

Letter from the Chairman of the APS Trustees, sent to APS members & pensioners
December 2009

Dear APS member

Actuarial valuation update – £1.0 billion deficit as at 31 March 2009

In our last *In Focus* we said we would come back to you when we had information to report on the progress of the actuarial valuation.

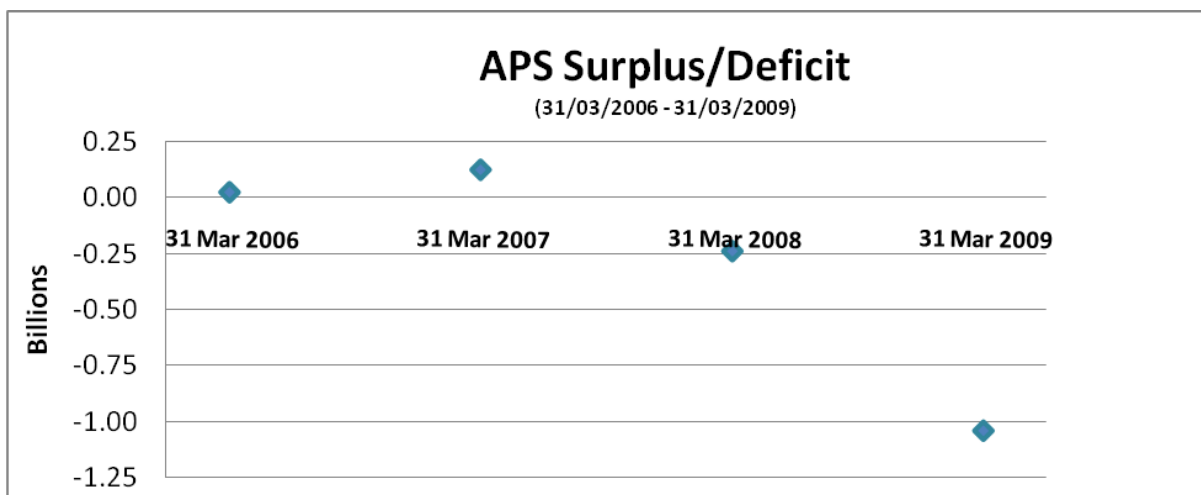
The first part of the valuation process is to establish the extent of any funding gap and the next stage is to devise a recovery plan to fill that gap. Work is underway on the second part and is likely to continue on through 2010 when the Trustees and Company will need to reach agreement on how the deficit will be made good. In the meantime this letter is to let you know the preliminary conclusions that have been reached in relation to determining the extent of the gap to be filled; the monetary value of the deficit.

After taking extensive advice from the Actuary and detailed advice, based on exhaustive research and analysis, from PricewaterhouseCoopers (PwC) on BA's financial condition we have now analysed the information which is available to us. The provisional APS deficit is £1.0 billion. Taken together with the provisional NAPS deficit of £2.7 billion, the combined deficit is £3.7 billion. APS was not in deficit in 2006 (the last full valuation), NAPS had a deficit of £2.1 billion.

Although the Schemes are separate entities we are providing you with details of the combined number as the results are likely to be the subject of media attention and this is the figure that the media is likely to focus on. The value of the combined deficit is also relevant, regardless of which Scheme you belong to, as BA contributions will be required to repair both deficits. BA has said, and this is supported by the independent analysis commissioned by the Trustees, that they cannot afford to pay more than the current level of pension contributions in the short term. The challenge will be how current and future levels of contribution inflows can be apportioned to secure member benefits and what other protections can be agreed. The recovery plan will be designed to ensure that benefits are paid in full as they fall due. The Pensions Regulator will, in due course, consider the funding arrangements that have been agreed to confirm if they are acceptable.

Why has the position worsened since 2006?

In the period since 2006 we have reported to you annually on the evolution of the funding position.



The impact of the global economic crisis is evident from the chart which tracks the development of the funding position since the last valuation. The reduction in the value of the assets held by the Scheme over this period had the greatest impact on the deficit although the impact would have been significantly greater had the Scheme not de-risked (sold equities to buy bonds) in 2006 and 2007. In addition the Trustees have strengthened the assumption made for the life expectancy of Scheme members and this has increased the value of the liabilities.

Is the deficit due to poor investment performance?

It has been challenging to manage the Scheme's investments in such extreme market conditions. In 2008-9 absolute returns were negative. However, APS returned -5.7% versus the benchmark return of -6.7%. In essence, whilst returns were negative the Scheme's in-house investment manager's (BAPIML) performance compared well with the benchmark.

I am worried by the deficit. What is being done?

The discussions between BA and the Trustees as to how to rectify the deficits are underway and the recovery plan will be designed to remove the shortfall over an agreed period. It is evident that both Schemes require employer contributions even though BA's current ability to pay is constrained. The way the available contributions are apportioned, and the extent to which other protections can be made available, will be the focus of the work needed to develop a sustainable recovery plan. The resultant funding arrangements will need to be acceptable to the Pensions Regulator.

Pension schemes operate over long time horizons and although the 2009 valuation indicates that the potential liabilities of the Scheme are greater than the assets, the recovery plan will seek to bring the potential liabilities and assets into balance. The law requires that this plan be in place by June 2010. The extent to which progress is achieved against the plan is reported to members annually and is comprehensively reassessed every three years.

Can the Scheme afford to pay my pension payments?

As at 31 March 2009 the value of APS assets was around £6.0 billion. This is a substantial funding base and although the potential value of the benefits due to be paid exceeds this (around £7.0 billion) the pension payments due from the Scheme will be spread over many years, possibly up to the year 2100. The recovery plan will be designed to ensure that all of the pension payments due to be paid over that time period are paid.

Is the proposed Iberia merger relevant?

The funding valuation process to date has not included speculative analysis, other than at the highest level, of any potential merger activity. On 13 November 2009 it was announced that the boards of Iberia and BA had agreed a binding memorandum of understanding setting out the basis for a merger of the two companies. The Trustees will be reviewing the impact of the potential merger and will be discussing this with BA. The Trustees are alert to the issues that they will need to investigate as part of any merger related due diligence exercise and will be supported in this work by their advisers. PwC, in particular, have a great deal of experience of these types of transactions and are already familiar with the Schemes by virtue of the analysis and advice they provide to the Trustees as part of the employer covenant review.

What is an employer covenant review?

An employer covenant review is an objective and independent assessment of the overall financial strength of the participating employers of defined benefit pension schemes. A credit rating alone is not specific enough for the needs of a pension scheme, and is not far reaching enough to provide a meaningful assessment of the covenant.

PwC have been engaged by the Trustees since 2006 to undertake the extensive investigations required to perform this task. All of the employer covenant reviews which PwC complete for a wide variety of pension schemes follow a similar methodology, which PwC tailor to meet the requirements of each individual client. As well as employing credit specialists using similar analysis that banking and financial institutions would use when assessing their exposure to corporate entities, the PwC team in our case also utilised economists, actuaries and commercial, operational, treasury and IT specialists. The advice that PwC have provided to the Trustees has been based on this in depth work and analysis which has been undertaken over the past 10 months and which includes continuing detailed monitoring of BA's financial performance.

The valuation date was 31 March 2009. What has happened to the deficit since then?

Although investment markets have performed strongly since the valuation date this is likely to have increased the value placed on the liabilities as well as the assets. As a result the overall funding position is not expected to have improved materially.

This is a long letter but the Trustees feel it is important that our members are kept up to date on developments as they occur. This is only one step in the process of agreeing the funding arrangements and we will write again when further progress has been made. Finally, I would mention that I will be stepping down as Chairman to avoid concerns about perceived conflict of interest arising as a result of the Iberia merger.

Yours sincerely



Roger Maynard
Chairman of Trustees