Yang			▪	▪	▪					▪			▪
Nick Luff				▪	▪	▪		▪	▪		▪	▪	
Sir Kevin Smith	▪	▪	▪	▪				▪		▪	▪	▪	▪
Jasmin Staiblin	▪	▪	▪	▪	▪			▪		▪	▪		
Dame Angela Strank	▪	▪	▪				▪	▪			▪	▪	▪

Directors' attendance at Board and Committee meetings in 2020

	Board 9 scheduled (13 additional)	Nominations & Governance 5 scheduled (1 additional)	Audit 6 scheduled (9 additional)	Remuneration 7 scheduled (4 additional)	Safety, Ethics & Sustainability 3 scheduled (1 additional)	Science & Technology 3 scheduled (1 additional)
Sir Ian Davis	9 (13)	5 (1)	–	–	–	–
Warren East	9 (13)	5 (1)	–	–	–	–
Stephen Daintith	9 (13)	5 (1)	–	–	–	–
Lewis Booth	9 (12)	5 (1)	6 (9)	7 (4)	–	–
Sir Frank Chapman	9 (11)	5 (1)	–	–	3 (1)	2 (1)
George Culmer	8 (11)	5 (1)	5 (9)	–	2 (1)	–
Irene Dorner	9 (10)	5 (1)	–	7 (4)	3 (1)	–
Beverly Goulet	9 (13)	5 (1)	6 (9)	7 (4)	–	–
Lee Hsien Yang	8 (13)	5 (1)	6 (9)	–	3 (1)	–
Nick Luff[1]	9 (11)	5 (1)	6 (9)	–	2 (0)	–
Sir Kevin Smith	9 (13)	5 (1)	–	7 (4)	–	3 (1)
Jasmin Staiblin	9 (11)	5 (1)	–	–	–	3 (1)
Dame Angela Strank[2]	6 (12)	4 (1)	–	–	2 (1)	2 (1)

[1] Nick Luff stepped down from the Safety, Ethics & Sustainability Committee in July 2020.
[2] Dame Angela Strank joined the Board in May 2020.
Figures in brackets indicate attendance at an additional meeting.

The table above sets out the Directors' attendance at Board and Committee meetings throughout 2020, both scheduled and additional. Most scheduled meetings end with a private discussion of the Non-Executive Directors led by the Chairman of the Board or Committee, without the Executive Directors or members of the Executive Team or management present.

Dame Angela Strank joined the Board as a Non-Executive Director in May and was appointed to the Nominations & Governance, Safety, Ethics & Sustainability and Science & Technology Committees. In February, the Company announced Nick Luff's appointment as Chair of the Audit Committee. However, in light of COVID-19, Lewis Booth resumed chairing the Audit Committee on an interim basis and provided continuity of support through 2020. Nick will resume his role as Chair of the Audit Committee from March 2021. Nick stepped down from the Safety, Ethics & Sustainability Committee after its meeting in July.

Additional meetings and sub-committee meetings

To ensure the Board's response to COVID-19 remained current and in step with the unfolding developments both in the business and globally, the Board held weekly update calls from March to June and a series of additional meetings during 2020. There was also one additional meeting of the Nominations & Governance Committee to consider Directors' external appointments. The Audit Committee held nine additional meetings to support the finance team and our external auditors in view of the heightened workload and the challenges with remote working brought about by COVID-19. Four additional meetings of the Remuneration Committee were held to consider a revised Remuneration Policy specific to the challenges facing Rolls-Royce as a result of the pandemic. The Safety, Ethics & Sustainability Committee held one additional meeting to consider the impacts of the pandemic on our safety, ethics and sustainability agendas. The Science & Technology Committee held one additional meeting to review the Group's engineering technologies, capabilities and skills post-restructuring.

In addition to the meetings set out above, the Board delegated authority to a sub-committee to approve certain matters specifically in relation to the rights issue. This sub-committee met four times during September to November. A sub-committee of the Remuneration Committee was also convened in November to consider share plan adjustments in relation to the rights issue.

In support of the Committees' work, where there is a requirement for greater, in-depth discussion, we hold deep dives into specific areas of focus outside the meeting schedule. In November, the Audit Committee reviewed in detail the finance transformation programme while the Safety, Ethics & Sustainability Committee held a deep dive into the safety management system. This was the second of three sessions on the topic, the first being held as part of a scheduled meeting and the third to be held in 2021.

Non-attendance

Board members' attendance was high in 2020 and our Directors attended an unprecedented number of meetings called at short notice. However, where Directors were unable to attend, this was solely due to other business commitments and they communicated their responses to the matters for consideration via the Chairman of the Board and the Committee Chairs, where relevant.

BOARD FOCUS THROUGH 2020

The COVID-19 pandemic had a sudden and material impact on the Group. The Board focused on the health, safety and wellbeing of our people and the financial resilience of the Group. We also provided oversight of the management team as they materially reduced the cost base and restructured the Group's operations.

AREA OF FOCUS	KEY MATTERS CONSIDERED	OUTCOME
Strategy	Impact of the pandemic	COVID-19 and its impact on the Group and our markets globally led the Board to refine the strategy during the year (see page 9): — to restore financial performance in order to improve returns and build a more resilient and more appropriate balance sheet; — to drive growth and maximise value from our existing capabilities; and — to position the Group to benefit from new technologies, with a focus on sustainable power.
	Review of the business	In light of the impact of COVID-19 on the Group, the Board regularly discussed the appropriateness of the Group's strategy and, in June, held an in-depth strategy meeting with the Executive Team focused on operational and financial progress against the Group's short and long-term plans. The regular dialogue throughout the year was imperative given the operational environment and in view of the Board's focus to rebuild the balance sheet and increase financial resilience which was key to positioning the Group for the future (see pages 6 to 11).
	Acquisitions and disposals	During the year, we made three acquisitions to accelerate our strategy to enhance the Group's position as an enabler of net zero emissions whilst ensuring alignment with post-pandemic economic recovery: a majority stake in electricity storage specialist Qinous, to enhance our microgrid offering; Kinolt, a dynamic uninterruptible power supply system business; and Servowatch Systems, an international supplier of integrated marine automation solutions for navies, commercial vessels and large yachts. Following a strategic review, we announced the sale of our Bergen Engines business in early 2021, which is not core to our future strategy. During the year, we also signed an agreement to sell our Civil Nuclear Instrumentation & Control business, and completed the sale of our Civil Nuclear North America Services business (see pages 11 and 174).
Group purpose	Corporate narrative	Our Group purpose remains – to connect, power and protect society. However, during the year we refined our strategic pillar of 'champion electrification' to encompass a wider range of net zero carbon technologies under the banner 'champion sustainable power'. This is in recognition of the increasing importance of ensuring that economic recovery and growth is achieved in a manner compatible with combatting climate change. We are determined to play a leading role in pioneering a resilient, inclusive, net zero carbon future.
Culture	Review of the culture change agenda	The Board sought ways to track progress and seek feedback on the areas articulated in our people framework (see page 40) throughout the significant restructuring activity in the year through reports from the management team and through the Employee Champions on: — diversity & inclusion, talent and succession and the leadership learning, performance management and career frameworks; — progress report on the anti-bullying and harassment campaign and training (see page 43); — engagement with the UK Trade Unions and European Works Council and their reactions to the 2020 restructuring proposals; — the continued delivery of the safety agenda; — the Ethics Line programme, including the review of the operation of the speak up procedures, statistics, types of cases raised and the average completion time; and — outcome from the employee surveys.
Risk	Review of risk appetite and principal risks	The sudden and material effect of the COVID-19 pandemic influenced the discussions at each Board meeting and the risk and impact to the Group were considered. The Board received weekly updates on the COVID-19 position from the Chief Financial Officer.

CORPORATE GOVERNANCE

AREA OF FOCUS	KEY MATTERS CONSIDERED	OUTCOME
Risk continued	Review of risk appetite and principal risks	During the year, the Board completed a review of the principal risks and how we manage them in light of COVID-19. The principal risks are set out on pages 47 to 51. In addition, the Board reviewed and approved the effectiveness of the Group's risk management system, following an update from the Audit Committee. The implications of Brexit were kept under review. For more information on our approach to emerging risks (see page 47).
Operational performance/ challenges	Civil Aerospace, Defence and Power Systems	An update on each business was presented at every Board meeting in the form of a business review including progress against key operational milestones. The Board was kept appraised of the outcomes of the inspection programme on the Trent XWB-84 engines. For further information on the performance of each business, see pages 25 to 33.
Financial performance	COVID-19	The sudden and material impact of the COVID-19 pandemic resulted in a sharp deterioration in the financial performance of our Civil Aerospace business and, to a much lesser extent, in our Power Systems business. In 2020, the Board committed to undertake a number of significant actions to mitigate the financial and operating impact of COVID-19 in order to strengthen our financial position and seek to ensure we can deliver improved future returns. They continue to review the ongoing significant uncertainty over the precise shape and timing of the recovery in air traffic and its impact on the Group.
	Balance sheet review	The Board recognises the material uncertainties resulting from COVID-19 on the Group's immediate future and the need to rebuild the Group's balance sheet for the longer term. We approved a £2bn rights issue, completed in November. We are confident that, despite the more challenging near-term market conditions, the Group is well positioned for the future to capitalise on the long-term opportunities in all the Group's markets.
	Payments to shareholders	The Board made the difficult decision, in light of the uncertain macroeconomic outlook resulting from the COVID-19 pandemic, to not recommend a final payment to shareholders in respect of the financial year ended 31 December 2019. In addition, for the financial year ended 31 December 2020, an interim shareholder payment was not made and a final payment was not recommended, see page 5.
	Capital allocation	The Board continued to review the primary capital allocation priority, to strengthen the Group's balance sheet. The Board recognises the importance of a strong balance sheet due to the Group's long-term customer relationships and the cyclical nature of civil aviation and remains committed to its ambition of an investment grade credit profile in the medium term and a return to a net cash position.
	Finance transformation	Throughout the year, the Board was updated on the finance transformation programme, in particular, whether the final deliverables and outputs of the programme were fit for purpose and would address the current issues and risks faced by the Group. The Board recognised that the benefits of the finance transformation programme have other additive measures to the Group as a whole, including better provision of data which can be used by the business to support not only financial reporting, but also operational decision-making, future scenario reporting, etc.
Governance	Stakeholder engagement and governance	Details on the Board and Executive Team's engagement with stakeholders can be found on pages 72 and 73 and referenced in our s172 statement on pages 56 and 57. The Board also reviewed investor commentary following our full and half-year financial results as well as from our engagement with our investors as part of the rights issue programme. In addition, the Board received feedback from the Ethics Line, payment practices for the Group's subsidiaries, gender pay gap reporting and the Group's modern slavery statement.
	Non-financial controls	The Board considered the framework and concluded it remained appropriate. This articulates our freedom within a framework culture (see page 63).
Succession and leadership	Succession planning	During the course of the year, the Board considered the principal risk relating to Talent and Capability and reviewed succession at the most senior levels of the business (see page 75) as well as ensuring there was a robust emergency succession framework in place during the pandemic for members of the Executive Team and the business leadership teams. The Company announced the resignation of Stephen Daintith as Chief Financial Officer and Executive Director. The Board immediately began a process to identify and appoint a successor. It was announced in February 2021 that Panos Kakoullis would join the Company as Chief Financial Officer and Executive Director in May 2021.
	Effectiveness of the Board, Chairman and Chief Executive	A light touch external evaluation was undertaken, following on from the comprehensive evaluation in 2018, and it concluded that the Board continued to operate effectively in 2020 (see page 74). The Chairman and Chief Executive received constructive feedback on their respective performance.

STAKEHOLDER ENGAGEMENT

At Rolls-Royce, we understand that who we are and how we behave matters not only to our people but to the many stakeholders who have an interest in our business.

We believe that stakeholder engagement remains vital to building a sustainable business and we interact with many stakeholders at different levels of the organisation. Engagement is carried out by those most relevant to the stakeholder group or issue.

The table below identifies some of our stakeholders and how both the Company and the Board engage with them. There has been continuous dialogue with our stakeholders throughout the year and this has become part of our governance framework. We believe we have a clear responsibility to all our stakeholders to return the Group to strength with a sustainable and right-sized cost base, aimed at ensuring the Group's future success and the Board intends to take all appropriate actions to secure this outcome.

The Board considers the different stakeholder groups and our engagement programmes and identifies opportunities for strengthening both its relationships and understanding to facilitate the decisions and contributions made by the Board to the success of the business.

Customers	The Board recognises that the quality of the Group's customer relationships is based on mutual trust as well as its engineering expertise. We recognise that as we recover from the impact of the pandemic, we must retain and strengthen our focus on playing a leading role in the transition to a net zero carbon global economy by creating the sustainable power that our customers require. In light of COVID-19, the Company and the Board have been regularly engaged with customers. Warren East reported on his meetings with Singapore Airlines, COMAC the aircraft manufacturer in China, and the Chairman of Gulf Air as well as a number of interactions he and Stephen Daintith had with our aircraft manufacturing customers. The Board regularly receives operational updates, including customer metrics and feedback, from each of the businesses with the business presidents regularly presenting to the Board. During the challenges faced as a result of COVID-19, the Board has kept very close to our customer engagement throughout the year and received specific feedback from each of the business presidents on the issues and mitigation plans including the impacts on our customers, which greatly influenced the Board's deliberations and support for the Executive Team when considering our strategy.
Investors	The investor relations team is the key interface between the investment community and the Board, providing frequent dialogue and feedback. The Chairman and members of the Board make themselves available to meet with institutional investors and seek to understand and prioritise the issues that matter most. In addition, the Chief Executive and Chief Financial Officer, supported by members of the Executive Team and investor relations, interact regularly with investors, most notably after our financial results, at conferences as well as at key points throughout the year. With 2020 being an unprecedented year, and as the COVID-19 pandemic took hold, the need for clear and effective communication with our investors became more important than ever and we adapted our investor engagement to suit an online environment. In May, unable to meet in person as usual at our AGM, we provided a virtual update on the business and encouraged shareholders to submit questions to the Board. In August, our Chief Executive and Chief Financial Officer communicated our half-year results in a webcast format. Crucially, in the second half of the year our Executive Team, supported by our Chairman, held a virtual roadshow with our equity and debt investors to gain the support required to successfully achieve a rights issue and bond issuance, which further supplemented the additional liquidity provided by the UK Government. We also conducted a remuneration consultation process with our largest shareholders. More than ever we recognise the importance of our investors as key stakeholders in our discussions and endeavour to ensure that we are able to create confidence in our Company through financial performance and the economic impact of our decisions, robust governance and transparency of reporting and delivering a sustainable, stable and predictable performance.
Employees	The Board recognises that it is through our people that we fulfil our potential, achieve our vision and execute our strategy. During 2020, the Board ensured that the safety and wellbeing of our employees remained at the heart of our decision-making. Our employees were provided with regular video messages on the Group's intranet from the Executive Team and were kept up to date on the rapidly changing environment and the impact of COVID-19 on our business. Following any decisions, communications were sent to all employees with FAQ sections and employees were invited to Q&A sessions held by the Executive Team via webcast. In addition to this, we took time to understand the impact of COVID-19 on employee resilience and continued to note progress with our injury rates. We take the role of Employee Champion very seriously to ensure there is a voice of the employees in the boardroom. Irene Dorner has continued in her role as Employee Champion for a fourth year and where possible meets with employee groups and attends employee stakeholder engagement meetings. Irene also has regular dialogue with the Chief People Officer and together they review the outcomes from the employee surveys and Ethics Line reports. Irene can be contacted by any employee by email. Beverly Goulet also continued in her role as the Board's Employee Champion for our North American employees and Lee Hsien Yang has been appointed this year as the Board's Employee Champion for Asia Pacific. The Employee Champions are supported by an employee stakeholder engagement group where we discuss what we have learnt and plan future schedules. The Employee Champions provide regular feedback to the Board on employee topics of interest and/or concern.

Employees (continued)

The direct link that they provide between the employees and the Directors is proving to be extremely valuable, particularly through a period of extensive change. Our Employee Champions recorded a video message to all employees in July 2020 and invited them to complete a survey suggesting other methods of engagement of benefit to them during such uncertain times and requested information on specific topics they want to discuss. A follow-up communication from our Employee Champions was made available to all employees on our internal website. Further engagement sessions have been scheduled for 2021 as a result of the survey, with a focus on diversity & inclusion as a topic employees sought to discuss with our Employee Champions. We believe that these methods of engagement with our employees are effective in building and maintaining trust and communication. They also act as a platform for employees to influence change in relation to matters that affect them.

During 2020, Irene attended the European Works Council Select Committee with the most senior employee representatives across Europe, chaired by our head of employee relations. In November, Irene attended a Global D&I Council meeting and, together with Beverly and Hsien Yang, a people leadership team meeting chaired by the Chief People Officer. As can be read in the People and Culture and Ethics and Compliance reports (pages 40 to 45) and the Committee reports, the Board reviews both the behaviours and statistics on safety and diversity & inclusion as well as the talent management agenda at all levels across the Group. The Board also continued to receive feedback on the anti-bullying and harassment programme and other training. Furthermore, the Employee Champions ensured that the employee voice remained at the heart of Board debate on the fundamental restructuring.

Many of our employees are also our shareholders and we encourage their participation in a variety of share plans. Recognising the complexity of a rights issue, we developed bespoke, clear and simple communications to create awareness and understanding of the transaction so that our employees could make informed decisions.

Suppliers and partners

The Group's global supply chain is a vital contribution to its performance, with significant investment in resources to ensure the complex global supply chain is resilient and efficient. The interests of both our suppliers and partners are considered as part of the Board's discussions on manufacturing strategy and when reviewing specific projects. The Board supports our Executive Team who work collaboratively with our suppliers and partners to continue to improve operational performance through various means. There are of course a number of critical suppliers to the Group who, like us, have been materially impacted by COVID-19. As part of the assessment of the business continuity risks, the Audit Committee has focused on business continuity and the supply chain during 2020 when reviewing the individual business' risk management programme.

Communities

COVID-19 has significantly impacted our planned community investment and education outreach activities during 2020. Many planned events were cancelled, and projects delivered with schools and other community-based partners severely disrupted. However, we have worked with our partners to sustain engagement by adapting events, programmes and activities to virtual events wherever possible. In our STEM education outreach programme, we sought new opportunities to enhance engagement with young people and disadvantaged groups who have been significantly impacted by disruption to education and social activities. For example, our digital academy shared resources to help people of all ages around the globe to digitally upskill and we partnered with Scouts in the UK to share a library of educational activities with home-schooling parents. In addition, we introduced the 2020 Armed Forces Association (AFA) National Teacher of the Year at the virtual AFA annual conference in the US and created new STEM content for virtual delivery with many partners around the globe.

We responded to a variety of the challenges presented by COVID-19 so our 2020 contributions would be enhanced by a specific and rapid response to a dynamic situation. These contributions have been largely non-financial and include: manufacturing capability, including VentilatorChallengeUK Consortium to help increase the UK's supply of ventilators; local community involvement wherever Rolls-Royce has a footprint, including donations of hand sanitisers in China, to food banks in Derby, surplus PPE to Bristol NHS, and a policy change to encourage employees, furloughed or not, to become community volunteers at test centres etc, and providing our technical expertise, for example, some of our HSE personnel were seconded into Derby & Burton Hospitals Trust to assist in strategy planning.

Governing bodies and regulators

The Board recognises the importance of governments and regulators as stakeholders. Not only are governments across the world customers but they also support the Group's investment in infrastructure and technology. The General Counsel provides regular updates to the Board on compliance with regulators and the Safety, Ethics & Sustainability Committee reviews how the business engages with airworthiness regulators as well as receiving updates on the continuing dialogue and co-operation with prosecutors, regulators and government agencies. The Board is updated on the Group's engagement with the tax authorities and the related regulatory landscape is discussed by both the Board and the Audit Committee.

In addition, meetings with ministers and senior officials are held as relevant throughout the year. During 2020, the Chairman, Chief Executive and Chief Financial Officer met senior UK Government officials to discuss the financial status of the Company. The Chairman also met with the President, European Council (representing 27 member states), to discuss competitiveness issues, as well as decarbonisation and digitalisation challenges for our industry. He participated in a call with the President of the European Commission on the COVID-19 situation and the EU green deal, and in a virtual meeting with the EU Commissioner for Jobs and Social Rights to discuss an action plan for skills. Since then, we have been involved in the EU pact for skills for the aeronautic sector. The Chief Executive met senior government ministers during the COVID-19 crisis to explain the impact of the pandemic on the Group and the restructuring of the Civil Aerospace business. He also met with groups of MPs who are local to our facilities in the UK. The Group is also involved with the Aerospace and Defence Industries Association in Europe and the European Round Table for Industry.

BOARD EFFECTIVENESS

Review of Board and Committees

In 2018, having undertaken both benchmarking and tender exercises, Belinda Hudson Limited (BHL), experts in enhancing board effectiveness, was appointed for a three-year term to undertake our externally-facilitated effectiveness reviews. BHL's appointment was based on cultural fit, the research that BHL had undertaken which highlighted the areas that needed addressing, and commercial competitiveness. BHL had no other connection with the Company nor its Directors.

Following a comprehensive review in 2018, slightly less in-depth reviews were conducted in 2019 and 2020. As in 2018, they covered Board composition and dynamics, the Board's role and the Board at work but with particular focus on those areas identified as requiring further development during the previous years' reviews.

The effectiveness of each of the Board's Committees was taken into account as part of the evaluation.

In 2020, the review took the form of confidential one-to-one discussions between BHL and members of the Board, Executive Team and senior management. BHL discussed the findings with the Chairman and the Company Secretary who, together with the Senior Independent Director, are refining an action plan for 2021. BHL has reviewed and agreed this disclosure of Board effectiveness.

In addition to BHL's review, during a private meeting of the Non-Executive Directors, the Senior Independent Director, led a review of the Chairman's performance without the Chairman present. The Nominations & Governance Committee also met without any management present to discuss the performance of the Chief Executive. Constructive feedback was shared with each of the Chairman and Chief Executive.

AREA OF FOCUS	2020 FOCUS IDENTIFIED IN 2019	PROGRESS IN 2020	FOCUS FOR 2021
Board composition and dynamics	The Board could be clearer in the communication of their priorities and expectations with the Executive Team	The impact of COVID-19 drew close alignment on the priorities to restore the Group to financial health	Board succession is important as a number of Directors and the Chairman reach their nine-year terms in 2021 and 2022
The Board's role	Continued close scrutiny of the plans and risks relating to the transformation programme. There is scope for the Board to add more value as there is increased focus on strategic issues and opportunities	There was clear identification and good oversight of the priorities for restructuring and targeted disposals	To ensure delivery on the commitments made to investors in 2020
The Board at work	Continued support and linkage between the work of the Executive Team and the Board to ensure they are aligned for success	The Board remained agile and flexible in their approach as demonstrated by the number of meetings held during the year and the pace of decision-making	To remain agile to ensure the Group remains appropriately sized, resourced and placed to take advantage of the recovery in the commercial aviation sector

STAGES OF THE BOARD EFFECTIVENESS REVIEW

OCTOBER 2020	NOVEMBER – DECEMBER 2020	DECEMBER 2020	JANUARY 2021
Briefing and areas of focus identified	One-to-one discussion with Board members, Executive Team and senior management	Feedback to Chairman and Company Secretary	Chairman, SID and Company Secretary agree action plan for 2021

NOMINATIONS & GOVERNANCE

Key areas of focus in 2020
- Board appointments
- CFO succession
- Culture and behaviour
- Talent & leadership through restructure
- Diversity & inclusion

Key areas of focus for 2021
- Board succession
- Culture and behaviour
- Diversity & inclusion through continued restructure

Activities and overview of 2020

Board and committee composition

The Committee is responsible for keeping the structure, size and composition of the Board and its Committees under review.

We have recently announced the appointment of Paul Adams as a Non-Executive Director, who joined the Board on 11 March 2021 and will stand for election by shareholders at the 2021 AGM. Paul is a member of the Nominations & Governance, Safety, Ethics & Sustainability and Science & Technology Committees. His full biography can be found at rolls-royce.com.

George Culmer and Dame Angela Strank both joined the Board in 2020 as Non-Executive Directors. Further information on George and Dame Angela's Committee appointments can be found on page 66, and information on Dame Angela's induction programme can be found on page 67. George's induction programme was reported in the 2019 Annual Report and Accounts. You can read the full biographies for George and Dame Angela at www.rolls-royce.com.

Prior to making any new appointments to the Board, the Committee considers the skills and attributes required and, together with the Chairman, agrees a profile. The Committee also provides input into a shortlist of candidates. Members of the Committee were involved in the interview process for Paul and the Committee recommended the appointment to the Board. MWM Consulting was appointed to lead the search; they have signed up to the voluntary code of conduct for executive search firms and had no other connection to the Company or its Directors during the year. The Company Secretary ensures that new Directors have a thorough and appropriate induction programme. More detail about inductions and continuing development can be found on page 67.

At the 2020 AGM, on the recommendation of the Board, shareholders approved the re-election of both Lewis Booth and Sir Frank Chapman as Non-Executive Directors for a further term, although both Directors completed nine years on the Board in 2020. The Board carefully considered the extension of their terms and acknowledged that both Lewis and Sir Frank continued to provide constructive challenge and scrutiny of Board and Committee matters. Neither Director had served simultaneously with an Executive Director for the full nine years. For this reason, the Board concluded that both Lewis and Sir Frank remained independent. Lewis and Sir Frank will step down from the Board in May 2021 and will not stand for re-election at the 2021 AGM. In addition, Jasmin Staiblin will have completed nine years on the Board in May 2021 and will not stand for re-election at the 2021 AGM.

In June 2020, the Committee considered the reappointment of Beverly Goulet for a further three years and recommended this to the Board. This was Bev's second three-year term and the Committee considered her effectiveness and commitment together with her attendance and time allocation to Rolls-Royce matters.

Directors' conflicts of interest

As required under the Code, any additional external appointments taken up by Directors during the year are considered by the Committee and approved by the Board prior to the Directors accepting further appointments. The Committee considers any conflicts that may arise as a result of any external appointments taken up by the Directors and the Board monitors the extent of those interests and the time commitment required to fulfil them to ensure that effectiveness is not compromised. As part of the Committee's discussions, the external appointments are considered against the parameters set by ISS. The Committee has found this to be a useful gauge when discussing whether there is potentially any impact on Directors' time commitments when taking on additional external appointments.

In 2020, the Directors demonstrated a strong commitment to the Company, as shown by their almost total attendance at all our meetings, whether scheduled or additional (see page 69). During the year, the Board considered, amongst others, the external appointments of Dame Angela Strank to SSE plc as a non-executive director, George Culmer to Aviva plc as chairman and Jasmin Staiblin as a board member of Ammann Group Holding AG and Enerim OY. The Board considered Warren East's appointment to ASML Holding N.V as a significant appointment in view of his position as Chief Executive and considering that ASML is a Dutch-listed company. The Board approved this appointment and took into consideration the fact that, as part of their ongoing development, the Executive Directors may seek one external non-executive role on a non-competitor board.

Succession planning

As part of the succession planning, the Committee considers the current skills, experience and tenure of the Directors and assesses future needs against the longer-term strategy of the Group.

The Committee regularly reviews succession planning at Board, Executive Team and senior management levels. This year, the Board considered the principal risk relating to talent and capability and reviewed emergency succession in light of COVID-19 in particular focusing on crisis governance and succession across the Executive Team and business leadership teams. Sharpening our talent management strategy and process has been a priority since 2018 and we have improved succession planning by implementing systematic talent reviews, consistently assessing potential and closely monitoring the successors' development plans and proactively looking at external talent to improve the quality and diversity of our succession plans.

The Committee plays a vital role in promoting effective Board and leadership succession, making sure it is fully aligned to the Group's strategy. Following the announcement in August 2020 that Stephen Daintith had resigned as Chief Financial Officer and an Executive Director, the Committee was regularly appraised by the Chief People Officer on progress to identify and appoint a successor. In February 2021, the Committee recommended to the Board the appointment of Panos Kakoullis as Chief Financial Officer and as an Executive Director.

Diversity & inclusion

In 2020, the Committee continued to oversee the development of a diverse pipeline for succession. D&I continues to be an area of focus for the Board and for the Group as a whole. We support and monitor Group activities to increase the percentage of senior management roles held by women and other under-represented groups across the organisation. During the year, the Committee was updated on the Group's approach to diversity & inclusion and agreed the 2025 targets.

Our Board diversity policy remains unchanged and we continue to ensure it remains in line with best practice. The policy is available at www.rolls-royce.com. We continue to promote an inclusive and diverse culture and the Committee reaffirmed our aspiration to meet and exceed the recommended voluntary target of 33% of Board positions being held by women, while recognising that we will fall short of this target for a temporary period as Jasmin Staiblin steps down from the Board. We have always recognised that there may be periods of change on the Board where we may fall short of our stated aim for periods of time while the Board is refreshed.

The Parker Review, first published in 2017, made a series of recommendations aimed at improving ethnic diversity on FTSE 100 boards. Our Board has one person of colour and we are therefore compliant with the Parker Review recommendations and the Committee will continue its work to maintain a balance on the Board of individuals representing a wide cross-section of experience, cultural backgrounds and specialisms.

We fully recognise that diversity in our Executive Team needs to be improved and there is a continued focus on improving this through succession planning. The Committee continued to support and monitor Group activities to increase the percentage of women and other under-represented groups in the senior leaders population. Last year, the Group's target was to achieve 21% by 2020 and 30% by 2025 (see page 44).

Improving D&I remains a priority and we continue to track progress. We are particularly pleased to note that, despite COVID-19, we have been able to increase female representation globally and increased the number of females in the ELG year-on-year. (See People and culture on page 44).

More on our progress against our 2020 and 2025 diversity & inclusion targets can be found on page 44.

Principal risk review

The principal risk of Talent and Capability was considered throughout the 2020. The Board met in full to review Talent and Capability as development of our leaders is critical to ensuring the right culture and behaviours are embedded across the Group and to ensure we maintain the right skills and capability for future growth.

Corporate governance

We strive to take an innovative approach in all that we do and that includes our approach to governance. We have always promoted good governance at Board level and, as we addressed the challenges presented by the global pandemic, we found that our governance was indeed appropriate at a time of crisis and needed no further change. Throughout 2020 we have continued to keep up-to-date through ensuring agendas were reflective of the current issues and information provided to the Board was always current and timely. It was encouraging that our approach to governance, when tested, was able to evolve and adapt as we remained flexible in a changing and uncertain external environment.

We have kept under review the enhancements put in place in 2018 to ensure we meet both the regulation and the spirit of the revised Code. This includes the Group's governance framework which is also applied to our subsidiary companies and is our response to the Wates principles. Extracts from the framework are available on the website at rolls-royce.com. You can read more about our framework on page 63.

Engagement with shareholders

Together with the Chief Governance Officer, I have met with investors and proxy advisers during the year to discuss our governance arrangements. Conversations were largely focused on the impact of COVID-19 on our ESG agenda and succession planning.

Role of the Committee

The Committee ensures that the composition of the Board is appropriate and relevant so that the Board is in the best position to oversee operational performance and to drive the Group's strategy. The Committee also keeps the Group's corporate governance arrangements under review.

Membership of the Committee

All members of the Committee are independent Non-Executive Directors. Our biographies are on pages 64 to 66 and meeting attendance is on page 69. No Director attends discussions relating to their own appointment. In addition to the members of the Committee, the Chief Executive attends when it is considered appropriate.

The Committee's responsibilities are outlined in its terms of reference which can be found at www.rolls-royce.com. We review these annually and refer them to the Board for approval. No changes have been made in 2020.

Sir Ian Davis
Chair of the Nominations & Governance Committee

AUDIT

Key areas of focus in 2020
- Impact of COVID-19 on the Group's assumptions and judgements
- Impact of decreased US dollar net cash flows on the US dollar hedge book
- Going concern and viability scenario planning
- Finance transformation programme
- Internal controls, in particular in light of increased remote working

Key areas of focus for 2021
- Impact of COVID-19 on accounting assumptions and judgements
- The risk management and internal control environment in relation to the restructuring programme
- The continuing finance transformation programme
- Developments with the audit reforms in the UK
- Changes to the internal control framework influenced by the Brydon review
- Impact of climate change on assumptions

I am pleased to present the 2020 report of the Audit Committee which describes how the Committee has carried out its responsibilities during the year. In light of COVID-19, I continued chairing the Audit Committee on an interim basis and provided continuity of support through 2020. Nick Luff will assume his role as Chair of the Audit Committee from March 2021. Unfortunately, it was not possible for us to meet with our shareholders in person in 2020. However, we look forward to our 2021 AGM, where we will be able to answer any questions regarding this report.

This report sets out the work of the Committee in 2020. The Committee recognised both the heightened workload and the challenges of remote working during 2020 and, therefore, reviewed the Company's reporting timetable. We recommended to the Board that the half-year announcement be delayed by several weeks and we introduced a series of additional, shorter meetings to support the finance team and our external auditors with meeting the revised schedule. So successful was this, we have adopted the same process for the 2020 full-year results and will continue to do so through 2021.

We also supported the Board in its preparations for the rights issue, keeping under regular review the working capital report which underpinned the rights issue together with the internal financial controls review and reporting. During the year, the Committee received individual business presentations focused primarily on the governance and control framework together with a review of the risk and assurance system. Each business has its own risk and audit committee and members of the Committee are invited to attend their meetings. We also received a detailed review from the Group's tax director, setting out the main drivers of the Group's tax position including the key areas of tax risk. Towards the end of the year, we held a separate meeting to carry out a deep dive review focused on the Group's finance transformation programme.

The Committee has played an active role in the succession of the Chief Financial Officer following the resignation of Stephen Daintith. Stephen has brought significant expertise and provided strong guidance to the Committee during his tenure and we wish him every success for the future.

Membership of the Committee

In addition to myself, members of the Committee during 2020 were George Culmer, Beverly Goulet, Lee Hsien Yang and Nick Luff, all Independent Non-Executive Directors. For the purposes of the Code and DTR 7.1, George Culmer, Beverly Goulet, Nick Luff and I have recent and relevant financial experience. The Board has confirmed that it believes that the Committee as a whole has competence relevant to the Company's sector. Our biographies are on pages 64 to 66 and our meeting attendance is shown on page 69. In addition to the members of the Committee, the Chairman, Chief Executive, Chief Financial Officer and all Non-Executive Directors may attend one or more meetings at my invitation. The Committee is supported by the General Counsel, the corporate governance director, the group financial controller, the director of risk and internal audit and the external auditors.

Role of the Committee

The Committee is responsible for recommending to the Board the financial reporting, focusing on accounting policies, judgements and estimates; disclosures; compliance with regulations; and whether the Annual Report is fair, balanced and understandable.

We monitor the effectiveness of the risk management and internal control environment and review concerns of financial fraud. The Business Continuity and Financial Shock principal risks are considered by the Committee while the Cyber principal risk is reviewed by our data security committee.

In addition, the Committee provides oversight in respect of the scope, resources, results and effectiveness of internal audit. We are responsible for the relationship with and the effectiveness of the external auditor as well as approving their terms of engagement and fees.

The Committee's responsibilities are outlined in its terms of reference, available at rolls-royce.com. We review these annually and refer them to the Board for approval. No changes have been made in 2020.

Financial reporting

The Group has complex long-term contract accounting and every year the Committee spends much of its time reviewing the accounting policies and judgements implicit in the Group's financial results. In 2020, in addition to our scheduled workload, we focused much of our time on the assumptions in respect of the recovery of civil aviation, in particular the implications of changes in Civil Aerospace engine flying hours (EFHs), and all areas impacted by this, such as going concern, impairments, long-term contract accounting, potential onerous contracts and customer losses.

We have ensured that the disclosures in respect of all key areas of judgement are appropriate and balanced. In light of the increased regulatory guidance on enhancing disclosures, we have provided additional information with regard to the sensitivity of the estimates to changes in key assumptions which are summarised in note 1 of the Consolidated Financial Statements on page 116.

In November 2020, the Financial Reporting Council (FRC) concluded their review of the Group's 2019 Annual Report. Their role is to consider compliance with reporting requirements; their review does not provide assurance that the 2019 Annual Report was correct in all material aspects. The principal areas where the FRC required further information were in relation to distributable profits; provision for Trent 1000 costs; and free cash flow and the summary funds flow statement. The Committee reviewed all correspondence in this regard and in December 2020, the Company received a final letter from the FRC confirming their satisfaction with the responses provided and the closure of their enquiries. We welcome the FRC's engagement and have incorporated improvements in our 2020 Annual Report based on their observations and extended disclosures where these have been considered material and relevant.

A summary of the principal matters we considered in respect of the 2020 Consolidated Financial Statements is set out below.

Significant issues relating to the 2020 financial statements:

AREA OF FOCUS	CONSIDERATIONS
Alternative Performance Measures (APMs)	The Committee reviewed the clarity of the definitions and the reconciliations of the APM to its statutory equivalent. The Committee concluded that the refined definitions and full reconciliations ensured there was not undue prominence to APMs in the Annual Report (see notes 1, 2 and 28 to the Consolidated Financial Statements).
Accounting for Trent 1000 in-service issues	The Committee considered the key judgements and estimates in accounting for the Trent 1000 in-service issues and provisions made in respect of customer loss-making contracts and expected wastage costs. We are satisfied that the provision held in respect of the future expected wastage costs and customer claims is appropriate and therefore the exceptional wastage credit that has been excluded from underlying (see notes 2 and 20 to the Consolidated Financial Statements).
Consideration of onerous contracts	In light of the impact of COVID-19 on our Civil Aerospace business and the significant reduction in EFHs, the Committee paid particular attention to the drivers of the onerous contracts. We reviewed the nature of the costs included in the assessment of onerous contracts, the discount rates applied in calculating the charge and the sensitivity analysis performed. We ensured the outcome was included in the underlying performance and the disclosures were appropriate (see notes 2 and 20 to the Consolidated Financial Statements).
Deferred tax assets	The Committee reviewed the basis for the recognition of UK deferred tax assets and considered the judgements and estimates necessary to assess the recoverability of the UK deferred tax assets. We confirmed the approach adopted and the additional disclosures included in note 5 to the Consolidated Financial Statements.
Carrying value of intangible and tangible assets	The Committee assessed the carrying value and the recoverability of tangible and intangible assets, with a specific focus on programme intangible assets in Civil Aerospace and the carrying value of the investments the Company holds in the underlying Group. We confirmed that the basis on which management assesses the risk of impairment, the methodology for calculating the recoverable amount, including the basis for the key assumptions, the discount rates and the long-term growth rates was appropriate. Additionally, we reviewed the sensitivity disclosures made in respect of goodwill and programme intangible assets. (See note 12 to the Consolidated Financial Statements).
Going concern and viability disclosures	In light of COVID-19, we undertook an enhanced review of the going concern and viability position of the Group in both our 2020 half-year and full-year results, including the basis for assessing the going concern assumption for the business and the principal risks of the Group and how these were modelled in the viability scenarios. We confirmed our agreement with the basis of the assessments and agreed the appropriate disclosures. See pages 52 to 55.
US dollar hedge book	The Committee focused on the Group's hedge book position, in light of the impact of COVID-19 on our actual and forecast US dollar net cash flows. We considered the risk of potential further over-hedged positions in the event of further reductions in forecast US dollar net cash flows. We confirmed the approach adopted, the accounting treatment in the Group's underlying results and the associated disclosures (see notes 2 and 4 to the Consolidated Financial Statements).

Fair, balanced and understandable
As part of its review of the 2020 Annual Report, the Committee considered whether the report, taken as a whole, was fair, balanced and understandable and that it provided the information necessary for shareholders to assess the Company's position, performance, business model and strategy. In so doing, the Committee considers the processes and controls involved in preparing the report. There is a robust governance framework to ensure the report is critically reviewed and signed off by key business and function teams. The Committee was satisfied that the process was effective and confirmed to the Board that, when taken as a whole, the Annual Report is fair, balanced and understandable.

Risk management and the internal control environment

Our risk management and internal control framework is described on page 46. We satisfied ourselves that improvements have been made in the approach to risk management including simplifying policies and guidance which has improved the clarity of risk and control ownership and through the focus on mitigating controls and risk appetite as described on page 46. Future improvements should focus on embedding more of the lessons learned from COVID-19 and in continuing to improve the quality of our risk assessment and management activities in relation to our restructuring programmes, financial planning and critical decision-making.

We also satisfied ourselves that the processes for identifying and managing risks are appropriate and that all principal risks and mitigating actions had been subject, during the year, to a detailed review by the Board or an appropriate Board Committee. Based on this and on our other activities, including consideration of the work of internal and external audit and attendance at the Committee by business and functional risk owners, we reported to the Board that a robust assessment of the principal risks facing the Group had been undertaken. Details of our principal risks are set out on pages 47 to 51. The Board allocated certain principal risks to the Committee and we considered these in detail throughout the year, as described below. From our discussions, we are satisfied that all of the principal risks that we oversee have received significant management attention during the year:

— Business Continuity: the Committee received updates on the status of the continuity risk management of each business, including the impact of COVID-19, particularly on our external suppliers and internal facilities.

— Cyber: at each meeting of our data security committee, emerging risks as a result of COVID-19 were considered together with lesson learnt from incidents and assessment of risk management effectiveness. Changes to the cyber security strategy were reviewed.

— Financial Shock: separated from market shock at the half-year, this was considered extensively during 2020 by the Committee and the Board due to COVID-19 and in our preparations for the rights issue. This included reviewing the Group's policies, procedures and controls for identifying, managing and mitigating financial shock in relation to, for example, financial scenario planning, financial forecasting, hedging and interest and discount rates.

Internal financial control

The Committee specifically reviews the Group's internal financial controls (see page 46). During 2020, we reviewed the results of self-attestation and testing performed by the internal control and internal audit teams to confirm the effective operation of key financial controls across the Group. We reviewed the ongoing impact of COVID-19 on our financial control environment and additional mitigating activities established as a result. We considered the external auditor's observations on the financial control environment. We reviewed the progress of the programme to strengthen financial reporting and compliance controls with particular focus on the use of spreadsheets, systems access and inventory management as well as the outcome of the increased supervisory review and oversight controls over balance sheet integrity and manual processes. We continued to review progress in and changes to the scope of the finance transformation programme with respect to financial control.

Effectiveness of risk management and internal control systems

We have conducted a review of the effectiveness of the Group's risk management and internal control systems, including those relating to the financial reporting process, and concluded that it is effective, whilst recognising the need for ongoing and continuous improvement. Where opportunities for improvement were identified, action plans have been put in place and progress is monitored by the Committee. We consider that our review of the risk management and internal control systems, in place throughout 2020 and up to the date of this report, satisfies the requirements of the Code, the DTR and the FRC's guidance on risk management.

Going concern and viability statements

Having regard to the net liabilities of £4,875m on the Group's 2020 balance sheet, we paid particular attention to these assessments. We reviewed the processes and assumptions underlying the statements set out on pages 52 to 55, considering in particular:

— the Group's forecast funding position over the next five years;

— the forecasts for material subsidiaries making up this position;

— an analysis of impacts of severe but plausible risk scenarios, ensuring that these included relevant principal risks and risks considered as part of the rights issue;

— the impact of multiple risks occurring simultaneously;

— additional mitigating actions that could be taken in extreme circumstances; and

— the current borrowing facilities in place and the availability of future facilities.

As a result, we are satisfied that the going concern and viability statements have been prepared on an appropriate basis.

Internal audit

The director of risk and internal audit regularly attends and reports to the Committee on risk and internal audit matters including:

— quarterly – a dashboard identifying key trends and headline findings from internal audit reports issued in the period and the status of related agreed actions; key themes from internal audit's work and details of any specific significant findings raised that warrant the Committee's attention, including those relating to audits conducted as part of the Group's response to the DPAs; and

— annually – compliance with expenses policies for the Directors and the Executive Team; and an internal audit work plan for the following year.

I meet the director of risk and internal audit before each meeting and on an ad hoc basis throughout the year, as do other members of the Committee, to discuss risk matters and the nature of internal audit findings in more depth. We continue to focus on the nature of issues raised by internal audit and the timescales to complete the related actions. The future work plan is risk-based, including risks to both short and longer-term objectives and balancing focus on principal risk areas and on business-as-usual transactional activity where controls are understood to be mature and established. Internal audit also provides assurance to our restructuring activities and incorporate the activities of our second line assurance functions in their approach. We monitor changes to their plan during the course of the year and in view of the impact of COVID-19 on the Group, during the year we noted changes to the 2020 internal audit plan. We considered and reviewed the effectiveness of the Group's internal audit function, including resources, plans and performance as well as the function's interaction with management. Based on the reports and discussion, we are satisfied that the scope, extent and effectiveness of internal audit work are appropriate for the Group and that there is an appropriate plan in place to sustain this.

External audit

PwC were appointed as the Group's external auditor for the financial year commencing on 1 January 2018 following a formal tender process in 2016. The external audit contract will be put out to tender at least every ten years. Ian Chambers is the lead audit partner and has been in post since PwC were appointed; he will be required to rotate after five years. Other key audit partners will also be required to rotate every five years. Any future audit tenders will be carried out in line with the FRC's practice aid for audit committees.

Other than the services detailed below, PwC have no other connection with the Company or its Directors.

2020 audit

The Committee reviewed the quality of the external audit throughout the year and considered the performance of PwC, taking into account the Committee's own assessment and feedback, the results of a survey of senior finance personnel across the Group focusing on a range of factors we considered relevant to audit quality, feedback from the auditors on their performance against their own objectives and the firm-wide audit quality inspection report issued by the FRC in January 2020 regarding the Group's Financial Statements for the year ended 31 December 2018.

Based on these reviews, the Committee concluded that there had been appropriate focus and challenge by PwC on the primary areas of the audit and that they had applied robust challenge and scepticism throughout the audit. Consequently, the Committee has recommended to the Board that they be reappointed at the 2021 AGM.

In May 2020, PwC presented its audit plan, which identified its assessment of the key audit risks and the proposed scope of audit work. We agreed the approach and scope to be undertaken. Subsequently, an updated plan was agreed in November 2020, building on the work undertaken at the half-year 2020. Key risks and the audit approach to these risks are discussed in the Independent Auditor's Report (pages 190 to 203), which also highlights the other risks that PwC drew to our attention.

As part of the reporting of the half-year and full-year results, in August 2020 and March 2021, PwC reported to the Committee on its assessment of the Group's judgements and estimates in respect of these risks and the adequacy of the reporting. Where effective to do so, PwC also reported on its assessment of the Group's controls.

I meet with the lead partner prior to each Committee meeting and the whole Committee has a private meeting with PwC at least once a year.

During 2020, the Audit Quality Review Team (AQRT) of the FRC conducted a review of PwC's audit of the Group's Financial Statements for the year ended 31 December 2019. In December 2020, the AQRT provided their final report and I, as Chair of the Committee, have acknowledged the findings with the FRC and discussed them with the audit partner. The report concluded that there were no significant findings with only one matter requiring improvement. PwC have reported to the Audit Committee their response to the findings and how the suggested improvements have been incorporated into the current audit along with continuation of the areas identified as being of a high standard.

Non-audit services

In order to safeguard the auditor's independence and objectivity, and in accordance with the FRC's ethical standard, we do not engage PwC for any non-audit services except where it is work that they must, or are clearly best-suited to, perform. Accordingly, our policy for the engagement of the auditor to undertake non-audit services broadly limit these to audit-related services such as reporting to lenders and grant providers, where there is a requirement by law or regulation to perform the work. All other non-audit services are considered on a case-by-case basis in light of the requirements of the ethical standards and in compliance with our own policy.

Fees paid to PwC are set out in note 7 to the Consolidated Financial Statements on page 137. All proposed services must be pre-approved in accordance with the policy which is reviewed and approved annually. Above defined levels, my approval is also required before PwC is engaged. Quarterly, we also review the non-audit fees charged by PwC.

Non-audit related fees paid to the auditor during the year were £2.7m (2019: £1.1m), representing 26% (2019: 11%) of the audit fee. This included £1.0m (2019: £0.5m) relating to the review of the half-year results. PwC was also engaged as reporting accountant for the rights issue and bond workstreams, with total fees of £1.0m, representing 10% of the audit fee. Our annual review of the external auditor takes into account the nature and level of all services provided.

Based on our review of the services provided by PwC and discussion with the lead audit partner, we concluded that neither the nature nor the scale of these services gave any concerns regarding the objectivity or independence of PwC.

Compliance

During 2020, the Company complied with the relevant provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014, as disclosed within the external audit section.

Conclusion

This has been an extraordinary year and I would like to thank the management team, the finance team and the external auditors for their enthusiasm and resilience as we handled new issues compounded by the need for remote working.

Lewis Booth
Chair of the Audit Committee

REMUNERATION

Key areas of focus in 2020
- Responding to the challenges of COVID-19
- New remuneration policy
- Wider workforce remuneration

Areas of focus for 2021
- Continue to review and carefully monitor the incentive measures and targets to ensure that they remain aligned with performance and strategy, including ongoing consideration of sustainability measures
- Implement the new remuneration policy, subject to shareholder approval
- Gain further insights into the remuneration of the workforce to further inform decisions on senior management reward

I am pleased to present my report as Chair of the Remuneration Committee, outlining what we have accomplished in a very challenging year.

What has happened

As a result of the effects of COVID-19, we have had to take significant actions to manage the Group's financial position and we are well aware that the impact is being acutely felt by all of our stakeholders, including our employees, who are affected by restructuring and cost mitigation activity.

Against this backdrop, there have been no salary increases and the Executive Directors took a salary reduction and a salary deferral as well as deferring part of their 2019 bonus. No Group-level bonuses will be paid for 2020 and the existing LTIP awards are not expected to vest for the next three years.

Looking forward, there remains significant uncertainty over the severity, extent and duration of the pandemic and therefore the timing and shape of the recovery in our key markets, particularly in the civil aviation sector. As a Committee, we are acutely aware of the need to reward and motivate our people to deliver in a way that aligns with the interests of our shareholders.

The Committee met on eight occasions between April and December to work through what needed to be done. Initially, we considered whether we could reset the incentive targets under our current policy but concluded that the current remuneration policy does not work and will not support the necessary actions required to restructure and accelerate the Group's recovery to future growth. We gave some thought to whether restricted stock would be appropriate but concluded that it would not drive the performance that we need to deliver in the next few years. We also considered the intense workload and elevated risks faced by management and, whilst we recognise the impact of the pandemic on all of our stakeholders, we are increasingly concerned that we retain our key talent.

We concluded that the right course of action was to develop a new policy which is bespoke to Rolls-Royce and our unique circumstances.

What needs to happen

We need to incentivise our people to deliver our business strategy and restore our financial performance by:

- generating cash to strengthen the balance sheet and reduce net debt;
- improving operating margins to improve the quality of our underlying profit and cash;
- completing an ambitious restructuring plan in the Civil Aerospace business and the central functions;
- growing revenue in our Power Systems and Defence businesses; and
- engaging our people to deliver during an unprecedented period of disruption for the organisation.

Our remuneration policy must move us from where we are now to where we need to be. Accordingly, we have focused on:

- retaining our talent;
- emphasising short-term performance turning into longer-term growth;
- delivering reward in shares and requiring the long-term holding of those shares; and
- ensuring alignment between the Executive Directors, shareholders and the wider organisation.

We must balance the incentivisation of key short-term measures that are critical to our future success with longer-term value creation for our shareholders, whilst at the same time ensuring that our people are motivated and rewarded for delivering our recovery.

New remuneration policy

The policy comprises a new incentive plan designed to reward the key drivers for success, recognising the very different challenges for each of our businesses. It provides greater focus on shorter-term performance measures reflecting the urgency of our challenges and the importance of the actions during 2021 but includes longer-term, cumulative measures in 2022 and 2023. This is a hybrid scheme which replaces the current annual bonus and LTIP structure and removes the risk of windfall gains arising from grants issued up front in a traditional LTIP. Any awards from this plan will be deferred into shares after the end of the performance period at the share price at that time.

At the same time, we have reduced the maximum award which can be earned under the plan recognising the wider stakeholder environment and the shorter-term focus. This structure will give the Committee greater control to determine incentive outturns based on performance against strategy and we retain our usual discretion to ensure a fair result.

The shorter-term focus of the metrics is balanced by the delivery of incentive awards in shares, which will be required to be held for long periods, ensuring alignment with our shareholders. In addition, Executive Directors will take a portion of their salary in shares, deferred for two years, which further contributes to that alignment.

We have taken the opportunity to lower overall fixed reward, reducing Executive Directors' pension contributions to 12% with effect from January 2021, which fully aligns the Executive Directors' pension to the wider workforce.

We are focused on creating the right incentive structure for our business given our current circumstances. The new policy represents an intervention under extraordinary circumstances. As a Committee we will carefully monitor these arrangements in the context of the business circumstances and consider a more business-as-usual structure when and if appropriate.

Consultation with shareholders

We have consulted with our largest shareholders and the proxy agencies on the new policy. The meetings have been extremely helpful to enable us to explain the context for the bespoke approach and why it is appropriate for Rolls-Royce in these challenging circumstances. Our shareholders have given us valuable feedback to enable us to finalise the proposed policy and we have received a good level of support for both the overall approach and detailed policy.

Appointment of Chief Financial Officer

I am pleased that we have appointed Panos Kakoullis as our new Chief Financial Officer, who will join us in May 2021. We intend to apply the proposed new policy in setting Panos' reward package and further details are included in the report (see page 95).

2020 outturns

We had made good progress in 2019 on our transformation journey, reducing our cost base and improving cash generation to hit our cash flow target of £1bn. However, the global pandemic has been devastating for the aerospace industry in 2020, forcing us fundamentally to reset our business targets and focus on strengthening our balance sheet to support our financial recovery.

It became clear from an early stage in 2020 that our in-year financial performance (both profit and cash) would be severely impacted and that we would not achieve the financial targets to generate a bonus. With respect to non-financial metrics, we were pleased to see a continued strong response to our engagement survey with an improved overall score despite the difficult circumstances that our employees faced with salary reductions and deferrals, furlough and significant numbers of redundancies. It is testament to the loyalty and resilience of our management team and employees that we have seen improved employee engagement against this backdrop.

As a result of our financial performance in 2020, the Committee has confirmed that no bonus will be payable at Group level. This is consistent with the experience of all our stakeholders and is entirely appropriate for our circumstances.

Our long-term incentive plan targets for the 2018 plan will have a zero outturn. The severe effect of the pandemic on our financial performance in 2020 and beyond will also mean that the 2019 and 2020 LTIPs are no longer expected to vest.

The Committee feels that this is in line with the experience of our stakeholders and has chosen not to revisit these plans but rather to focus on a new remuneration policy that rewards delivery and execution of the actions that are needed in the next few years.

2020 salary review

The Committee has reviewed the salary levels of the Executive Directors and has concluded that there will be no increases in 2021 in line with the majority of the wider workforce. This will be the fourth year of zero increases for Executive Directors but is appropriate in the circumstances.

Wider workforce

The Committee has been kept informed of the broader reward actions taken across the workforce this year which have included furlough, reduced hours working, salary reductions and deferrals. Mindful of the difficult position that the Group faced and the experience of all stakeholders, the Executive Directors led the way, by agreeing to the deferral of 30% of their 2019 bonus, taking a 10% salary reduction plus a 10% salary deferral from April to December 2020. The Executive Directors also agreed to reduce pension allowances to 12% of salary from 1 January 2021. This reduction is sooner than previously anticipated under our policy and fully aligns the Executive Directors' pension contribution rate to the UK workforce rate.

The Committee has also been keen to ensure that as the new remuneration policy has developed, there is alignment to the wider workforce and that we are putting a plan in place that can cascade down the organisation rather than focusing only on the Executive Team. This has been front of mind in developing the metrics that will apply across the Group's bonus plans, so that the whole organisation is focused on delivering financial performance via the metrics that are applicable to each business.

Membership and operation of the Committee

In addition to myself, members of the Committee during 2020 were Lewis Booth, Beverly Goulet and Sir Kevin Smith. All Committee members are independent Non-Executive Directors. Our biographies are on pages 64 to 66 and our meeting attendance is on page 69. In addition to the members of the Committee, the Chairman, Chief Executive, Chief Financial Officer and any of the Non-Executive Directors may attend one or more meetings at the invitation of the Committee Chair. The Committee is supported by the Company Secretary, the Chief People Officer and the people director, performance and reward.

No Executive Director or Executive Team member was present during discussion of his or her own remuneration package and they were not involved in the final approval of the new remuneration policy design.

The Committee's responsibilities are outlined in its terms of reference, available at rolls-royce.com. We review these annually and refer them to the Board for approval. No changes were made in 2020.

Conclusion

Many hyperboles have been used to describe 2020 and I will not attempt to find more. Suffice to say that this has been an extremely difficult year for everyone, but I am confident that we have developed a remuneration policy which supports what we need to achieve over the next few years. As a Committee, we will be vigilant and mindful of our responsibilities. I appreciate the encouragement and support of our shareholders thus far and trust that they will continue to support us.

Irene Dorner
Chair of the Remuneration Committee

Advisers

During the year, the Committee had access to advice from Deloitte LLP's executive compensation advisory practice. Total fees for advice provided to the Committee during the year by Deloitte were £110,200 (2019: £96,025). Fees are based on a time and materials basis. Deloitte also advised the Company on tax, corporate compliance, employee global mobility, assurance and corporate finance and Deloitte MCS Limited provided consulting services. They also provided personal tax advice to Sir Ian Davis and Lewis Booth. In addition, Stephen Daintith's son is employed by Deloitte.

The Committee requests that Deloitte attend meetings periodically during the year. The Committee is exclusively responsible for reviewing, selecting and appointing its advisers and is satisfied that the advice it has received has been objective and independent and that there is no conflict of interest associated with any advice provided. Deloitte is a founding member of the Remuneration Consultants Group and adheres to its code in relation to executive remuneration consulting. The lead engagement partner has no other connection with the Company or individual directors.

Shareholder voting

The remuneration policy and report were last approved by shareholders at our 2020 AGM. Details of voting are shown in the table below.

Principal responsibilities

- Determine the remuneration policy for the Executive Directors and set the remuneration for the Chairman, the Executive Directors, the Executive Team and the Company Secretary.
- Review workforce remuneration and related policies and the alignment of incentives and rewards with our culture.
- Determine the design, conditions and coverage of annual incentives and LTIPs for senior executives and approve total and individual payments under the plans.
- Determine targets for any performance-related pay plans.
- Determine the issue and terms of all-employee share plans.
- Oversee any major changes in remuneration.

	For		Against		Withheld [1]
	Number of votes	%	Number of votes	%	Number of votes
Approval of the Directors' remuneration policy (7 May 2020)	1,380,264,437	96.73	46,667,350	3.27	7,597,751
Approval of the Directors' remuneration report (7 May 2020)	1,424,182,299	99.36	9,155,974	0.64	1,192,855

[1] Withheld votes are not counted towards the total percentage of votes cast.

Remuneration Committee focus during 2020

AREA OF FOCUS	MATTERS CONSIDERED	OUTCOME
Policy review and shareholder consultation	The impact of COVID-19 forced us to consider our remuneration policy out of cycle to ensure it supports delivery and execution of our business strategy in the next few years and aligns with stakeholder interests. Consultation with shareholders on proposed policy changes.	The Committee reviewed the current remuneration policy and concluded that changes had to be made to focus on the recovery of financial performance through cash generation, to strengthen the balance sheet and reduce net debt, improve operating margins and the significant restructuring of the business. A unique solution, specific to our circumstances, was proposed and discussed with shareholders and their feedback was incorporated into the final policy design. The key proposed changes are as follows: — a new incentive plan designed to reward the key drivers for success across our businesses, with focus on shorter-term metrics in 2021, with additional longer-term metrics in 2022 and 2023; — no LTIPs for the duration of the policy, minimising the risk of windfall gains; — a reduction in the maximum incentive level from 200% of target to 175%; — a focus on share-based reward with incentives delivered fully in shares and 30% of salary deferred into shares for the Chief Executive and 20% for other Executive Directors; — long deferral periods on incentive awards, increasing the average duration by one year versus existing incentives; and — an immediate reduction in pension contributions to 12% of salary to align with the wider workforce. In developing the policy, the Committee has also created alignment with the remuneration of the wider workforce though a cascade of key elements of the policy down through the organisation.

AREA OF FOCUS	MATTERS CONSIDERED	OUTCOME
Base salaries	Review of base salaries in accordance with the remuneration policy and the broader employee and external context.	The Committee reviewed the salaries of the Executive Directors in the context of the severe challenges facing the organisation and implemented a 10% reduction in salary from April to December for 2020 and a 10% salary deferral from April (which was repaid at the end of 2020). They also concluded that no increases would be made in 2021. Under the proposed policy, 30% of the CEO's salary and 20% of the CFO's salary will be delivered in shares with two-year deferral periods.
Annual bonus	2020 annual incentive – review of performance against the 2020 bonus targets.	Warren East and Stephen Daintith did not receive a bonus for 2020 as the performance targets were not met as a result of the significant impact of COVID-19.
Rolls-Royce incentive plan	2021 incentives – review of appropriate metrics and targets for the new incentive plan to reflect the key deliverables to restore financial performance in 2021 and beyond.	The Committee agreed that for 2021 a new incentive plan would be introduced to better reflect the current circumstances. This will replace the existing annual bonus and LTIP with a blend of short and long-term metrics. The following metrics would apply for 2021: — Profit – 37.5% — Cash – 37.5% — Cost base reduction – 15% — People – 10% The plan will focus on short-term metrics in 2021, in line with the Group's critical near-term priority to restore financial stability. For 2022 and 2023, a blend of short and long-term metrics will apply. Awards will be based 80% on Group performance and 20% on individual performance and will be delivered in shares. The target levels will be 220% of salary for the Chief Executive (maximum 385%) and 190% of salary for other Executive Directors (maximum 333%). The Committee also agreed the long-term metrics and weightings for the 2022 and 2023 incentive plans as follows (the short-term targets for those years will be set in early 2022 and 2023 respectively): **2022** Cumulative Cash – 20% Net Debt – 20% **2023** Cumulative Cash – 20% Relative TSR [1] – 25% Sustainability – 5% Targets for each metric were also agreed. [1] measured equally versus the FTSE 100 constituents and S&P global industrials index constituents.
Long-term incentive plan	2018 LTIP – review of achievement of performance measures.	The 2018 LTIP will not vest in March 2021 due to performance conditions not being met as a result of the significant impact of COVID-19. There will be no LTIP grants for the duration of the new policy. The only incentive plan in place will be the Rolls-Royce incentive plan.

REMUNERATION POLICY FROM 2021

Introduction

The policy will take effect from 13 May 2021, subject to shareholder approval at the AGM. The letter from the Chair of the Remuneration Committee sets out the decision-making process for recommending a new policy (see page 81).

Key policy themes

At the 2020 AGM, shareholders approved a new remuneration policy, which was broadly similar to the one that was in place previously, on the basis that at the time the Committee felt that it continued to support the business strategy; however, the devastating impact of COVID-19 on the Aerospace sector has forced the Committee to review the policy once again to ensure that it is right for the current circumstances and supports the necessary restructure and the recovery required to secure future growth over the next three years. They have concluded that a bespoke solution is needed that is tailored to the specific challenges facing Rolls-Royce and which will:

- **Retain talent** – Ensure that we have the right talent in our organisation to deliver the financial recovery and a return to growth. Shareholders have shared this concern during the consultation process. The changes we are proposing to our remuneration policy are designed to engage and motivate our talent and reward the behaviours that we need to succeed in the current circumstances. We also need to be able to recruit new talent into the organisation over the next few years to secure our future. Our policy needs to attract and motivate key talent to deliver and execute our strategy.
- **Place emphasis on short-term performance turning into longer-term growth** – This reflects the urgency of our challenges and the importance of the actions during 2021 to restore financial stability. We also recognise that we must balance the incentivisation of key short-term measures that are critical to our future success with longer-term value creation for our shareholders.
- **Emphasise shares and long-term holding of those shares** – As part of the balance of incentivising short-term performance with longer -term shareholder interests we are proposing that 100% of any incentive payment should be delivered in shares with meaningful deferral requirements. In addition, a proportion of fixed pay will be delivered in shares. This both protects cash and increases executive alignment with shareholders.
- **Ensure alignment between Executive Directors and the wider organisation** – It is important that our policy cascades throughout the organisation and all employees are rewarded for delivery and execution of our policy.

The Committee sees this as a temporary intervention and intends to consider a more business-as-usual policy in due course.

Changes to policy design

We have developed a policy which is specific to the challenges facing Rolls-Royce which has been carefully designed to incentivise our people to restore our financial performance through:

- cash generation to strengthen the balance sheet and reduce net debt;
- improved operating margins to improve the quality of our underlying profit and cash;
- an ambitious restructuring plan in the Civil Aerospace business and the central functions;
- revenue growth in our Power Systems and Defence businesses; and
- engaging our people to deliver during an unprecedented period of disruption for the organisation.

In creating this solution we have aimed to ensure that the focus on short-term performance is balanced with long-term value creation and whilst the overall target reward package is maintained, there is a significant reduction in the maximum, together with heavy emphasis on delivery in shares and long-term deferral of those shares.

No Executive Director or Executive Team member was present during discussion of his or her own remuneration package and they were not involved in the final approval of the new remuneration policy design.

A new incentive plan

This has been designed to reward the key drivers for success across our businesses, supporting the financial recovery required in 2021 and beyond. Initially the focus will be on short-term metrics in 2021; cash, profit, cost base reduction and people. For 2022 and 2023 longer-term metrics will be introduced including net debt reduction, cumulative profit and cash, TSR and a sustainability metric. The short-term metrics will be set annually, whereas the long-term metrics have been set by the Committee at the beginning of 2021. The structure of the incentive plan is designed to reflect the urgency of our challenges and the importance of delivery and execution in 2021. There will be no cash awards from this plan – any awards will be delivered in shares.

	2021	2022	2023
Financial			
Cash	37.5%	20.0%	20.0%
Profit	37.5%	20.0%	20.0%
Costbase reduction	15.0%	10.0%	
Total financial	**90.0%**	**50.0%**	**40.0%**
Non-financial			
People	10.0%	10.0%	10.0%
Total non-financial	**10.0%**	**10.0%**	**10.0%**
Long term [1]			
Cumulative cash (2 year)		20.0%	
Net debt		20.0%	
Cumulative cash (3 year)			20.0%
Relative TSR			25.0%
CO_2 sustainability			5.0%
Total long term		**40.0%**	**50.0%**
Total	**100.0%**	**100.0%**	**100.0%**

[1] Long-term targets set in 2021.

This plan will be the only incentive plan in operation for the period of the policy; it will replace the current annual incentive and long-term incentive plan. This removes the risk of windfalls arising from grants issued at current share price and places greater control for the Remuneration Committee to determine incentive outturns based on performance against strategy.

The target award level for the CEO will be 220% of salary, and 190% of salary for other Executive Directors.

A reduction in maximum potential awards

This recognises the stakeholder environment and shorter-term performance periods upon which a significant proportion of the incentives over the three-year period would be based. The maximum is reduced from 200% of target to 175%. For the Chief Executive, this is from 430% to 385% and for other Executive Directors, from 375% to 333%.

Delivery of incentives and pay in shares

All awards from the incentive will be deferred into shares at the end of a performance period and will be settled as follows:

- 40% after three years
- 60% after four years

When compared with the current combination of cash bonus, deferred bonus shares and LTIP (including holding periods) the actual duration of shareholdings is materially increased. In addition, 30% of salary will be deferred into shares for the Chief Executive and 20% for other Executive Directors, which will be required to be deferred for two years. This creates alignment with the long-term interests of our shareholders and balances the focus on shorter-term metrics, helping to ensure the longer-term balance in the reward package.

Pension reduction

In the current policy we committed to reduce pension contributions for existing Executive Directors from a maximum of 25% of salary to 17% by 2022 to align with the wider workforce rate for existing UK employees. 17% was a weighted average wider workforce rate at that time, which has now reduced to 12% of salary following the closure of the UK Defined Benefit pension plan to future accrual. As part of the new policy we have reduced pension contributions to 12% of salary with effect from 1 January 2021.

Consideration of shareholder feedback

During the policy review we have engaged in detailed consultation with our largest shareholders and the proxy agencies to provide context for the proposed new policy and gain feedback on how it could be improved. We have been pleased that the majority of our shareholders understand the context for the new policy and support the approach of developing a bespoke solution that is unique to our circumstances. The overall feedback from this consultation was:

- an understanding of the need to place more focus on the short-term performance metrics to deliver financial stability;
- support for us continuing to apply performance based incentives, rather than using restricted stock;
- a need to align the incentive targets with the promises made in our equity raise;
- support for alignment of shareholder interests through a significant proportion of the package being delivered in shares;
- recognition of the accelerated pension reduction to 12% of salary and the reduction in maximum incentive award to 175% of target;
- the importance of focusing on talent retention and attraction;
- the importance of aligning the wider workforce with the Executive Directors' remuneration;
- the approach is simple and well balanced;
- the trust placed in the Remuneration Committee's track record in applying discretion – as this is expected to be key to ensuring appropriate outcomes for the next three years. Setting stretching but achievable targets will be key as will the disclosure of those targets; and
- support for inclusion of a CO_2 based sustainability metric as a long-term measure.

These views have been reflected in the final policy design for 2021.

Summary of our revised remuneration policy

Fixed pay

- Base salary
- Benefits
- Pension

Variable Pay

Rolls-Royce Incentive Plan

80% Group performance		20% personal performance
Financial: Profit Cash Cost base reduction	Non-financial: People	Goals and leadership behaviours

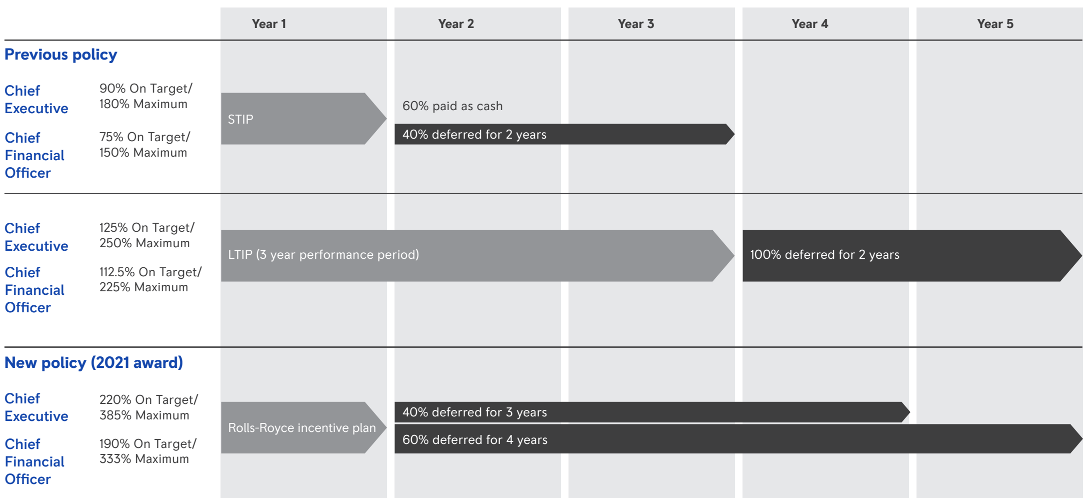
Long-term metrics to be included in 2022/2023
Cumulative profit, cumulative cash, net debt reduction, TSR, sustainability

All awards to be made at the end of the performance period in shares
40% settled after three years and 60% after four years

Malus and clawback – Incentive awards are subject to malus and clawback provisions where there has been a material misstatement of audited results; serious financial irregularity; material financial downturn or an event causing a material negative impact on the value of the Group; material failure of risk management; a serious breach of Our Code; individual misconduct or actions that materially damage the Group; a breach of or inadequate response to a significant HSE or other environmental issue; and/or materially incorrect calculation of an award. These provisions apply from the start of the performance period to three years after date of grant or the settlement date, if later.

Shareholding requirement – Executive Directors are required to work towards holding beneficially-owned shares equivalent in value to a percentage of their salary by retaining at least one half of after-tax shares released from the incentive plan until this requirement is met. For the Chief Executive this requirement is 250% of salary and for other Executive Directors this requirement is 200% of salary. In addition, the lower of their shareholding requirement or their actual shareholding at leaving date (based on shares vesting following the introduction of the 2020 policy) must normally be retained by Executive Directors for 12 months following leaving date and then 50% of that amount for the following 12 months.

Summary of new incentive compared to previous policy



Remuneration policy table

The table below sets out each element of Executive Directors' remuneration.

Pay element – fixed pay

Base salary	
Purpose and link to strategy	The Company provides competitive salaries suitable to attract and retain individuals of the right calibre to develop and execute the business strategy.
Operation	Salaries are reviewed, but not necessarily increased, annually. Decisions on salary are informed but not led by reference to companies of a similar size, complexity and international reach. A proportion of salary may be deferred into shares for up to two years.
Maximum opportunity	Any salary increases will be assessed annually and will not normally exceed average increases for employees in other appropriate parts of the Group. The Committee may exercise discretion to make larger increases in circumstances where it is necessary to address particular issues or risks, including growth in the role for new appointments.
Benefits	
Purpose and link to strategy	The Company provides competitive benefits suitable to attract and retain individuals of the right calibre to develop and execute the business strategy.
Operation	Benefits may include car or car allowance and related costs, financial planning assistance, private medical insurance, life assurance and other appropriate benefits at the discretion of the Committee. Relocation support or support for accommodation and travel may be offered to executives where necessary. Executive Directors may participate in all-employee share plans including ShareSave and the Share Incentive Plan.
Maximum opportunity	Benefits excluding all employee share plans, and any accommodation, relocation and associated tax costs will not exceed £100,000 per annum.
Pension	
Purpose and link to strategy	The Company provides a competitive retirement savings plan suitable to attract and retain individuals of the right calibre to develop and execute the business strategy.
Operation	Executive Directors are offered membership of a defined contribution plan. A cash allowance may be payable in lieu of pension contributions.
Maximum opportunity	The maximum contribution is 12% of base salary only.

Pay element – variable pay

Rolls-Royce incentive plan	
Purpose and link to strategy	To incentivise the execution of the business strategy, delivery of financial targets, and the achievement of personal objectives.
Operation	Incentives are determined based on Group financial performance and the individual performance of the Executive Directors. Group measures may combine both short and long-term measures. The Committee may also apply non-financial metrics that support the underlying strategic priorities for the forthcoming year and/or adjust the pay-out level to ensure the outturns reflect performance. Maximum incentive levels will reduce from 200% to 175% of target. This reduction in maximum opportunity means that 29% of the maximum opportunity is payable if base performance is achieved and 57% of maximum for target performance. The financial and non-financial metrics are generally set with reference to the prior year and to the budgets and business plans for the coming year, ensuring the targets are appropriately stretching. Metrics may be one-year or a combination of one-year and multi-year cumulative metrics. All the incentive is compulsorily deferred into shares: 40% for three years and 60% for four years, and released subject to continued employment. Deferred shares may attract an issue of C Shares or equivalent during the deferral period.

Pay element – variable pay

Rolls-Royce incentive plan (continued)	
Operation (continued)	Awards are subject to malus and clawback provisions where there has been a material misstatement of audited results; serious financial irregularity; material financial downturn or an event causing a material negative impact on the value of the Group; material failure of risk management; a serious breach of Our Code; individual misconduct or actions that materially damage the Group; a breach of or inadequate response to a significant HSE or other environmental issue; and/or a materially incorrect calculation of an award. These provisions apply from the start of the performance period to three years from the date of grant or the settlement date, if later. For awards granted prior to the adoption of this policy, legacy malus and clawback provisions may apply. The Committee has discretion to adjust the formulaic outcome (including down to zero) to ensure alignment of pay with performance and fairness for shareholders and participants.
Maximum opportunity	The normal annual maximum for the Chief Executive is 385% of salary and 333% for other Executive Directors.
Performance measures	The incentive is weighted 80% on Group metrics, and 20% on individual performance. Within the Group metrics: — at least 85% is based on Group financial targets (for example profit and free cash flow); — up to 15% is based on non-financial metrics such as employee engagement and sustainability — individual objectives are set and agreed with the Remuneration Committee at the start of each year, to reflect the prevailing business context; and — the Committee may, in the context of the underlying business strategy, use different performance measures.

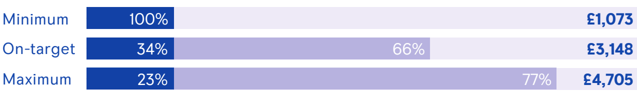
The table below sets out the main elements of Non-Executive Directors' remuneration.

Pay element

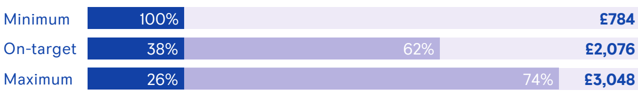
Fees	
Purpose and link to strategy	To reward individuals for fulfilling their role and attract individuals of the skills and calibre required.
Operation	The Committee makes recommendations to the Board on the Chairman's remuneration. The Chairman and the Executive Directors determine the remuneration of the Non-Executive Directors. Levels take into account fees paid by other companies of a similar size and complexity. The Chairman is paid a single fee. Other Non-Executive Directors are paid a base fee covering Board and Board Committee membership, with Chairs of Committees, the Senior Independent Director and the Employee Champion receiving an additional fee.
Maximum opportunity	The maximum total remuneration payable to Non-Executive Directors, including the Chairman, is £1,600,000 per annum.
Benefits	
Purpose and link to strategy	To devote maximum time and attention to the requirements of the role.
Operation	Travel, hotel and subsistence incurred in attending meetings are reimbursed by the Company. The Group may pay tax on such benefits. It may provide support with tax matters for Non-Executive Directors based outside the UK. The Chairman has occasional use of chauffeur services.
Maximum opportunity	Maximum value of £5,000 per annum towards tax advice and filing, and £15,000 per annum for chauffeur services.

Remuneration policy – worked examples for 2021

Chief Executive £000



Chief Financial Officer £000



■ Fixed remuneration (including salary, benefits and pension)
■ Rolls-Royce incentive plan

Minimum – fixed remuneration (salary, pension, benefits), no incentive award.
On-target – fixed remuneration, 57% of maximum incentive award.
Maximum – fixed remuneration, 100% of maximum incentive award.
There is no share price impact as incentive awards are granted following the end of the performance period.

Performance measures and targets

The Committee will set Group financial targets for incentive awards with reference to the prior year and to forward-looking business forecasts, ensuring the targets are appropriately stretching. Metrics may include both annual and longer-term measures.

The Committee may, in the context of the underlying business strategy, use different performance measures for incentives and/or vary the weightings of the measures, including increasing the proportion based on Group measures.

The measurement of performance against performance targets is at the Committee's discretion, which may include appropriate adjustments to financial or non-financial elements and/or consideration of overall performance in the round. Adjustments may be either upwards or downwards.

Long-term performance conditions may also be replaced or varied if an event occurs or circumstances arise which cause the Committee to determine that the performance conditions have ceased to be appropriate.

Policy on new appointments

The Committee will appoint new Executive Directors with a package that is in line with the remuneration policy. Base salary may be set at a higher or lower level than the previous incumbent. The maximum incentive opportunity on appointment is 385% for the Chief Executive and 333% for other Executive Directors.

Remuneration forfeited on resignation from a previous employer may be compensated. This will be considered on a case-by-case basis and may comprise cash or shares. In general:

- if such remuneration was in the form of shares, compensation will be in the Company's shares;
- if remuneration was subject to achievement of performance conditions, compensation will, where possible, be subject to performance (either Rolls-Royce performance conditions or actual/forecast performance outturns from the previous company); and
- the timing of any compensation will, where practicable, match the vesting schedule of the remuneration forfeited.

Legacy terms for internal appointments may be honoured, including any outstanding incentive awards. If an Executive Director is appointed following a merger or an acquisition of a company by Rolls-Royce, legacy terms and conditions may be honoured.

Wider workforce considerations

When setting remuneration for Executive Directors and the senior management team, the Committee carefully considers wider remuneration across the Group, including salary increases, bonus awards, share plan participation and pay ratios between Executive Directors and other employees.

This has been a particular area of focus for the Committee in designing a new policy that is capable of cascade down the organisation.

There have been a number of additional areas where alignment has been created between Executive Directors and the workforce in 2020 including salary reductions and deferrals, and alignment of pension contributions at 12% of salary.

At more senior levels, remuneration is increasingly long-term and larger proportions are dependent on Group and business performance, as well as individual performance and an increasingly larger proportion is delivered in the form of shares. In terms of the management population generally, the direction of travel is to re-balance the total reward package from fixed elements to variable performance-related elements to support cultural transformation. The Committee periodically reviews benchmarking data to ensure that they are aligned with market practice within the appropriate comparator groups, as one source of data.

We are committed to sharing business success across the organisation, with employees participating in a short-term incentive plan. There is strong alignment of business metrics between the Executive Directors bonus plan and those in which the majority of the workforce participate. In addition, the Group offers an all-employee sharesave plan to eligible employees globally every two years which aligns employee interests with those of our shareholders. This continues to be a popular benefit with over 40% of employees joining the most recent plan.

Input on the new remuneration policy was sought from the Company's Board apprentice cohort. Application of the policy will be influenced by the remuneration arrangements for all employees. Irene Dorner has designated responsibility for engaging with employees and bringing their voice into the boardroom, in addition to being the Chair of the Remuneration Committee, which further strengthens the link between employees and executive remuneration. See stakeholder engagement, page 72.

Share plans

The Committee retains a number of discretions consistent with the relevant share plan rules. In the event of any variation in the share capital of the Company, a demerger, special dividend, distribution or any other transaction which will materially affect the value of shares, the Committee may make an adjustment to the number or class of shares subject to award.

The treatment of leavers in our ShareSave and Share Incentive Plan is covered by the respective plan rules. Change of control provisions in respect of employee share plans are set out on page 210.

Termination

The Company is required to give Executive Directors 12 months' notice under their service contracts. Payment in lieu of notice will not exceed the value of 12 months' salary, benefits and pension contributions. Both mitigation and the timing of payments through the notice period will be considered by the Committee where appropriate, as will the funding of reasonable outplacement and other professional fees. There is no automatic entitlement to an incentive. Taking into account the circumstances, the Committee has discretion to award an incentive applying the relevant performance conditions and with appropriate time pro-rating.

Deferred shares from the incentive plan will generally be retained in cases such as retirement, death, injury, ill-health, redundancy or any other reason at the discretion of the Committee and may include appropriate time pro-rating. Awards will typically vest at the normal time unless the Committee determines otherwise.

For the LTIP grants issued under the previous policy, the rules state that unvested awards may be preserved at the Committee's discretion according to the circumstances. In such cases vesting will be at the normal date, subject to the established performance conditions, and pro-rated to employment in the performance period. In cases such as death and terminal illness, the Committee also has the discretion to vest the awards immediately using an estimate of future outturn. If an individual leaves after the LTIP shares have vested but during the holding period, shares will not be forfeited but the holding period will remain in force. The Committee also has the discretion to mitigate or clawback awards where an Executive Director retires and then becomes employed or engaged by another business in a non-voluntary capacity within 12 months.

Post-employment

Post-employment, an Executive Director will normally be required to retain the lower of their shareholding requirement or their actual shareholding at leaving date (based on shares vesting following the introduction of the new policy) for one year after leaving, and 50% of this level for a second year. The Committee can waive or modify this requirement (for example in compassionate circumstances).

Service contracts

The service contract for Warren East includes 12 months' notice of termination from the Company and six months' notice from the Executive Director. The service contracts for Stephen Daintith and Panos Kakoullis include 12 months' notice from the Company and 12 months' notice from the Executive Director. All contracts include the entitlement to paid holidays, sick pay, and other standard employment terms including reimbursement of reasonable business expenses.

The Chairman and Non-Executive Directors have letters of appointment. No compensation is payable to the Chairman or to any Non-Executive Director if the appointment is terminated early or if they fail to be re-elected at an AGM. Service contracts and letters of appointment can be viewed at the Company's registered office.

Legacy commitments

Any remuneration payments and/or payments for loss of office made under legacy arrangements prior to the approval of the Company's remuneration policy may be paid out subject to the terms of the remuneration policy in place at the time they were agreed. For these purposes, 'payments' include the Company satisfying awards of variable remuneration and, in relation to an award over shares, the terms of the payment are agreed at the time the award is granted. LTIPs granted under previous policies remain in place, consistent with the terms of that policy.

Minor amendments

The Committee may make minor amendments to the policy (for regulatory, exchange control, tax or administrative purposes or to take account of a change in legislation) without obtaining shareholder approval.

Provision 40, section 41 disclosures

When developing the proposed remuneration policy and considering its implementation for 2021, the Committee was mindful of the Code and considers that the executive remuneration framework appropriately addresses the following factors:

Clarity	We provide open and transparent disclosures regarding our executive remuneration arrangements. We have explained the changes to our proposed remuneration policy in a way that highlights their alignment to both our vision and strategy as well as the provisions of the Code.
Simplicity	Remuneration arrangements for our Executives and our wider workforce are simple in nature and well understood by both participants and shareholders.
Predictability	Our remuneration policy contains details of maximum opportunity levels for each component of pay, with actual incentive outcomes varying depending on the level of performance achieved against specific measures.
Proportionality, risk, and alignment to culture	The metrics used to measure performance for incentive awards drive behaviours that are closely aligned to our vision and strategy. In particular our variable pay arrangements continue to focus on delivering an unprecedented level of transformation. The Committee considers that our variable pay structure does not encourage inappropriate risk-taking. The incentives are subject to the achievement of stretching performance targets, and the Committee's holistic assessment of performance that can result in the application of discretion. The use of holding periods, the payment of fixed salary in shares with holding periods, and our shareholding requirements (including after leaving employment with Rolls-Royce) provide a clear link to the ongoing performance of the business and therefore alignment with shareholders. Malus and clawback provisions also apply to the incentive plan.

REMUNERATION REPORT FOR 2020

Executive Directors' remuneration

The following pages show how we have applied our remuneration policy during 2020 and disclose all elements of remuneration received by our Executive Directors. Details of remuneration received by our Non-Executive Directors during 2020 can be found on pages 99 and 100.

Executive Directors' single figure of remuneration (audited)

	Salary (a)[1] £000		Benefits (b) £000		Bonus (c) £000		Long-term incentives (d)[2,3] £000		Pension (e) £000		Total remuneration £000		Total fixed remuneration £000		Total variable remuneration £000	
	2020	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Executive Directors																
Warren East	873	944	17	17	–	883	–	448	220	236	1,110	2,528	1,110	1,197	–	1,331
Stephen Daintith	629	680	22	20	–	530	–	297	144	150	795	1,677	795	850	–	827

1 Neither Warren East nor Stephen Daintith received a salary increase in 2020. The last increase made to Warren East was in September 2017. A 10% reduction in salary was applied from April to December 2020. In addition, a further 10% of salary was deferred. The deferred amount was repaid in December 2020.
2 The 2020 long-term incentives value is based on the 2018 LTIP award due to its three-year performance period ending on 31 December 2020. The 2018 LTIP award will lapse on 8 March 2021 as the performance conditions were not met.
3 The 2019 long-term incentives value is based on the 2017 LTIP award due to its three-year performance period ending on 31 December 2019. The 2017 LTIP award matured on 5 May 2020 at 53% of maximum, determined according to the achievement against the performance measures during the performance period. The 2019 long-term incentives value has been updated from the 2019 Annual Report. This value is now based on the share price on 5 May 2020 of 102.95p and has been adjusted for the rights issue.

a) Salary
The Company provides suitable competitive salaries to attract and retain individuals of the right calibre to develop and execute the business strategy. Given the significant impact of COVID-19 on the Group in 2020, Warren East and Stephen Daintith both had a temporary reduction in their salary from April to the end of 2020 and an additional 10% salary deferral (which was repaid in December 2020). The Committee reviewed the salary of Warren East as part of the remuneration policy review and agreed there would be no increases for 2021 (which is the fourth consecutive year of no pay adjustment). In addition as part of the policy review, 30% of his 2021 salary is proposed to be deferred into shares for two years.

Executive Director	Base salary as at 1 March 2021	Base salary as at 1 March 2020
Warren East	£943,500	£943,500
Stephen Daintith	£680,000	£680,000

b) Executive Directors' benefits (audited)
Benefits are provided to ensure that remuneration packages remain sufficiently competitive to attract and retain individuals of the right calibre to develop and execute the business strategy and to enable them to devote themselves fully to their roles. The taxable value of all benefits paid to Executive Directors during 2020 is shown below.

	Car or car allowance inc. fuel allowance £000		Medical insurance £000		Travel and subsistence £000		Total £000	
Executive Directors	**2020**	2019	**2020**	2019	**2020**	2019	**2020**	2019
Warren East	15	15	1	1	0	1	16	17
Stephen Daintith	17	17	2	2	3	1	22	20

c) Annual bonus outturn (audited)
The Company's annual bonus scheme is designed to incentivise the execution of the business strategy, delivery of financial targets and the achievement of personal objectives. Executive Directors receive any annual bonus awarded in March following the performance period. 60% of the bonus is paid in cash with the remaining 40% awarded in deferred shares. Deferred shares are held in trust for two years before being released, subject to the recipient still being employed by the Group and include the right to receive an amount equal in value to the C Shares issued during the deferral period. The annual maximum for the Chief Executive is 180% of salary and 150% for the other Executive Director(s):

— 80% of the award is based on Group performance

— 20% of the award is based on individual performance

The Committee reviewed the 2020 outturn against the performance measures.

Bonus outturn table

	Profit	Cash	Customer [1]	Employee Engagement	Total
Weighting	25.0%	50.0%	12.5%	12.5%	100.0%
Base (25%)	£890m	£970m	Performance measured as the average of business scorecards	3.58	
Target (50%)	£990m	£1,120m		3.66	
Maximum (100%)	£1,190m	£1,420m		3.74	
2020 Performance [2]	(£1,946m)	(£4,171m)	76.8%	3.68	
% of maximum	0.0%	0.0%	38.4%	62.5%	0.0%

Overall outturn is 0% as the Group base level of profit has to be met to generate any bonus.

[1] Customer metric is measured on the average of the business scorecards (see below).
[2] Adjusted to exclude ITP Aero, non-core businesses, FX and exceptional items.

Achievement of the base level of Group profit is the trigger for any bonus awards for Executive Directors and as it has not been met for 2020 due to the impact of the COVID-19 pandemic, no bonuses are payable to Warren East or Stephen Daintith and the Committee did not apply any discretion.

Definitions used for performance measures:

Profit – adjusted operating profit before tax for 2020.

Cash – free cash flow which is cash flow before acquisitions and disposals, shareholder payments and foreign exchange.

Customer metric – Group performance is assessed using an index score based on the average outcome of bespoke customer metrics for each of Civil Aerospace, Power Systems and Defence. This approach means that each business focuses on the most meaningful customer metrics (see page 17). The customer metrics for each business are below:

Civil Aerospace – OE delivery to purchase order, TotalCare engine availability, CorporateCare engine availability, Trent 1000 aircraft on ground (AOG).

Power Systems – OE delivery to purchase order, spares delivery to purchase order, claims per unit, time to solve.

Defence – OE delivery to purchase order, spares delivery to purchase order, engine availability, submarines composite delivery. The specific business targets are commercially sensitive.

Employee engagement – measured through our annual Gallup engagement survey. 72% of employees completed the survey and we achieved a Group score of 3.68, which showed a strong year-on-year improvement from 3.53.

Individual performance

Subject to achievement of a minimum profit threshold, the Executive Directors have 20% of their bonus based on achievement of their personal objectives. Personal performance objectives are set at the beginning of the year and are aligned with the Group's internal strategic priorities.

For Executive Directors, these have included:

- Deliver Group revenue, profit and cash in line with budget with specific focus on at least £1bn of free cash flow
- Strengthen the balance sheet with a view to regaining a Grade A credit rating
- Deliver Group restructuring measured by headcount reductions and run-rate cost savings of at least £400m by the end of 2020
- Accelerate progress on diversity and HSE against agreed plans and objectives
- Rebuild trust and confidence with Civil Aerospace customers

The Committee recognised that the impact of COVID-19 had rendered the majority of personal objectives set at the beginning of 2020 obsolete. In any case, as the minimum Group profit threshold had not been met, no personal element of bonus was payable.

The Committee noted the significant efforts made by the management team in addressing the severe impact of the COVID-19 pandemic, specifically initiating the largest restructure in our recent history, consolidating our global manufacturing footprint, delivering significant cost reduction measures and securing additional liquidity.

The Committee noted that in respect of HSE, despite the challenges faced in 2020, there was a continued focus on the healthy, safety and wellbeing of employees with a range of support measures being put in place for employees. There was a significant reduction in reportable injuries and the wellbeing target for all sites becoming 'LiveWell' accredited by 2020 was exceeded.

On diversity & inclusion, the 2020 target of women accounting for at least 17% of the global workforce was delivered by the end of 2020. In addition, there was a marked improvement in the attraction of diverse talent; for ELG hires in 2020, 50% were female and women now represent 30% of the Executive Team, Company Secretary and their direct reports.

2020 annual bonus outturn

	Group performance (% of maximum)	Individual performance (% of maximum)	Total bonus (% of maximum)	Total bonus (% of salary)
Warren East	–	–	–	–
Stephen Daintith	–	–	–	–

2019 deferred bonus shares

Grants of deferred shares from the 2019 annual incentive plan were made on 16th March 2020 as follows:

	Face value of shares on grant
Warren East	£353,246
Stephen Daintith	£212,163

There are no further performance conditions attaching to these shares. They are due to vest on 16 March 2022 subject to the rules of the plan.

d) Long-term incentives (audited)

Conditional share awards are made to Executive Directors under the LTIP to reward the execution and development of the business strategy over a multi-year period. The conditional shares are then subject to a further two-year holding period.

2018 LTIP awards

The following sets out details in respect of the March 2018 LTIP award for which the final year of performance was the 2020 financial year. The performance conditions were assessed to the end of 2020 and the shares are then subject to a two-year holding period.

	Weighting	Threshold (20% vesting)	Mid (50% vesting)	Maximum (100% vesting)	Performance achieved	Vesting as a % of maximum
CPS [1]	60%	78p	123p	162p	(94)p	0%
EPS [2]	20%	67p	80p	94p	(47)p	0%
Relative TSR v FTSE 100 constituents	10%	Median		Upper quartile	Below median	0%
Relative TSR v constituents of the S&P Global Industrials index	10%	Median		Upper quartile	Below median	0%
						Total vesting of 0%

[1] CPS ranges were adjusted to reflect M&A activity in line with the plan definition. The original targets were minimum 95p, mid 126p, maximum 158p.
[2] EPS ranges were adjusted to reflect M&A activity in line with the plan definition. The original targets were 73p, 86p, 103p.

e) Pension entitlements (audited)

Executive Directors are offered membership of a defined contribution plan. A cash allowance may be payable in lieu of pension contributions. For incumbent directors, the maximum employer contribution to a defined contribution plan (or to be taken as a cash allowance) for 2020 was 23% of salary for the Chief Executive and 21% of salary for the Chief Financial Officer.

From 1 January 2021, all Executive Directors will be offered an employer contribution of 12% of salary into the defined contribution pension plan (or cash allowance of equivalent value). This aligns to the average rate for the UK workforce. This reflects the reduction in the wider workforce UK rate to 12%, with the closure of the legacy defined benefit plan.

LTIP awards made in March 2020

The performance targets for awards made in March 2020 are shown below. Performance will be measured over three years to 31 December 2022.

	Threshold (20% vesting)	Mid (50% vesting)	Maximum (100% vesting)
CPS (60%)	162p	203p	244p
EPS (20%	85p	106p	127p
Relative TSR (20%)	Median	Between median and upper quartile	Upper quartile

	Numbers of shares [1]	% of salary	Face value of award [2] £000	Performance period end date
Warren East	481,771	250	2,359	31 December 2022
Stephen Daintith	312,500	225	1,530	31 December 2022

[1] Number of shares adjusted following the rights issue.
[2] Calculated as 250% of salary for Warren East and 225% of salary for Stephen Daintith, divided by share price at date of grant of 489.6p per share.

As disclosed at the time of the award, under the LTIP rules, the Committee has full discretion to ensure that the final outturns reflect all relevant factors, including consideration of any windfall gains. Currently, the LTIP awards are not expected to vest.

Other (audited)

Payments to past directors

An agreement was put in place between the Company and Colin Smith in 2017, for Colin to represent the Company in an ambassadorial capacity. The agreement was for up to 21.5 days for the latter part of 2017, 35 days for 2018 and 2019 and up to 20 days for 2020. This agreement has been extended for 2021 for up to 20 days. Total payments of £193,380 have been made under this agreement, of which £34,020 was paid in 2020.

Chief Financial Officer succession

As announced in August 2020, Stephen Daintith has resigned from the Company. He will leave Rolls-Royce on 19 March 2021. A statement in accordance with s430(2B) Companies Act 2006 will be available at rolls-royce.com from his leaving date, 19 March 2021. Stephen will not receive any payment for loss of office. Panos Kakoullis will join the Company as Chief Financial Officer on 3 May 2021. His remuneration arrangements are set out below. His incentive opportunity for 2021 will be time pro-rated. No buy-out arrangements were needed to facilitate his recruitment.

Implementation of remuneration policy in 2021

(Subject to approval by shareholders at the 2021 AGM)

Base salary

There will be no change to base salary for 2021; base salaries remain as: Warren East – £943,500; Stephen Daintith – £680,000; Panos Kakoullis – £680,000. 30% of Warren East's salary and 20% for Panos Kakoullis will be deferred into shares for two years.

Benefits

There will be no change to our approach to benefits in 2021, which includes car allowance, financial planning assistance, insurances and other benefits.

Pensions

The pension cash allowance for Warren East and Stephen Daintith was reduced to 12% of salary from 1 January 2021 in line with the rate applied to the wider UK workforce from the same date. Panos Kakoullis will receive a pension allowance of 12% of base salary.

Rolls-Royce incentive plan

For 2021, the Rolls-Royce incentive plan will be implemented in place of the existing bonus and LTIPs. Awards will be made based on 80% Group performance and 20% individual performance.

For 2021, the Group measures and weightings: profit before tax (37.5%); free cash flow (37.5%); cost base reduction (15%); and employee engagement (10%). Where targets are set with a one-year performance period, these are considered to be commercially sensitive and will be disclosed following the end of the performance period. The 2022 and 2023 awards will include longer term multi-year performance metrics as illustrated on page 87. Performance against targets and the details and context for the assessment of performance will be disclosed at the end of the relevant performance period. The Committee can disclose the following:

2022	Weighting	Target	2023	Weighting	Target
Cumulative cash (2 year target)	20%	(£1,215m)	Relative TSR (50% versus the FTSE 100 constituents and 50% versus the S&P global industrials index constituents)	25%	Median triggers threshold vesting and upper quartile maximum
Net Debt	20%	(£1,409m)			

The Committee may make appropriate adjustments and use judgement in assessing performance outcomes. It retains its overriding ability to use discretion to adjust any formulaic outcome to ensure that the final outcome is fair and justified in the context of the overall performance of the business.

Target opportunities:
- Chief Executive – 220% of salary
- Chief Financial Officer – 190% of salary (126% of salary pro-rated for time)

Maximum opportunities are 175% of target:
- Chief Executive – 385% of salary
- Chief Financial Officer – 333% of salary (222% of salary pro-rated for time)

Any awards will be deferred fully into shares which will be settled as follows:
- 40% after three years
- 60% after four years

Other information

Executive Directors' share interests (audited)

The Directors and their connected persons hold the following interests in the ordinary shares of the Company:

	Ordinary shares		Conditional shares not subject to performance conditions (deferred share bonus)	Conditional shares subject to performance conditions (LTIP)	Options over shares subject to savings contract (Sharesave)
	31 December 2020	11 March 2021	31 December 2020	31 December 2020	31 December 2020
Warren East	932,771	932,771	342,446	3,411,539	3,683
Stephen Daintith	613,876	613,876	205,675	2,218,540	3,545

Executive Directors' interests in vested and unvested share awards (audited)

Warren East	31 December 2019	Granted during the year	Rights issue adjustment	Vested awards	Lapsed awards [1]	31 December 2020	Market price at date of award (p)	Date of grant	Vesting date/ lapse date [2]	Market price at vesting (p)
LTIP 2017	281,954	–	285,990	–	132,518	435,426	820.17	05/05/17	05/05/22	–
LTIP 2018	275,083	–	526,453	–	–	801,536	857.47	08/03/18	08/03/23	–
LTIP 2019	264,532	–	506,261	–	–	770,793	891.67	15/03/19	15/03/24	–
LTIP 2020	–	481,771	922,013	–	–	1,403,784	489.60	16/03/20	16/03/25	–
Total	**821,569**	**481,771**	**2,240,717**	**–**	**132,518**	**3,411,539**				
Deferred share bonus (2017)	54,321	–	–	54,321	–	–	857.47	08/03/18	09/03/20	556.62
Deferred share bonus (2018)	45,376	–	86,840	–	–	132,216	891.67	15/03/19	15/03/21	–
Deferred share bonus (2019)	–	72,150	138,080	–	–	210,230	489.60	16/03/20	16/03/22	–
Total	**99,697**	**72,150**	**224,920**	**54,321**	**–**	**342,446**				
ShareSave (options) [3]	1,264	–	2,419	–	–	3,683	211.68	12/10/15	01/02/21	–

Stephen Daintith	31 December 2019	Granted during the year	Rights issue adjustment	Vested awards	Lapsed awards [1]	31 December 2020	Market price at date of award (p)	Date of grant	Vesting date/ lapse date [2]	Market price at vesting (p)
LTIP 2017	186,547	–	189,217	–	87,677	288,087	820.17	05/05/17	05/05/22	–
LTIP 2018	178,432	–	341,483	–	–	519,915	857.47	08/03/18	08/03/23	–
LTIP 2019	171,589	–	328,387	–	–	499,976	891.67	15/03/19	15/03/24	–
LTIP 2020	–	312,500	598,062	–	–	910,562	489.60	16/03/20	16/03/25	–
Total	**536,568**	**312,500**	**1,457,149**	–	**87,677**	**2,218,540**				
Deferred share bonus (2017)	26,708	–	–	26,708	–	–	857.47	08/03/18	09/03/20	556.62
Deferred share bonus (2018)	27,253	–	52,156	–	–	79,409	891.67	15/03/19	15/03/21	–
Deferred share bonus (2019)	–	43,334	82,932	–	–	126,266	489.60	16/03/20	16/03/22	
Total	**53,961**	**43,334**	**135,088**	**26,708**	–	**205,675**				
ShareSave (options) [3]	925	–	1,770	–	–	2,695	260.28	13/10/17	01/02/21	–
ShareSave (options) [3]	292	–	558	–	–	850	232.17	16/10/19	01/02/23	–

1 LTIP awards are subject to performance adjustment after three years (the performance period).
2 LTIP awards are subject to a two-year holding period following the performance period.
3 The ShareSave exercise price shown has been adjusted as a result of the rights issue in 2020.

Shareholding requirement (audited)

Executive Directors are required to work towards holding beneficially-owned shares equivalent in value to a percentage of their salary by retaining at least one half of after-tax shares released from the incentive plans until this requirement is met. For the Chief Executive this requirement is 250% of salary and for other Executive Directors this requirement is 200% of salary. The current shareholdings, as a percentage of salary, for Warren East and Stephen Daintith are 170% and 153% respectively.*

In addition Executive Directors are required to retain the lower of their shareholding requirement and their actual shareholding (based on shares vesting following the approval of the remuneration policy at the 2020 AGM) at the date of leaving for one year after leaving and 50% of this level for a second year. During 2021, the Committee will be formalising the structures in place to allow it to monitor and enforce post-employment shareholding requirements.

* The percentage of the requirement was calculated by reference to the average share price, over the three months to 31 December 2020 and salary as at the date of the last grant on 9 March 2020. LTIP awards subject to the two-year holding period following the performance period are included in this calculation. LTIP awards that have not been subject to the performance adjustment and ShareSave options are not included in this calculation.

Pay across the organisation

This section of the report enables our remuneration arrangements to be seen in context by providing:

— a comparison of the year-on-year percentage change in our Director's remuneration with the change in average remuneration across the UK;
— a year-on-year comparison of the total amount spent on employment costs across the Group and shareholder payments;
— a ten-year history of our Chief Executive's remuneration;
— our TSR performance over the same period; and
— an indication of the ratio between our Chief Executive's remuneration and the remuneration of employees.

Percentage change in Directors' remuneration

The following table compares the percentage change in each of the Director's salary/fees, bonus and benefits (excluding LTIP) to the average percentage change in salary, bonus and benefits for all UK employees from 2019 to 2020.

Change in remuneration

	Salary	Benefits	Annual bonus
Warren East	(7.5)%	(8.03)%	(100)%
Stephen Daintith	(7.5)%	11.01%	(100)%
Sir Ian Davis	(7.5)%	(84.55)%	n/a
Lewis Booth	(7.5)%	(73.58)%	n/a
Sir Frank Chapman	(7.5)%	(61.73)%	n/a
George Culmer (appointed 2 January 2020)	n/a	n/a	n/a
Irene Dorner [1]	14.26%	(92.41)%	n/a
Beverly Goulet	(7.5)%	(72.27)%	n/a
Lee Hsien Yang	(7.5)%	(82.56)%	n/a
Nick Luff	(7.5)%	–	n/a
Sir Kevin Smith	(7.5)%	(79.32)%	n/a
Jasmin Staiblin	(7.5)%	(72.72)%	n/a
Dame Angela Strank (appointed 1 May 2020)	n/a	n/a	n/a
UK employees average [2]	1.96%	2.23%	(89.94)%

[1] Irene Dorner became Remuneration Committee Chair on 1 January 2020.
[2] UK employees were chosen as a comparator group in order to avoid the impact of exchange rate movements over the year. UK employees including apprentices, graduates and interns, make up 43% of the total employee population and are employed by Rolls-Royce plc or its relevant subsidiaries. Rolls-Royce Holdings plc has no employees.

Chief Executive pay ratio

The Committee is mindful of the relationship between the remuneration of the Chief Executive and the wider employee population. This is the third year that we have published our CEO pay ratio and we have continued to use method A, as we believe that this is the most accurate and robust methodology. We have used the full time equivalent total remuneration of all UK employees at 31 December 2020.

Year	Method	25th percentile	Median	75th percentile
2020	Option A	26:1	22:1	19:1
2019	Option A	66:1	56:1	48:1
2018	Option A	92:1	77.1	66:1

For 2020, the salary and total remuneration for the three employees identified at the 25th, median and 75th percentiles are as follows:

Year	25th percentile	Median	75th percentile
Salary	£37.0k	£44.4k	£54.0k
Total Remuneration	**£42.7k**	**£50.1k**	**£59.4k**

The pay ratio has reduced again this year as a result of the 2020 bonus not meeting the threshold for payment and the 2018 LTIP plan not vesting.

The Chief Executive has a larger proportion of his total pay based on variable elements linked to performance than other UK employees. As outlined on page 90, the Committee has considered the wider workforce context in terms of alignment of total reward or the Executive Directors, with the pension changes being one such example from 2020.

The majority of employees participate in a bonus plan, with a good degree of alignment of financial measures with the Executives Directors' bonus plan. We also encourage all eligible employees to join our ShareSave plan. For our most recent launch in 2019 approximately 40% of our global population joined the plan, sharing in approximately 14 million shares and stock appreciation rights.

The Remuneration Committee believes that the median pay ratio for 2020 is consistent with the pay and progression policies for the Group's UK employees as a whole.

Relative importance of spend on pay

The following chart sets out the percentage change in payments to shareholders and overall expenditure on pay across the Group.

Payment to shareholders (£m) *
(Consolidated cash flow statement)

Group employment costs (£m)
(Note 8 – employee information)

* Value of C Shares redeemed during the year.

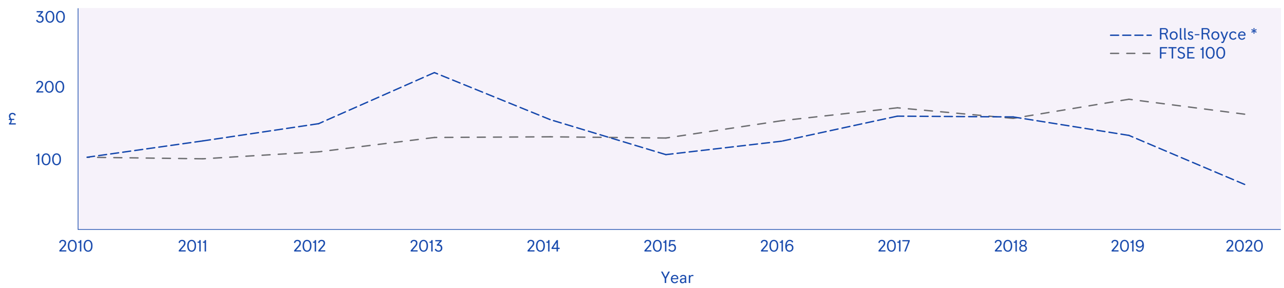
Chief Executive pay

Year	Chief Executive[1]	Single figure of total remuneration £000	Annual bonus as a % of maximum	LTIP as a % of maximum
2020	Warren East	1,110	–	–
2019	Warren East	2,528	52	53
2018	Warren East	4,075	60	100
2017	Warren East	2,331	68	–
2016	Warren East	2,089	55	–
2015	Warren East	543	–	–
2015	John Rishton	754	–	–
2014	John Rishton	2,596	–	45
2013	John Rishton[2]	6,228	55	100
2012	John Rishton[2]	4,577	85	–
2011	John Rishton	3,677	63	–
2011	Sir John Rose[3]	3,832	–	75

[1] On 31 March 2011, Sir John Rose retired and John Rishton was appointed. John Rishton retired on 2 July 2015 and Warren East was appointed as Chief Executive on 3 July 2015.
[2] John Rishton received a special grant of shares on joining the Company on 1 March 2011 to mirror the shares he forfeited on resigning from his previous employer. The share price had increased from 483.50p at the time this grant was made to 870p at the end of 2014. These are the main reasons why John Rishton's remuneration in 2012 and 2013 exceeded that of his predecessor.
[3] The remuneration for Sir John Rose does not include any pension accrual or contribution as he received his pension from 1 February 2008.

TSR performance

The Company's TSR performance over the previous ten years compared to a broad equity market index is shown in the graph below. The FTSE 100 has been chosen as the comparator because it contains a broad range of other UK-listed companies. The graph shows the growth in value of a hypothetical £100 holding in the Company's ordinary shares over ten years, relative to the FTSE 100 index.

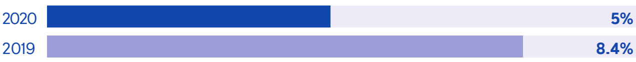


* Prior years have been adjusted for the rights issue.

Gender pay reporting

The Company is committed to creating a diverse and inclusive place to work where our people can be themselves and be at their best. More information about this can be found on pages 40 to 44. We published our UK gender pay gap in March 2021, which showed:

Median gender pay gap across all Rolls-Royce employees in the UK



Mean gender pay gap across all Rolls-Royce employees in the UK

Overall women represented 15.7% of our workforce at 5 April 2020. However, we continue to make progress in recruiting more women into senior positions and 25% of our women are now in management positions (compared to 17% of men). See pages 40 to 44 for further information on what we are doing to address diversity across the organisation.

Contractual arrangements

Each Executive Director has a service agreement that sets out the contract between that Executive Director and the Company.

Executive Directors' service contracts

	Date of contract	Notice period from Company	Notice period from individual
Warren East	21 April 2015	12 months	6 months
Stephen Daintith	21 September 2016	12 months	12 months

Payments received for serving on external boards

Executive Directors retain payments received from serving on the boards of external companies, the details of which are given below:

	Directorships held	Payments received and retained £000
Warren East	ASML Holding NV	52
Stephen Daintith	3i Group plc	81

Non-Executive Directors' remuneration

Single figure of remuneration (audited)

	Fees [1] (£000)		Benefits (£000)		Total remuneration (£000)	
Chairman and Non-Executive Directors	**2020**	2019	**2020**	2019	**2020**	2019
Sir Ian Davis	**393**	425	**–**	3	**393**	428
Lewis Booth	**88**	95	**11**	40	**99**	135
Ruth Cairnie (stepped down 31 December 2019)	n/a	**90**	n/a	**3**	n/a	**93**
Sir Frank Chapman	**83**	90	**1**	3	**84**	93
George Culmer (appointed 2 January 2020)	**65**	–	**1**	–	**66**	–
Irene Dorner [2]	**97**	85	**–**	1	**97**	86
Beverly Goulet	**65**	70	**3**	11	**68**	81
Lee Hsien Yang	**65**	70	**7**	40	**72**	110
Nick Luff	**65**	70	**–**	–	**65**	70
Brad Singer (stepped down 9 December 2019)	n/a	**66**	n/a	**21**	n/a	**87**
Sir Kevin Smith	**97**	105	**–**	2	**97**	107
Jasmin Staiblin	**65**	70	**4**	14	**69**	84
Dame Angela Strank (appointed 1 May 2020)	**42**	–	**–**	–	**42**	–
Total	**1,125**	1,236	**27**	138	**1,152**	1,374

1 In line with the senior management team, a 10% reduction in fees was applied from April to December 2020. In addition, a further 10% of fees was deferred. The deferred amount was repaid in December 2020.

2 Irene Dorner became Remuneration Committee Chair on 1 January 2020.

Non-Executive Directors' fees

The Chairman's fee is reviewed by the Board as a whole on the recommendation of the Committee. The review of the other Non-Executive Directors' base fees is reserved to the Executive Directors, who consider recommendations from the Chairman. No individual may be involved in setting his or her own fee. The Chairman and the Non-Executive Directors are not eligible to participate in any of the Group's share schemes, incentive arrangements or pension schemes. A facility is in place which enables Non-Executive Directors (who reside in a permitted dealing territory) to use some or all of their fees, after the appropriate statutory deductions, to make market purchases of shares in the Company on a monthly basis. Sir Ian Davis and Lee Hsien Yang use this facility.

Non-Executive Directors' fees

(Fees are unchanged for 2021)

	2020 £000	2019 £000
Chairman	425	425
Other Non-Executive Directors base fee	70	70
Chairman of the Audit Committee	25	25
Chairman of the Remuneration Committee	20	20
Chairman of the Safety, Ethics & Sustainability Committee	20	20
Chairman of the Science & Technology Committee	20	20
Senior Independent Director	15	15
Employee Champion	15	15

Non-Executive Directors' benefits (audited)

The benefits for Non-Executive Directors relate predominantly to travel, hotel and subsistence incurred in attending meetings. For Non-Executive Directors based outside the UK, the Company may also pay towards tax advice and the cost of making tax filings.

Non-Executive Directors' share interests (audited)

The Non-Executive Directors and their connected persons hold the following interests in the ordinary shares of the Company:

Chairman and Non-Executive Directors	31 December 2020	11 March 2021
Sir Ian Davis	378,550	384,279
Paul Adams [1] (appointed 11 March 2021)	n/a	10,000
Lewis Booth	303,333	303,333
Sir Frank Chapman	144,326	144,326
George Culmer (appointed 2 January 2020)	37,960	37,960
Irene Dorner	54,578	54,578
Beverly Goulet	40,560	40,560
Lee Hsien Yang	52,482	55,326
Nick Luff	43,333	43,333
Sir Kevin Smith	116,540	116,540
Jasmin Staiblin	–	–
Dame Angela Strank (appointed 1 May 2020)	–	–

1 Share interests held as American Depository Receipts.

Non-Executive Directors' letters of appointment

Our Non-Executive Directors serve three, three-year terms (nine years in total). In light of the COVID-19 pandemic, we announced extensions to the terms for both Lewis Booth and Sir Frank Chapman until the 2021 AGM at the latest.

Chairman and Non-Executive Directors	Original appointment date	Current letter of appointment end date
Sir Ian Davis	1 March 2013	28 February 2022
Paul Adams (appointed 11 March 2021)	11 March 2021	10 March 2024
Lewis Booth [1]	25 May 2011	24 May 2020
Sir Frank Chapman [1]	10 November 2011	13 May 2021
George Culmer	2 January 2020	1 January 2023
Irene Dorner	27 July 2015	26 July 2021
Beverly Goulet	3 July 2017	2 July 2023
Lee Hsien Yang	1 January 2014	31 December 2022
Nick Luff	3 May 2018	2 May 2021
Sir Kevin Smith	1 November 2015	31 October 2021
Jasmin Staiblin [1]	21 May 2012	20 May 2021
Dame Angela Strank	1 May 2020	30 April 2023

1 Lewis Booth, Sir Frank Chapman and Jasmin Staiblin will not be standing for re-election at the 2021 AGM.

Statutory requirements

The Committee's composition, responsibilities and operation comply with the principles of good governance, as set out in the Code, the Listing Rules (of the Financial Conduct Authority) and the Companies Act 2006. The Directors' remuneration report has been prepared on the basis prescribed in the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

SAFETY, ETHICS & SUSTAINABILITY

Key areas of focus in 2020
— Effects of COVID-19 on both people and product safety and oversight of the mitigations
— Maintaining product safety governance through organisational change and transfer to the new RRMS
— Improvement in HSE performance against targets
— Delivery of the Group's sustainability strategy
— Progress of the Group's ethics and compliance programme

Key areas of focus for 2021
— In-depth review of climate change principal risk
— Development of an operational environment strategy and next generation targets, aligning with our sustainability strategy
— Review of the product safety and compliance principal risks relative to our risk appetite

Activities and overview of 2020

Product safety
— we reviewed product safety and safety governance frameworks through organisational and systematic change;
— as a result of COVID-19, we considered the management of fleet safety while aircraft have been grounded and monitored safety following return to flight;
— we reviewed large engine safety management status reports;
— we provided oversight of the integration of Rolls-Royce Electrical activities into the Group's product safety governance system;
— we considered detailed reviews of in-service product safety issues;
— we analysed product safety policies, processes, performance metrics and training and scrutinised improvements; and
— the Committee and other Board members attended a series of deep dives into the operation of the safety management system.

HSE
— HSE performance and balanced scorecard, total reportable injury (TRI) rate and business reports were regularly considered;
— we monitored HSE programmes including safety cases, electrical safety, contractor management and employee wellbeing;
— we considered COVID-19 HSE impacts and mitigations and reviewed the HSE Group risk profile; and
— the Committee analysed shared learning from major and high-potential incidents, and tracked progress against HSE and environmental targets.

Ethics and compliance
— we discussed regulatory and prosecutorial matters;
— the Committee monitored and reported to the Board on concerns raised through the Ethics Line and reviewed detailed reports of significant issues;
— we reviewed the anti-bullying and harassment programme; and
— we monitored progress of the Group's ethics and compliance programme.

Sustainability
— we completed a strategic review of our sustainability approach, which is reported in the sustainability report (see pages 34 to 45);
— the Committee monitored progress against the sustainability strategy and its acceleration through COVID-19; and
— we reviewed sustainability reporting and communication expectations and supported sustainability engagement during 2020. We considered improvement plans for 2021.

Principal risks
— we undertook a review of the Product Safety, People Safety and Compliance principal risks and supported the development of more accurate risk indicators while scrutinising improvement plans; and
— we undertook a review of the People Safety Group risk appetite.

Role of the Committee
The Committee monitors the operation of the Group's product safety governance frameworks, scrutinising the development and implementation of changes. We review the Group's HSE performance, support improvement programmes, monitor incidents and investigate remedial actions. The Committee monitors the Group's compliance with legislative, regulatory and ethical standards while supporting management to embed ethics and compliance culture and behaviours. We endorse the Group's sustainability strategy, track progress towards sustainability targets and review the environmental impacts of products and operations. We continuously review the Product Safety, People Safety, Compliance and Climate Change principal risks.

The Committee's responsibilities are outlined in its terms of reference, available at rolls-royce.com. We review these annually and refer them to the Board for approval. No changes were made in 2020.

Membership of the Committee
In addition to myself, members of the Committee during 2020 were George Culmer, Irene Dorner, Lee Hsien Yang, Nick Luff and Dame Angela Strank. Dame Angela joined the Committee in May and Nick stepped down in July. All Committee members are Independent Non-Executive Directors. Our biographies are on pages 64 to 66 and our meeting attendance is on page 69. In addition to the members of the Committee, the Chairman, Chief Executive, General Counsel, Chief People Officer and Chief Technology Officer attend most meetings. The Committee is supported by the Chief Governance Officer.

Sir Frank Chapman
Chair of the Safety, Ethics & Sustainability Committee

SCIENCE & TECHNOLOGY

Key areas of focus in 2020
- Oversight of the Group's technology programme and approach to low carbon power
- Review of key programmes and business cases including SMRs, UltraFan and hybrid-electric regional aviation
- Review of digital, electrical and hybrid-electrical and hydrogen fuel-based technologies
- Continued review of efficiency and effectiveness of technology development

Key areas of focus for 2021
- Continued oversight of the Group's technology programme, providing support to technologies emerging from the net zero strategy in particular
- Continuous review of key programmes and business cases, including SMRs, UltraFan and Rolls-Royce Electrical
- Continued focus on the development of the Group's engineering capability in line with our future technology needs
- Resumption of site visits following a temporary suspension as a result of COVID-19

Activities and overview of 2020

Technology strategy

- we reviewed the strategic direction of the Group's research technology and development activities, with consideration to their environmental impact amongst other matters, and to ensure investment is appropriately allocated;
- the key technology programmes were kept under review throughout the year;
- we assisted the Board in its oversight of major R&D investment and provided assurance on its competitiveness and the adequacy of technology investment, with thorough consideration to the environmental impact of both new products and technology; and
- we maintained a focus on low carbon technologies. These underpin the Group's sustainability strategy and leverage the Company's advanced manufacturing capabilities as well as its nuclear power design expertise, to develop a near-zero carbon source of power generation by early 2030s, at a competitive cost of electricity.

Cross-sector technology

We continued to provide oversight of the effectiveness of key engineering and technology processes and operations, including the delivery of major product development and technology programmes.

Technology capabilities and skills

We discussed the processes for ensuring there was effective resourcing and development of required technological capability and skills.

Technology trends and risks

We provided assurance on the identification and management of key technological risks and reviewed and considered other topics or risks appropriate to the overall remit of the Committee as delegated by the Board.

Principal risk

We continued to monitor disruptive technologies as part of the Competitive Environment principal risk.

I would like to pay tribute to the work of our technology community and the flexibility, resilience and commitment of our people during these extremely challenging times. I thank them on behalf of the Board for their significant contribution which has enabled us to meet major technology milestones in the year that will be critical to the future of our Company.

Role of the Committee

In 2020, the Committee continues to provide dedicated focus to the research and technology part of the Group's R&D investment. This enables the Group to conceive, design and deliver world-class technology that meets our customers' current and future needs. We provide directional input and oversight of the Group's scientific and technological strategy, processes and related investments. In doing this, we place importance on ensuring active dialogue with engineering and technology leaders and experts, inviting relevant employees to Committee meetings, meeting with employees during site visits and developing future leaders through the Board apprentice programme.

The Committee's responsibilities are outlined in its terms of reference, available at rolls-royce.com. We review these annually and refer them to the Board for approval. No changes were made in 2020.

Membership of the Committee

In addition to myself, the members of the Committee during 2020 were Sir Frank Chapman, Jasmin Staiblin and Dame Angela Strank, all Non-Executive Directors are independent. Our biographies are on pages 64 to 66 and our meeting attendance is on page 69. In addition to the members of the Committee, the Chairman, Chief Executive, Chief Financial Officer and any of the Non-Executive Directors may attend one or more meetings at the Committee chair's invitation. The Committee is supported by the Corporate Governance Director and the Chief Technology Officer.

Sir Kevin Smith
Chair of the Science & Technology Committee

RESPONSIBILITY STATEMENTS

Statement of Directors' responsibilities in respect of the Financial Statements

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group Financial Statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. Additionally, the Financial Conduct Authority's Disclosure Guidance and Transparency Rules require the directors to prepare the group financial statements in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union and the parent company Financial Statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 Reduced Disclosure Framework, and applicable law).

Under company law, the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of the profit or loss of the Group and parent company for that period.

In preparing the Financial Statements, the Directors are required to:

— select suitable accounting policies and then apply them consistently;

— state whether, for the group and company, international accounting standards in conformity with the requirements of the Companies Act 2006 and, for the group, international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union, have been followed for the Group Financial Statements and United Kingdom Accounting Standards comprising FRS 101, have been followed for the Company Financial Statements, subject to any material departures disclosed and explained in the Financial Statements;

— make judgements and accounting estimates that are reasonable and prudent; and

— prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Group and parent company will continue in business.

The Directors are also responsible for safeguarding the assets of the Group and parent company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and parent company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and parent company. This enables them to ensure that the Financial Statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the Group's Consolidated Financial Statements, Article 4 of the IAS Regulation.

The Directors are responsible for the maintenance and integrity of the parent company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' confirmations

The Directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group and parent company's position and performance, business model and strategy.

Each of the Directors, whose names and functions are listed in the Directors' Report, confirm that to the best of his or her knowledge:

— the Group Financial Statements, which have been prepared in accordance with international financial reporting standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union, give a true and fair view of the assets, liabilities, financial position and loss of the Group;

— the parent company Financial Statements, which have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 Reduced Disclosure Framework, and applicable law), give a true and fair view of the assets, liabilities, financial position and result of the Company;

— the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and parent company, together with a description of the principal risks and uncertainties that it faces; and

— there is no relevant audit information of which the Company's auditor is unaware. The Director has taken all steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

By order of the Board
Pamela Coles
Company Secretary
11 March 2021

GREENHOUSE GAS EMISSIONS

In 2020, our total gross greenhouse gas (GHG) emissions were 423,000 tonnes of carbon dioxide equivalent (tCO_2e). This represents a decrease of 14% compared with 494,000 tCO_2e in 2019.

Aspect	tCO_2e	2016	2017	2018	2019	**2020**
Emissions from activities for which the company own or control including the combustion of fuel and operation of facilities. [Direct GHG Emissions (Scope 1)]	Global (excluding UK)	135,647	158,217	160,029	164,359	**140,676**
	UK	100,791	99,454	84,868	91,698	**88,353**
Emissions from the purchase of electricity, heat, steam and cooling purchased for our own use. [Indirect GHG Emissions (Scope 2) location-based]	Global (excluding UK)	163,999	154,484	152,787	150,997	**126,654**
	UK	144,334	122,635	100,808	86,803	**67,333**
Total gross GHG emissions	Global (excluding UK)	299,646	312,701	312,816	315,356	**267,330**
	UK	245,125	222,089	185,677	178,501	**155,687**
Energy consumption used to calculate above emissions- kWh	Global (excluding UK)	1,112,270,000	1,158,262,000	1,182,643,000	1,178,103,000	**1,000,063,000**
	UK	821,460,000	810,020,000	761,816,000	772,438,000	**702,092,000**
Intensity Ratio (total GHG emissions per £m revenue)	Total	40.0	38.6	33.3	30.1	**35.7**
Emissions from the purchase of electricity, heat, steam and cooling purchased for our own use. [Indirect GHG Emissions (Scope 2) market-based]	Global (excluding UK)	–	–	–	303	**2,399**
	UK	–	–	–	952	**2,090**
Outside of Scopes	Global (excluding UK)	–	–	–	0	**0**
	UK	–	–	–	20,743	**46,252**
Additional Supporting Information						
Electricity purchased from renewable sources – kWh	Global (including UK)	–	–	–	245,315,000	**311,619,000**
Energy generated on-site from renewable sources kWh	Global (including UK)		3,202,000	5,076,000	7,518,000	**8,811,000**

The above figures include 311,619,000 kWh of renewable energy purchases either backed by the Renewable Energy Guarantees of Origin (REGO) scheme in the UK or the Guarantees of Origin (GoO) from a relevant EU Member State. This energy is used by the majority of our facilities in the UK and Germany. The source in the UK includes a proportion of electricity that was generated by the combustion of biofuel. The associated emissions are included above under the location-based Scope 2 emissions (using grid average emission factors). They are also reported separately as market-based Scope 2 emissions (covering the emissions of nitrous oxide and methane) and Outside of Scopes (covering the emissions of carbon dioxide). This has resulted in a net reduction of 31,000 tonnes from our total GHG emissions. In addition, the above figures include 8,811,000 kWh of electricity and heat generated on-site from renewable energy sources, including solar panels and ground source heat pumps.

The figures for 2016 through to 2019 have been restated to remove emissions associated with the North American Civil Nuclear business sold on 3 February 2020 and Trigno Energy S.r.l. sold in April 2020. We include the reporting of fugitive emissions of hydrofluorocarbons (HFCs), associated with air conditioning equipment, into our GHG emissions figures. These include emissions from our facilities in the US and Canada only. We do not anticipate that emissions from other facilities will have a significant impact on the above figures.

With the exceptions noted above, we have reported on the underlying energy use and emission sources required under the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018. All these sources fall within the scope of our Consolidated Financial Statements.

We have used the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) as of 31 December 2014 utilising the operational control approach, supplemented by the GHG Reporting Guidance for the Aerospace Industry (version 3) and emission factors from the UK Government's GHG Conversion Factors for Company Reporting 2020. We report our emissions of: carbon dioxide; methane; nitrous oxide; hydrofluorocarbons and perfluorocarbons on a carbon dioxide equivalent basis. We had no emissions of sulphur hexafluoride or nitrogen trioxide.

Further details on our methodology for reporting and the criteria used can be found within our basis of reporting, available to download at rolls-royce.com.

DIRECTORS' REPORT

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Board of Directors

The Directors of the Company who were in office during the year and up to the date of signing the financial statements were Sir Ian Davis, Warren East, Stephen Daintith, Lewis Booth, Sir Frank Chapman, George Culmer, Irene Dorner, Beverly Goulet, Lee Hsien Yang, Nick Luff, Sir Kevin Smith, Jasmin Staiblin and Dame Angela Strank.

Directors' indemnities

The Directors have the benefit of an indemnity provision contained in the Articles. In addition, the Directors have been granted a qualifying third-party indemnity provision which was in force throughout the financial year and remains in force. Also, throughout the year, the Company purchased and maintained Directors' and Officers' liability insurance in respect of the Company and for its Directors and Officers.

Share price

During the year, the share price reduced by 53% from 234p* to 111p, compared to a 27% decrease in the FTSE aerospace and defence sector and a 14% decrease in the FTSE 100. The Company's share price ranged from 35p in October 2020 to 242p* in February 2020.

* Share price adjusted to reflect the rights issue.

Share capital

On 31 December 2020, the Company's issued share capital comprised:

8,367,596,989	Ordinary shares	20p each
27,540,015,227	C Shares	0.1p each
1	Special Share	£1

The ordinary shares are listed on the London Stock Exchange.

The Company issues non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend. Further information on payments to shareholders is on page 211.

Share class rights

The full share class rights are set out in the Company's Articles, which are available at rolls-royce.com. The rights are summarised below.

Ordinary shares

Each member has one vote for each ordinary share held. Holders of ordinary shares are entitled to: receive the Company's Annual Report; attend and speak at general meetings of the Company; appoint one or more proxies or, if they are corporations, corporate representatives; and exercise voting rights. Holders of ordinary shares may receive a bonus issue of C Shares or a dividend and on liquidation may share in the assets of the Company.

C Shares

C Shares have limited voting rights and attract a preferential dividend of 75% of LIBOR on the 0.1p nominal value of each share, paid on a twice-yearly basis. The Company has the option to redeem the C Shares compulsorily, at any time if: the aggregate number of C Shares in issue is less than 10% of the aggregate number of all C Shares issued on or prior to that time or the event of a capital restructuring of the Company; the introduction of a new holding company; the acquisition of the Company by another company; or a demerger from the Group.

On a return of capital on a winding-up, the holders of C Shares shall be entitled, in priority to any payment to the holders of ordinary shares, to the repayment of the nominal capital paid-up or credited as paid-up on the C Shares held by them, together with a sum equal to the outstanding preferential dividend which will have been accrued but not paid until the date of return of capital.

The holders of C Shares are only entitled to attend, speak and vote at a general meeting if a resolution to wind up the Company is to be considered, in which case they may vote only on that resolution.

Special Share

Certain rights attach to the special rights non-voting share (Special Share) issued to the UK Secretary of State for Business, Energy & Industrial Strategy (Special Shareholder). These rights are set out in the Articles. Subject to the provisions of the Companies Act 2006 (the Act), the Treasury Solicitor may redeem the Special Share at par value at any time. The Special Share confers no rights to dividends but in the event of a winding-up it shall be repaid at its nominal value in priority to any other shares.

Certain provisions of the Articles (in particular those relating to the foreign shareholding limit, disposals and the nationality of the Company's Directors) that relate to the rights attached to the Special Share may only be altered with the consent of the Special Shareholder. The Special Shareholder is not entitled to vote at any general meeting or any other meeting of any class of shareholders.

Restrictions on transfer of shares and limitations on holdings

There are no restrictions on transfer or limitations on the holding of the ordinary shares or C Shares other than under the Articles (as described here), under restrictions imposed by law or regulation (for example, insider trading laws) or pursuant to the Company's share dealing code. The Articles provide that the Company should be and remain under UK control. As such, an individual foreign shareholding limit is set at 15% of the aggregate votes attaching to the share capital of all classes (taken as a whole) and capable of being cast on a poll and to all other shares that the Directors determine are to be included in the calculation of that holding. The Special Share may only be issued to, held by and transferred to the Special Shareholder or their successor or nominee.

Shareholder agreements and consent requirements

No disposal may be made to a non-Group member which, alone or when aggregated with the same or a connected transaction, constitutes a disposal of the whole or a material part of either the nuclear propulsion business or the assets of the Group as a whole, without the consent of the Special Shareholder.

Authority to issue shares

At the 2020 AGM, authority was given to the Directors to allot new C Shares up to a nominal value of £500m as an alternative to a cash dividend.

In addition, an ordinary resolution was passed authorising the Directors to allot new ordinary shares up to a nominal value of £128,733,021 equivalent to one-third of the issued share capital of the Company. This resolution also authorised the Directors to allot up to two-thirds of the total issued share capital of the Company, but only in the case of a rights issue.

A further special resolution was passed to effect a disapplication of pre-emption rights for a maximum of 5% of the issued share capital of the Company.

These authorities are valid until the 2021 AGM or 30 June 2021, whichever is earlier, and the Directors propose to renew each of them at the 2021 AGM. The Board believes that these authorities will allow the Company to retain flexibility to respond to circumstances and opportunities as they arise.

Rights issue

A rights issue was approved by shareholders at a general meeting on 27 October 2020, resulting in the issue of a total of 6,436,651,043 new ordinary shares. The majority of these shares were subscribed for by existing shareholders before the rights issue closed at 11:00am on 11 November 2020 and the remaining shares were issued in the rump placing.

No. of ordinary shares	Price per share (p)	Date of issue
6,061,504,884	32	12 November 2020
375,096,792	90	13 November 2020

Authority to purchase own shares

At the 2020 AGM, the Company was authorised by shareholders to purchase up to 193,099,531 of its own ordinary shares representing 10% of its issued ordinary share capital.

The authority for the Company to purchase its own shares expires at the conclusion of the 2021 AGM or 30 June 2021, whichever is the earlier. A resolution to renew the authority will be proposed at the 2021 meeting.

The Company did not purchase any of its own ordinary shares under this authority during 2020.

Deadlines for exercising voting rights

Electronic and paper proxy appointments, and voting instructions, must be received by the Registrar not less than 48 hours before a general meeting.

Voting rights for employee share plan shares

Shares are held in an employee benefit trust for the purpose of satisfying awards made under the various employee share plans. For shares held in a nominee capacity or if plan/trust rules provide the participant with the right to vote in respect of specifically allocated shares, the trustee votes in line with the participants' instructions. For shares that are not held absolutely on behalf of specific individuals, the general policy of the trustees, in accordance with investor protection guidelines, is to abstain from voting in respect of those shares.

Major shareholdings

At 31 December 2020, the following shareholders had notified an interest in the issued ordinary share capital of the Company in accordance with section 5.1.2 of the Disclosure and Transparency Rules:

Shareholder	Date of change in interest	% of issued ordinary share capital*
Causeway Capital Management LLC	21 December 2020	6.98
Harris Associates L.P.	16 November 2020	4.99
Blackrock, Inc.	12 November 2020	5.99
The Capital Group Companies, Inc.	10 November 2020	8.69

* Percentages are shown as a percentage of the Company's issued share capital at the date of change in interest.

As at 11 March 2021, the following changes had been notified:

— Causeway Capital Management LLC notified the Company that on 25 January 2021 their holding had increased to 7.02% of issued ordinary share capital.

Changes to the Articles of Association

The Articles may be altered or added to or new articles may be adopted by a special resolution of the shareholders of the Company, subject to the provisions of the Act.

Change of control

Contracts and joint venture agreements

There are a number of contracts and joint venture agreements which would allow the counterparties to terminate or alter those arrangements in the event of a change of control of the Company. These arrangements are commercially confidential and their disclosure could be seriously prejudicial to the Company.

Borrowings and other financial instruments

The Group has a number of borrowing facilities provided by various banks. These facilities generally include provisions which may require any outstanding borrowings to be repaid or the alteration or termination of the facility upon the occurrence of a change of control of the Company. At 31 December 2020, these facilities were 26% drawn (2019: less than 2%).

The Group has entered into a series of financial instruments to hedge its currency, interest rate and commodity exposures. These contracts provide for termination or alteration in the event that a change of control of the Company materially weakens the creditworthiness of the Group.

Employee share plans

In the event of a change of control of the Company, the effect on the employee share plans would be as follows:

— Incentive Plan – deferred share awards will normally vest immediately, and may be time pro-rated. The new controlling company might offer an award in exchange instead (normally on substantially equivalent terms to the existing award).

— ShareSave – options would become exercisable immediately. The new controlling company might offer an equivalent option in exchange for cancellation of the existing option.

— Share Incentive Plan (SIP) – consideration received as shares would be held within the SIP, if possible, otherwise the consideration would be treated as a disposal from the SIP.

— LTIP – awards would vest on the change of control, subject to the Remuneration Committee's judgement of performance and may be reduced pro rata to service in the vesting period. Any applicable holding period will cease in the event of a change in control.

Political donations

The Company's policy is that it does not, directly or through any subsidiary, make what are commonly regarded as donations to any political party. However, the Act defines political donations very broadly and so it is possible that normal business activities, such as sponsorship, subscriptions, payment of expenses, paid leave for employees fulfilling certain public duties and support for bodies representing the business community in policy review or reform, which might not be thought of as political expenditure in the usual sense, could be captured. Activities of this nature would not be thought of as political donations in the ordinary sense of those words. The resolution to be proposed at the 2021 AGM, authorising political donations and expenditure, is to ensure that the Group does not commit any technical breach of the Act.

During the year, expenses incurred by Rolls-Royce North America, Inc. in providing administrative support for the Rolls-Royce North America political action committee (PAC) was US$68,100 (2019: US$81,866). PACs are a common feature of the US political system and are governed by the Federal Election Campaign Act.

The PAC is independent of the Group and independent of any political party. The PAC funds are contributed voluntarily by employees and the Group cannot affect how they are applied, although under US law, the business expenses are paid by the employee's company. Such contributions do not count towards the limits for political donations and expenditure for which shareholder approval will be sought at this year's AGM to renew the authority given at the 2020 AGM.

Disclosures in the Strategic Report

The Board has taken advantage of section 414C(11) of the Act to include disclosures in the Strategic Report including:

— employee involvement;

— the employment of disabled people;

— the future development, performance and position of the Group; and

— research and development activities.

Information required by UK Listing Rule (LR) 9.8.4

There are no disclosures to be made under LR 9.8.4.

Management report

The Strategic Report and the Directors' Report together are the management report for the purposes of Rule 4.1.8R of the DTR.

By order of the Board
Pamela Coles
Company Secretary
11 March 2021