



# In Focus

May 2007

## Valuation Results and Summary Funding Statement



This statement is intended to give members important information about the funding position of the New Airways Pension Scheme (NAPS).

In the July 2006 In Focus we provided you with the first Summary Funding Statement for NAPS. To comply with the Government's timescales this was sent before the scheme funding valuation exercise had been completed although we were able to provide some indication of how the funding position had moved since the last formal valuation in 2003. Since that time we have sent a number of updates, most recently in February 2007, to advise of the progress of the valuation process. We are now in a position to provide more precise information based on the formal valuation results as at 31 March 2006.

### How is the Scheme's financial health and how does this compare with the previous valuation?

	2006	2003
Value of liabilities	£7,941m	£4,112m
Value of assets	£5,846m	£3,184m
Shortfall	£2,095m	£928m
Funding level	73.6%	77.4%

### Why didn't the situation improve after 2003?

As a result of the 2003 valuation BA's contributions increased by around £100m a year and in 2005/6 BA paid £235 million to NAPS. Allowing for the interest on the shortfall (which can be thought of as the investment income that we would have received if the Scheme had been fully funded), the employer and member contributions together with investment income would have been expected to have reduced the deficit from £928 million to £851 million. Instead, the shortfall increased to £2.1 billion.

On the surface the larger shortfall seems all the more surprising given that, as the table opposite shows, the value of the assets of your Scheme have increased over the three year period from £3.2 billion to £5.8 billion. The key to the increased shortfall is the movement in the value of the liabilities.

### Why has the value of the liabilities increased?

Whilst the value of assets is calculated by reference to the market value of the assets, the calculation of the liabilities is a matter of judgement.

The additional contributions which BA made to the Scheme and the level of investment returns achieved during the period between valuations reduced the shortfall. However, the positive contribution of these factors was offset by taking a more cautious approach about future investment returns and recognising that pensioners are expected to live longer than previously assumed.

- The expectation of future returns (the discount rate) has been lowered from an average of 6.8% pa in 2003 to an average of 5.2% pa in 2006. This lower projection reflects observed market trends. The Trustees are necessarily concerned not only with the expected return but the level of certainty of achieving that return

## Valuation Results and Summary Funding Statement *continued*

- Life expectancy has improved and we know we need to pay pensions for longer. For example a member who is age 60 is now assumed to live three years longer than was assumed for a member who was 60 in 2003. This adds extra costs to the Scheme

As well as reflecting changes in market conditions the funding arrangements were determined against the backdrop of new pension legislation. The Pensions Act 2004 emphasises the need to be prudent when setting assumptions and for a heightened focus on what would happen in the event that BA was no longer able to support the Scheme (see the sections below concerning wind up).

The net effect of these changes to market conditions and legislation was that the shortfall increased from £928 million at the end of March 2003 to £2.1 billion at the end of March 2006.

### What has been done?

The Trustees have agreed the following steps with the Company to repair the shortfall. Taken together these steps are described as the 'recovery plan':

#### 1. Cap on pensionable pay

It has been agreed that future pensionable pay increases will be limited to no more than the annual increase in the Retail Price Index (RPI). (This cap does not include increments and promotions where special conditions apply). This particular change had the effect of reducing the past service deficit to £1.72 billion improving the funding level from 73.6% to 77.2%. (A number of other changes to the benefit structure have been made and all active members have been notified individually of these changes in the packs recently sent to them.)

#### 2. BA has paid additional contributions of £800 million to the Scheme this year

British Airways has made cash injections to the Scheme totalling £800 million and this has had the effect of further reducing the shortfall to around £1 billion. When allowance is made for these payments the funding level improves to 87.3%. Since the valuation date the funding position has improved further and, although not formally calculated, has been estimated to be currently just over 90%. This is in line with the Trustees' expectations of how the recovery plan will improve the funding position over time.

#### 3. Deficit contributions

In addition to BA's costs associated with future pension build up, BA will pay approximately £126.5 million a year from April 2007 for nine years increasing each year in April broadly in line with price inflation.

**These are the three key features of the recovery plan which the Trustees expect will eliminate the existing shortfall by 31 March 2016.**

#### *Other features of the plan*

##### **£150 million guarantee facility**

BA has arranged for a financial guarantee of £150 million to be available to the Scheme in certain circumstances, including BA's insolvency.

##### **Potential additional shortfall payments of £150 million depending on performance**

BA has agreed that, should certain financial conditions be met, that three further payments of up to £50 million each may be paid in the next three financial years. In these circumstances the £150 million guarantee mentioned above will be reduced to take account of any payment received.

## Ongoing pension build up and active member contributions

BA will pay contributions of approximately £165 million a year to cover the costs of future pension build up for active members and will also pay the Pension Protection Fund (PPF) levy expected to be £2-3 million this year.

As part of the agreed funding arrangements changes have been made to future pension build up. Whilst the Trustees were reluctant to make such changes, after considerable thought it was concluded that the funding package was the best achievable outcome and would improve security for all 70,000 members and pensioners of the Scheme.

By now all active members should have received individual packs explaining the changes and detailing the options which are available. If you have not received a pack please call our hotline on 0800 280 0965 (open 8am - 8pm Monday - Friday). The contribution rate paid by active members will depend on the options selected.

## Is there enough money to buy out benefits with an insurance company if the Scheme were to 'wind up' (or come to an end)?

The 2006 valuation showed that the Scheme's assets could not have paid for the full benefits of all members to be provided by an insurance company if the Scheme had ended on 31 March 2006.

The funding position on this basis can only be estimated as the Scheme may be too large to be bought out and the practical viability of this option would depend on how the insurance market evolves and the interest rates prevailing at the time. However by making certain assumptions about how an insurance company *might* value the benefits the solvency position can be estimated. Insurers are obliged to take a very cautious view of the future and need to make a profit. Using this approach, the 'overall solvency level', based on the position as at 31 March 2006, was 52%. This compares with a solvency level of 54% in the valuation as

at 31 March 2003, although that was carried out using different assumptions. The actual funding level would be improved by the £150 million guarantee facility which would be due to NAPS in the event of BA insolvency and this might well be supplemented by other amounts which the Scheme would seek to recover from the Company.

No thought is being given to winding up the Scheme. This is just another piece of information that we hope will help you understand the financial position of the Scheme.

## If BA became insolvent, would there be any alternative to winding up the Scheme?

It is not possible to say for certain what the alternatives might be as the Pensions Regulator would need to decide at the time. However, if it were possible to run the Scheme as a closed fund in the absence of Company support then it is very likely that the Trustees would move to a low risk investment policy investing mainly in Government bonds. Assuming that it were decided (and possible) to proceed on this basis the assets would, as at 31 March 2006, have covered 59% of the liabilities. Taking into account the relevant elements of the funding plan the current estimate of the funding level, on a closed fund basis, is over 70%.

## Would the Pension Protection Fund (PPF) protect my benefits?

The Government introduced the PPF in April 2005. The PPF is intended to ensure that pension scheme members receive a minimum proportion of their accrued benefits should their employer's business fail. Upon the insolvency of the Company the Trustees can apply for admission to the PPF and if it meets the criteria for entry then the PPF will absorb the assets of the Scheme and provide benefits up to certain prescribed levels. The pension you would receive from the PPF might well be less than the full benefit earned in the Scheme, depending on your age and when your benefits were earned.

## Investment split at 31 March 2006

The chart on the right shows the current investment split of NAPS



Cash	1%
Commodities	1%
Property	10%
Fixed Interest Bonds	13%
Index Linked Bonds	14%
Equities	61%

On a PPF basis, as at 31 March 2006, the Scheme was 77% funded. This means that if the Scheme had ceased at 31 March 2006 it would most likely have been accepted into the PPF. In the event that the Scheme was fully funded on a PPF basis it would not be eligible for entry to the PPF and the Scheme would either be run on as a closed fund or the possibility of buying out the benefit with an insurance company would be investigated.

Further information and guidance is available on the PPF website at [www.pensionprotectionfund.org.uk](http://www.pensionprotectionfund.org.uk). Or you can write to the PPF at Knollys House, 17 Addiscombe Lane, Croydon, Surrey, CR0 6SR.

### Has the Scheme's investment policy changed in the wake of the valuation?

No, in broad terms the split between return seeking and liability matching assets remains the same although there was a slight increase to the property allocation (8% to 10%) and a compensating reduction in the equity allocation (63% to 61%) in keeping with the decision taken in 2005 to incrementally increase the Scheme's exposure to property. The decision to retain broadly the same asset allocation mix was the conclusion of a thorough review of the investment strategy, which the Trustees undertook with the assistance of their advisers. The current investment split is shown in the chart above.

### Have there been any payments from NAPS to the Company?

There has not been any payment to the Company from the Scheme in the period since the last Summary Funding Statement was issued nor at any time since NAPS commenced. The Scheme Rules do not provide for payments to the Company unless there is a surplus following the winding up of the Scheme.

### How does the Scheme operate?

Employer and member contributions are held and invested in a common fund which is used to pay members' pensions. They are not held in separate funds for each individual member. The common fund is separate from the Company's assets.

### The Pensions Regulator

Under the provisions of the 2004 Pensions Act the Pensions Regulator has the powers to modify the future benefit structure of the Scheme, impose contribution rates for employers and members and issue directions concerning the length of the recovery plan and the assumptions to calculate the liabilities. The NAPS funding plan has been submitted to the Regulator who has not applied any of these measures to NAPS.

## Policy and Rule changes



### Factor changes

As part of our valuation work, with effect from 1 April 2007 we have adopted new factors to convert one type of benefit to another - for example converting pension into tax free cash at retirement. In broad terms members taking early retirement and converting pension for lump sum will receive more than the old factors would have provided. Conversely those members who are taking late retirement (including crystallisation) will receive less than the old factors would have provided. These changes only affect those with options/benefits coming into effect after 1 April 2007.

### Maximum contribution limit increases to 30%

The maximum limit for contributions to NAPS has increased from 15% to 30% of taxable pay. The new limit covers both normal contributions and AVCs. The new limit applies to contributions in respect of payments in the tax year starting 6 April 2007.

### Drawing your pension while working for British Airways

Provided you are over age 50 (over age 55 after April 2010) it is now possible (in certain circumstances with British Airways' agreement) to draw your pension while remaining in employment with British Airways. To do this you must, after giving appropriate notice, opt out of the Scheme. Opting out of the Scheme is a significant step as it means that there is no further build up of pension for future service, no death in service lump sum cover and no facility to continue to pay AVCs. Consequently, careful consideration needs to be given to this option before any decision is taken. Generally, where a member opts out of NAPS it will not now be possible to re-join NAPS (or any other British Airways pension arrangement) for any future pension benefits build-up. Re-joining may be allowed only in special circumstances as determined by British Airways e.g. if a member opts out of NAPS 1 specifically in order to join NAPS 2 for future service.

(It is expected that Flexible Retirement arrangements - which will allow active members to draw part of their pensions while remaining an active member of the scheme - will come into operation some time during the next year. We will let you know details in due course.)

### Members moving from Ground Staff to Air Crew or vice versa

With the introduction of Plan 65 and Plan 60 from 1 April

2007 all members whether ground staff or air crew are building up benefits for future service under the same arrangements i.e. the same build up rates and same retirement age options apply to all members. Historically where members changed category it was necessary to make an adjustment to their pensionable service record to allow for the different levels of benefits. From April 2007 there will be no adjustments to pensionable service where a member changes employment category. The pension will continue to build up in the same manner. Where there is a significant change in pensionable pay between the different categories members may wish to discuss the potential impact to their pension with the team at Whitelocke House. Pensions are based on Retiring Pay, which is the average of the best two years pensionable pay in the five years proceeding the date you leave the Scheme.

### Variable Pension Option

From 1 April 2007 the Scheme no longer offers the variable pension option. This option was designed to provide those retiring before State Pension Age (SPA) with broadly the same level of income throughout retirement by giving a higher NAPS pension up to SPA and then a lower NAPS pension thereafter so that the total stayed the same taking account of the State Pension. This change does not affect Pensioners who are already participating in the option.

### Transferring benefits to another scheme

Until recently the Trustees would allow a transfer only in respect of all of a member's benefit to another arrangement. However, it is now possible to transfer just that part of the benefit which is in excess of the statutory Guaranteed Minimum Pension (GMP). This change is only relevant to members who are transferring benefits to an external pension arrangement which is not able to accept the GMP e.g. overseas or 'contracted-in' arrangements. The GMP part of the benefit will be retained in NAPS.

### Anti-age discrimination issues

The Scheme Rules previously contained various conditions which were attached to options where the age of a member was relevant to their application. For example, members were required to take a medical examination if an option was being taken up within five years of Normal Retirement Age. The Trustees have agreed to amend the Rules to ensure that the same conditions (if any) apply to all members irrespective of the age of the member.

### Member Nominated Trustees

New Regulations covering the appointment of Member Nominated Trustees (MNTs) will transfer the responsibility for election arrangements from employers to trustees. As a result the Trustees have undertaken a comprehensive review of current arrangements and have agreed that while most of the current arrangements should remain unaltered it is appropriate for some changes to be introduced. These are:

- The Trustees consider that the level of training expected of Trustees has increased significantly in recent years reflecting increasingly complex legislative and investment responsibilities. This training can take several months to complete and the Trustees have decided to extend the Term of Office for Trustees from between three and three and a half years to between five and five and a half years in order that the Scheme can benefit from the significant investment in courses and training materials.
- The number of signatures required for a valid nomination will be reduced from 20 to 10 for vacancies for MNTs to be elected from the pensioner membership. However, 20 signatures will continue to be required for vacancies for MNTs to be elected from the active membership.
- The new regulations require all Trustee functions to be open to all Trustees and as a result in future the Chairman of the Trustees, and also any Deputy Chairmen, will be chosen from all of the Trustees rather than from just the Employer Appointed Trustees as is currently the case.

It has been agreed with British Airways that in the normal course of events these changes will be in place for elections for the vacancies arising for Terms of Office commencing on 1 October 2007.



### New faces and reappointments

There have been a number of changes to the Trustee Board since the last edition of In Focus.

Dr Andrew Sentance retired as an Employer Representative on 30 September 2006 and was replaced by Steve Gunning (Managing Director, World Cargo) on 2 November 2006.

Following the retirement of Dave Gunner, Geoff Le Boutillier was appointed, unopposed as a Member Representative from 1 April 2007.

The Trustees would like to take this opportunity to thank both Andrew and Dave for their service to the Board and to wish them both well for the future.

Three Member Representatives have stood for re-election during the period. Nikki Jones (Cabin Crew - by election) and David Southcott (Administration and the rest of management - unopposed) were reappointed with effect from 1 October 2006 and Michael Grey (Ground Services - unopposed) was reappointed with effect from 1 April 2007.

### General notices

Our next In Focus, to be published later in the year will provide a summary of the Scheme's Annual Report and Accounts.

#### Where can I get more information?

As always copies of current and past editions of 'In Focus', the full valuation report, the last Annual Report and Accounts and the current Statement of Investment Principles (explains how the money paid into the Scheme is invested) and other documents relating to the Scheme are available on our website at [www.mybapension.com](http://www.mybapension.com). We have also added the Statement of Funding Principles (which explains the funding approach in more detail), the Recovery Plan and the Schedule of Contributions (which shows how much money is being paid into NAPS) to the website.

### Reminder

So that we can keep you updated on funding and other pension issues please ensure that we are notified of any change to your home address. If you have left or retired you will need to write direct to BA Pensions to update your address. If you are employed by BA, then the address details will automatically be updated when your People Online record is updated.

Important: You should consult a professional adviser, such as an independent financial adviser, before taking any decisions concerning your pension arrangements.