

Airways Pension Scheme (APS)

STATEMENT OF INVESTMENT PRINCIPLES

1. BACKGROUND

Under Section 35 of the Pensions Act 1995 (“the Act”), and as amended by the Pensions Act 2004 and the Occupational Pension Schemes (Investment) Regulations 2005, the Management Trustees are required to prepare and maintain a written statement of the principles governing their investment decisions. The purpose of this document is to fulfil this requirement.

The Management Trustees will review this document at least every three years, or following any significant change in investment policy or where the Management Trustees consider a review is needed. British Airways plc will be consulted on behalf of the employers of APS before any change is made to this document.

2. SCHEME DETAILS

APS provides retirement benefits for employees of British Airways plc and some of its subsidiary and associated companies and benefits for dependants of members and pensioners who die.

APS was established under a Trust Deed dated 8 October 1948 in accordance with Regulations made under Section 20 of the Civil Aviation Act 1946 and was closed to new members as at 31 March 1984. The operation of the Scheme is governed by its Rules (as updated from time to time), which provide for salary-related benefits. The Scheme's assets are held under the legal control of the Management Trustees.

The Scheme was “exempt approved” by the Inland Revenue and is now a registered scheme under the Finance Act 2004. Parts V and VI of APS are contracted out of the State Second Pension (formerly known as the State Earnings-Related Pension Scheme). Part IV of APS is not contracted out of the State Second Pension.

3. ORGANISATION AND MANAGEMENT ARRANGEMENTS

The Management Trustees, having taken expert advice, have established an Investment Committee consisting of Trustees and highly experienced and independent pension scheme investment specialists (Investment Advisors). Where appropriate, advice is also sought from other parties including the APS actuary, Towers Watson (formerly Watson Wyatt) and other investment professionals.

The Management Trustees have agreed that all strategic policy decisions on investments will be taken by the Main Trustee Board after in depth consideration by the Investment Committee and following receipt of advice from the Investment Advisors. Strategic policy decisions are those which have the potential for requiring an amendment of this document.

The Investment Committee has adopted an annual Business Plan setting out the investment objectives and the work required to support the achievement of these objectives, and a plan for complying with the Investment Principles identified by Paul Myners. As well as requiring the Committee to give detailed consideration to investment policy issues, the Management Trustees have agreed to delegate authority to approve specific transactions to the Investment Committee, where such transactions are in excess of the limits delegated to BAPIML in the Investment Management Agreement.

The Management Trustees delegate their discretion to make all routine or day to day investment decisions to British Airways Pension Investment Management Ltd (BAPIML) in accordance with Section 34 of the Act.

The appointment of BAPIML as Investment Manager to APS is subject to periodic review. Such a review considers issues such as the management, organisation, resources, investment process and philosophy of BAPIML, together with the likelihood that BAPIML will be able to achieve the objectives which the Management Trustees consider appropriate in terms of this Statement of Investment Principles. Currently, BAPIML's costs are borne by the fund without the inclusion of a profit element.

4. DIVERSIFICATION AND SUITABILITY OF INVESTMENTS

It is the Management Trustees' policy to maintain suitable structures, resources and processes to ensure that the assets of APS are invested in a suitable manner bearing in mind the circumstances of APS and the requirements of the Act, including the requirements relating to the diversification and suitability of investments as set out in Section 36 of the Act.

5. OTHER ASPECTS OF INVESTMENT STRATEGY

(a) Kinds of investment to be held

The APS Trust Deed does not specifically exclude any form of investment or investment activity although the Management Trustees do restrict the types of asset that BAPIML may hold and the type and extent of investment activity which they are permitted to undertake. The assets of APS currently include equity, fixed interest bonds (government and corporate), index linked bonds (government and corporate), cash, property & private equity (including, but not limited to, venture capital, development capital, capital restructuring, management buy-outs and mezzanine funds) and alternative assets (including, but not limited to, infrastructure (including private/public finance initiatives), commodities, leveraged loans, emerging market debt and currency). Assets may be UK or overseas. BAPIML are also permitted to deal in commodity instruments, swaps, futures, options and contracts for differences as well as property gearing and currency hedging. Stock Lending is also permitted and this activity is delegated to the independent global custodians.

The Investment Management Agreement (as amended from time to time) between the Management Trustees and BAPIML documents the detailed restrictions that apply in terms of the types of investment which are permitted and the diversification parameters operative at any time. Adherence to these specifications is monitored by administrators who report directly to the Management Trustees.

(b) Balance and suitability of investments

The Management Trustees have been advised, and they believe, that having regard to the long-term liabilities of APS, an investment strategy based predominantly on investment in bonds (both index linked and fixed interest), as detailed in Appendix 2, is for the time being the most appropriate strategy for APS.

(c) Risk

The Management Trustees regard risk as any factor that may render APS unable to meet its liabilities or satisfy its funding objectives as set out in its Statement of Funding Principles. They do not regard risk as inherently unacceptable: there is no such thing as an entirely risk-free investment. What is of concern is the degree of risk relative to the liabilities to be met. The terms of the Investment Management Agreement between the Management Trustees and BAPIML have been negotiated following expert advice from APS' Legal Advisers. Through the investment management arrangements with BAPIML, risk is principally addressed by:-

Investment Risk

- recognising the very mature membership of APS with a continually increasing proportion of pensioners, the advice received by the Management Trustees has been to structure the assets in a manner which is likely to keep short-term volatility within acceptable bounds;
- establishing the investment parameters (Appendices 1 and 2) within which BAPIML must operate in the Investment Management Agreement, which also details the prudential limits associated with specific investment activities, and monitoring compliance with these parameters and limits;
- diversifying investments geographically and ensuring that there is no undue concentration of assets in a single investment;
- ensuring that investments are appropriate in terms of security and appropriately liquid to meet payments due from APS and to facilitate any desired changes in asset mix;
- instructing BAPIML to avoid "self investment" of any kind in British Airways Plc other than in exceptional circumstances, in which case BAPIML are required to seek the express prior approval of the Management Trustees, setting out the reasons for this self investment and the incremental risk to which the fund would be exposed. In such an event this

investment would be subject to any statutory limitations in force at the time of the investment and subsequently;

- carefully and methodically monitoring the activities and performance of BAPIML on a regular basis. Performance is monitored relative to the overall fund benchmark and the various benchmark indices are shown in Appendices 1 and 2. The Management Trustees have explicitly decided that comparison with the average experience within the pension fund industry is inappropriate; and
- the Management Trustees arrange for the measurement of the investment risks to the Scheme by commissioning independent reports on such aspects of investment risk as the Management Trustees may from time to time consider appropriate.

Operational Risk

- delegating physical custody of evidence of title to securities to independent global custodians;
- subjecting investment management activity to internal audit scrutiny under the direction of the Governance Committee; and
- establishing a process to enable regular reporting and review of exposure to counterparty risk.

(d) Investment Objectives and policy

The Occupational Pension Schemes (Investment) Regulations 2005 (S.I. 2005/3378) (“the Investment Regulations”) require the Scheme’s assets to be invested in the best interests of members and beneficiaries. In order to fulfil this requirement the Management Trustees’ investment objectives are as follows:

- a) To maintain a portfolio of suitable assets of appropriate liquidity which will generate income and capital growth to meet, together with new contributions from members and the employers, the costs of current and future benefits which APS provides, as set out in the Trust Deed and Rules;
- b) To limit the risk of large adverse changes in the level of cover for the Technical Provisions over the shorter term and of the assets failing to meet the liabilities over the longer term, having regard to the increasing maturity of the liabilities; and
- c) To minimise the long-term costs of APS by maximising the return on the assets whilst having regard to (i) the objectives shown under 5 (d) (1) (b) above, (ii) the possibility of enhancing member benefits and (iii) the Trustees’ attitude to risk.

The Management Trustees use Asset Liability Modelling (ALM) and a 1 year risk budgeting framework to assist in setting investment policy. ALM is undertaken at each valuation. The investment policy adopted to implement the investment objectives is set out in Appendix 2 and

the projected returns used for the most recent ALM are set out in Appendix 3.

(e) Realisation of investments

The Management Trustees expect that the investments of APS (and any cash contributions thereto) would normally generate sufficient cash to meet the benefit obligations as they fall due but an adequate proportion of sufficiently realisable investments is held to meet additional cashflow requirements in most foreseeable circumstances. The Trustees are satisfied that the arrangements in place conform with this policy.

(f) Socially Responsible Investment

The Management Trustees' overriding objective is not to cause BAPIML to take any action (whether by purchasing, holding or selling any investment) which could be reasonably expected to diminish the financial returns on APS's investment as a whole.

Subject to this objective, the Management Trustees require BAPIML to incorporate as part of its investment process a systematic approach to the maintenance of ongoing dialogue with the management of those companies in which it retains, or proposes to make, significant equity investments and, where appropriate, other forms of investment. The specific purpose of such dialogue - called 'responsibility discussion overlay', or RDO - is to establish a framework within which BAPIML may, on behalf of the Management Trustees, raise issues concerning the social, environmental or ethical aspects of the operations of the investee company. BAPIML has been requested to report to the Management Trustees once in each calendar year on its activities under RDO and the Management Trustees use this report as a focus for issuing further guidance to BAPIML (in consultation with the Company where appropriate) if required.

6 CORPORATE GOVERNANCE

BAPIML has been instructed by the Management Trustees to exercise voting and other rights attaching to APS investments at meetings of UK and overseas listed companies wherever practicable. Where relevant rights are exercised, this will be based on the framework formulated by the National Association of Pension Funds.

The Management Trustees have also agreed to the incorporation of the principles set out in the Institutional Shareholders' Committee Statement of Principles on the responsibilities of Institutional Shareholders and Agents into their Corporate Governance arrangements.

The primary objective of these Corporate Governance arrangements is to protect the economic interests of APS. Details of the exercise of voting rights are reported to the Management Trustees at least quarterly and a summary of this information along with data summarising the Schemes' larger investments will be made available on the member website each year.

7 ADDITIONAL VOLUNTARY CONTRIBUTIONS

The Management Trustees, having taken advice from Towers Watson (including the APS Actuary) have arranged with BAPIML for members to be able to make Additional Voluntary Contributions to the Equity Biased Fund (EBF), the Short-Dated Gilts Fund (SGF) and the Mixed Portfolio Fund (MPF).

The Investment Objective of these funds is to provide a range of investments suitable for supplementing members' pensions at retirement.

Contributions to the EBF and the SGF are invested with the same asset allocation as is used for the main Scheme assets but with returns calculated on a different basis.

EBF returns consist of two parts – the Guarantee Component and the Bonus Component. Interest is added to EBF accounts monthly at the rate of 1/12th of the total of the annual Guarantee Component and 1/12th of the annual Bonus Component.

Guarantee Component - this rate is calculated monthly and is the interest that would have accumulated in a Seven-Days-Notice Local Authority Deposit Account during the previous month.

Bonus Component – this rate is calculated annually on 1 April each year. It is calculated by the Schemes' Actuary and is based on an investment portfolio equivalent to the NAPS asset allocation as this is a reasonable reflection of a long-term investment strategy for AVCs. When determining the Bonus Component the Actuary compares the actual rate of return achieved by the portfolio in recent years to the Guarantee Component and then calculates a weighted average return in excess of the Guarantee Component. An allowance is then made to the Bonus Component to allow for the cost of the guarantee. It is possible for the Bonus Component to be zero.

SGF returns are related to Government gilt-edged securities and give a return in the form of interest calculated as the average rate from the three highest-yielding, gilt-edged securities which have less than five years to maturity. Interest on SGF accounts is calculated annually but where funds are switched into, or out of, the SGF during the year, interest is calculated separately in respect of the money held before and after the date of the switch. Contributions made each month receive interest on a proportional basis.

In regard to contributions to the MPF the Management Trustees have been advised, and they believe, that an investment strategy based predominantly on investment in equities and fixed interest bonds as detailed in Appendix 4, is for the time being the most appropriate strategy. The Management Trustees set a benchmark for each type of asset (shares, bonds etc) held within the Fund and use this to monitor the Fund's performance by comparison with the returns produced by other large AVC providers.

Investments in the AVC funds will be realised to meet the benefit obligations as they fall due either in the form of cash or by means of the purchase of an annuity.

8 FRAMEWORK FOR INVESTMENT DECISION-MAKING

The Management Trustees have taken specialist advice on the new industry led framework for investment decision-making, based on revised Myners principles, issued by the Government in October 2008. The Management Trustees have implemented arrangements that comply fully with these updated principles and have reviewed their practices in line with the guidance given. The Management Trustees will continue to review the extent to which they meet suggested best practice and developments that may be introduced by the Investment Governance Group.

9 PREPARATION OF THIS STATEMENT

Prior to issuing this statement, the Management Trustees obtained and considered the written advice of the Investment Advisors, Towers Watson, and the Scheme's legal advisors, and consulted with British Airways Plc on behalf of the employers of APS. This statement supersedes the previous statement dated 24 March 2010.

The Management Trustees of the Airways Pension Scheme
Whitelocke House, 2-4 Lampton Road, Hounslow, Middlesex TW3 1HU
1 May 2010

APPENDIX 1

<i>Asset category</i>	<i>Index</i>
UK equities	FTSE All Share
North America US equities Canadian Equities	Standard & Poors 500 Toronto TSE 300
Europe (ex UK) equities	FTSE All World Developed Europe ex UK Index (net of tax)
Japanese equities	FTSE Japan
Asia Pacific (ex Japan) equities	FTSE All World (Mid and large cap) Asia Pacific ex-Japan
Emerging Market equities	FTSE All World Emerging Markets ex-emerging Asia
Overseas Bonds	FTSE Actuaries over 15 years gilts
Index-linked bonds	Customised Liability Driven Benchmark
UK Government Conventional Bonds	FTSE Actuaries over 15 years gilts
Corporate Bonds	75/25 AAA/AA (as defined by the Barclays Capital Sterling Aggregate 100 non-gilts greater than 15 years' maturity indices), but customised to ensure that the fund's prudential limits on any issuer are observed.
Property	IPD Quarterly Universe
Cash	LIBID 7 Day
Alternatives	3 month LIBOR plus 2%

Performance target:

The Management Trustees have set BAPIML the target of performance 0.3% per annum above the weighted average of the agreed strategic benchmark (above) over a rolling five year period though they will continue to monitor performance over a range of different time periods.

Whilst the Management Trustees recognise that the past should not be taken as a reliable guide to the future, previous performance data indicate that the Management Trustees would not be acting unreasonably to expect returns of the order so targeted.

APPENDIX 2

Strategic Asset Allocation

	Limits as % of Total Fund
	Target Benchmark
Equities	9.5%
- Quoted equities	8%
- Private equity	1.5%
Bonds ¹	82%
- Fixed Interest	14%
- Index-Linked ²	68%
Cash	0%
Property	4.5%
Alternatives ³	4%

¹ There is no set benchmark for overseas bonds

² Includes assets backing swaps

³ Separate allocations have been established for investment in each asset type

The strategic benchmark set out above is subject to more detailed control limits and bandwidths exercised by the Investment Committee in consultation with the investment advisers and BAPIML.

The specific limits and bandwidths set for BAPIML are prescribed in the Investment Management Agreement, which may be amended by the Investment Committee, subject to the overall limits set out by the Board.

Details of the actual asset allocation are provided at least annually to members in the 'In Focus' publication.

APPENDIX 3

Projected Investment Returns

The following table sets out the expectations for the rates of return to be earned in future on the various asset classes in which APS could invest. They are based on market conditions as at 31 March 2006. All figures are for real returns in excess of price inflation.

	10 year median real return
	%pa
Equity Investments	
Global (ex UK) equity (hedged)	5.3
Global (ex UK) equity (unhedged)	5.0
UK equities	4.9
Property	3.4
Bonds and cash	
AA UK long corporate bonds	2.0
Long term UK gilts	1.6
Index-linked gilts	1.3
Foreign bonds (hedged)	1.7
Foreign bonds (unhedged)	1.2
Global index-linked (ex UK)(hedged)	2.0
Cash	0.8
Inflation (RPI)	2.7

The above assumptions relate to the period from 31 March 2006 to 31 March 2016. Effectively, these assumptions represent a 'best estimate' so that there is a 50% chance of returns being higher and a 50% chance of returns being lower than the stated level.

The assumptions reflect a combination of historical performance analysis, the forward looking view of financial markets as revealed through the yield on bonds and the views of investment organisations. The assumptions for each asset class incorporate historical return relationships, market conditions as at 31 March 2006, and the increasing degree of global capital market integration.

APPENDIX 4

MPF Summary Asset Allocation and Bandwidths

	Minimum % Total Fund	Benchmark %	Maximum % Total Fund
Equity Total	75% (73%)	80%	85% (87%)
UK ¹	19.0%	24.0%	29.0%
International ^{1,2}	51.0%	56.0%	61.0%
Bonds and cash	13%	20%	28%
Fixed Interest Bonds	13%	18.0%	23%
Cash	0.0%	2.0%	5.0%

¹ These bandwidth limits are in place when the overall equity allocation is on benchmark. The limits are adjusted to reflect any under or over-weighting in overall equities in accordance with an agreed formula.

² Within this overall International equity benchmark limit, ranges have been established for investment in each region.