

The New Airways Pension Scheme
Actuarial Valuation as at 31 March 2006

The New Airways Pension Scheme

Report on the actuarial valuation as at 31 March 2006

To the Management Trustees and to British Airways Plc (BA)

I have carried out an actuarial valuation of the New Airways Pension Scheme (*the Scheme*) as at 31 March 2006 and now have pleasure in submitting my Report. The provisions of Clause 13 of the Consolidated Trust Deed and Rules require me to report to the Management Trustees (*the Trustees*) and BA on the financial position of the Scheme. This Report also satisfies the relevant requirements of the Pensions Act 2004. As required by Clause 13, my Report is submitted to both parties.

The Report has been prepared in accordance with the Professional Guidance Note “Funding Defined Benefits – Presentation of Actuarial Advice (GN9)” adopted by the Board for Actuarial Standards, and current at the date of signing.

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Certificate of Technical Provisions

Summary of results and conclusions

The current valuation takes account of the information set out in the Statement of Funding Principles dated 7 February 2007. In particular, as part of the valuation process, the Trustees and BA agreed the assumptions to be used. The principal conclusions of the current valuation are:

1 On the basis of the Statement of Funding Principles the accumulated assets of the Scheme as at the valuation date represented 77.2% of the Scheme's Technical Provisions (after allowing for the cap on future pensionable earnings increases) in respect of past service benefits; this corresponded to a funding shortfall of £1,723 million. This funding level improves to 87.3% when allowance is included for the lump sum payments of £240 million and £560 million described below.

2 Allowing for the changes to benefits and to member contributions from 1 April 2007 the Trustees and BA have agreed that Participating Employer contributions with effect from 1 April 2007 will be:

	Percentage of Pay for Contribution Purposes	
	Plan 60	Plan 65
General Staff	19.1%	18.1%
Air Cabin Crew	21.7%	20.7%
Pilots and Officers	25.9%	23.9%

3 The Trustees and BA have also agreed that BA will pay additional contributions of:

- £240 million on 9 February 2007 and £560 million by 2 April 2007, and
- £10.547 million per month from 1 April 2007 for 9 years increasing in line with Pension Increase (Review) Orders every April thereafter

4 BA will pay further sums up to £50 million in respect of each of its financial years ending 31 March 2007, 2008 and 2009. These sums will be paid if the Free Cash reported in BA's consolidated preliminary results exceeds specified levels.

5 BA has arranged a guarantee of £150 million to be paid to the Scheme, in full or in part, in certain circumstances including BA's insolvency. The guarantee expires on 31 March 2010, but there are provisions for renewal depending on the financial position of the Scheme as at 31 March 2009. The amount of the guarantee will be reduced by any amounts paid under (4) above.

6 The above contributions exclude those required to fund any augmentations made.

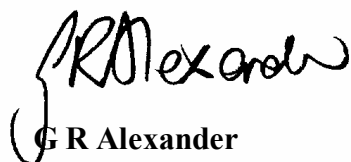
7 Administrative and investment related expenses are met by the Scheme. However, levies required by the PPF Board are payable by BA.

8 The results determined on the basis set out under Section 179 of the Pensions Act 2004 show that assets were insufficient to provide the benefits payable by the Pension

Protection Fund. The level of coverage on this basis was around 77% at the valuation date.

- 9 If the Scheme had been discontinued at 31 March 2006 and had then been wound up, there would have been insufficient assets to buy out the accrued benefits through the purchase of annuity policies with an insurer. The corresponding discontinuance funding level (or *solvency* position) for the Scheme as at the valuation date, on the assumptions specified in Section 4, is estimated to be 52%.

The financial position of the Scheme and the level of contributions required will be reviewed at the next actuarial valuation which is expected to be carried out as at 31 March 2009.



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29 March 2007

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Limitations of the investigation

I have written this Report for the Trustees of the Scheme and the Participating Employers as required under Clause 13 of the Consolidated Trust Deed and Rules. I have prepared it to satisfy the requirements of the Deed and Section 224 of the Pensions Act 2004. It has not been prepared for any other purpose. As such, it should not be used or relied upon by any other person for any other purpose, including, without limitation, by individual members of the Scheme for individual investment or other financial decisions, and those persons should take their own professional advice on such investment or financial decisions. Neither I nor Watson Wyatt Limited accepts any responsibility for any consequences arising from any third party relying on this Report. Except with the written consent of Watson Wyatt Limited, the recipient may not reproduce, distribute or communicate (in whole or in part) this Report to any other person, except as required by statute.

This Report was based on data available to me at, or prior to, the date on which it was signed, and takes no account of developments which may have become known after that date. The Trustees bear the primary responsibility for the accuracy of the information provided. They will have relied on others for the maintenance of accurate data, including the Participating Employers who must provide and update the membership information. Nevertheless it is their responsibility to ensure the adequacy of these arrangements. I have taken reasonable steps to satisfy myself that the data provided is of adequate quality for the purposes of the investigation, including carrying out basic tests to detect obvious inconsistencies. These checks have given me no reason to doubt the correctness of the information supplied. It is not possible, however, for me to confirm that the detailed information provided, including that in respect of individual members and the assets, is correct.

The assumptions on the basis of which the funding target and future contributions have been calculated are set out in the Scheme's Statement of Funding Principles dated 7 February 2007. They are not predictions or guarantees and it is not expected that the future experience of the Scheme will precisely follow those assumptions.

The structure of the Watson Wyatt global asset model, used to determine the spread of likely future outcomes for the Scheme's finances, is based on an historical analysis of investment returns, although Watson Wyatt has incorporated its subjective judgement to complement the information provided by historical returns. The model is designed to illustrate the future range of returns stemming from different asset classes and their inter-relationship and the consequent uncertainty in the future financial development of the Scheme. It should be noted that no economic model could be expected to capture future uncertainty perfectly or to be precise about the risk of extreme events. In particular, it should be noted that our timeframe in establishing our asset model and the assumptions used in this investigation are intentionally long term, and are not meant to be reflective of the possible, or even likely, course of the investment markets in the short term.

1 Background to the valuation

Reasons for carrying out an actuarial valuation

- 1.1 There are a number of reasons for making an actuarial valuation, quite apart from the requirement under the Trust Deed to provide a valuation at least once every three years. The main ones are:
- to advise the Trustees and BA on the financial position of the Scheme relative to the statutory funding objective as required by Section 224 of the Pensions Act 2004, and so determine the appropriate level of future contributions to be paid by the employers;
 - to examine whether the Scheme would have adequate resources to meet its accrued liabilities if it were discontinued.

Previous valuation

- 1.2 The previous valuation of the Scheme was carried out by me as at 31 March 2003. This disclosed a past service shortfall on an ongoing basis of £928 million (equivalent to a funding level of 77.4%).
- 1.3 BA agreed to pay monthly additional contributions of £9.560 million commencing from 1 January 2004 for 9¼ years to fund the shortfall. These payments were to be increased every April in line with retail price inflation (the first increase being a quarter increase).
- 1.4 In respect of benefits currently accruing, Employers' contributions would be paid as a multiple of members' standard contributions as set out below, from 1 January 2004:

General Staff	2.5
Air Cabin Crew	2.5
Pilots and Officers	3.8
Weighted Average	2.8

Legislative changes and other developments

- 1.5 This is the first actuarial valuation carried out with an effective date after 21 September 2005, and is consequently subject to the requirements of the Pensions Act 2004 and associated Regulations (including the Codes of Practice issued by the Pensions Regulator). A summary of these requirements is provided in Appendix E along with a summary of other relevant legislative developments since 31 March 2003.

Scheme benefits valued

- 1.6 I have valued the benefits set out in the Consolidated Trust Deed and Rules as amended up to 31 March 2006. The main benefits of the Scheme are summarised in Appendix A. The treatment of discretionary benefits is described in Appendix F. There are some pensions payable to former members of Dan Air and Davis & Newman, which are insured with contracts outside the Scheme. Assets and liabilities in respect of these contracts have been excluded from the results shown in this Report.
- 1.7 Significant changes have been made to benefits accruing after 1 April 2007. These changes are summarised in Section 3 of this Report and BA's contribution rates have been assessed taking these changes into account.

Membership data

- 1.8 In order to carry out the present valuation, I have obtained detailed information regarding the current membership of the Scheme from the records held by the administrators to the Scheme. A summary of the data supplied and used to estimate the future benefits payable from the Scheme is given in Appendix B. For two categories of deferred members introduced into the Scheme following a historic acquisition, the data is incomplete, but the number of members involved is small and we have made an approximate allowance for the liabilities in respect of these members.

Pension increases

- 1.9 In the intervaluation period most elements of pensions in course of payment and deferred pensions prospectively payable have continued to be increased in accordance with the Pension Increase (Review) Orders subject to a maximum in any one year of 5%. The actual rates of increase were as follows:

Date of increase	Increase
12 April 2004	2.8%
11 April 2005	3.1%
10 April 2006	2.7%

- 1.10 Pensions in payment as if under the Rules of British Caledonian and Dan Air Schemes, which are paid by the Scheme, were increased as provided for under the relevant rules.

Financial transactions

- 1.11 I have been provided with audited accounts for the years ending 31 March 2004, 31 March 2005 and 31 March 2006. The transactions of the Scheme and the change in the market value of its assets are summarised in Appendix C. This information is presented as a consolidated revenue account drawn from the accounts of the Scheme over the period of three years from 31 March 2003.

Assets

- 1.12 The audited asset statement in the latest accounts shows that the market value of the Scheme's assets at the valuation date was £5,846 million, including external AVC accounts. The corresponding market value of assets at the previous valuation date was £3,186 million. A breakdown of the Scheme's invested assets into the major investment categories is shown in Appendix D.
- 1.13 The Trustees take advice on whether their strategic benchmark asset allocation remains appropriate from time to time. Appendix D sets out the benchmark asset allocation at the valuation date and the revised benchmark after this date. In Section 5 of this Report I refer to the study undertaken to consider how the funding approach interacts with the investment strategy adopted by the Trustees.

Financial assumptions

- 1.14 The financial assumptions used to determine the funding results set out in Section 2 of this Report are specified in the Trustees' Statement of Funding Principles. The financial assumptions are used to estimate the projected amount of the benefits becoming payable and the likely proceeds from investment of the Scheme's assets.

- 1.15 The funding objectives underlying the choice of assumptions and set out in Appendix F are similar to those underlying the previous valuation of the Scheme. A summary of the financial assumptions adopted to determine the Technical Provisions in Section 2 and Section 3 at this valuation and those used in the 2003 valuation of the Scheme is shown below, both in nominal terms and in real terms, relative to the assumed rate of price inflation.

	2006 assumptions		2003 assumptions	
	Nominal	Real	Nominal	Real
	% pa	% pa	% pa	% pa
Price inflation (RPI)	2.7	-	2.5	-
Discount rate	5.2	2.4	6.8	4.2
Earnings escalation				
First 5 years	3.2	0.5	2.5	0.0
5 to 10 years	3.7	1.0	4.0	1.5
After 10 years	4.2	1.5	4.0	1.5
Abatement escalation	2.7	0.0	2.5	0.0
Pension increases other than GMP	2.7	0.0	2.5	0.0
Increases to (1988-1997) GMPs in payment	2.4	-0.3	2.25	-0.25

- 1.16 In Section 3 I have amended the earnings escalation assumption to reflect the fact that pensionable pay will be capped in future at the rate of price inflation. This assumption, together with the remaining financial assumptions in the above table, reflect the assumptions set out in the Statement of Funding Principles.

- 1.17 The Technical Provisions determined on the above financial assumptions will be compared with the market value of the investments of the Scheme. Because the discount rate adopted is determined in relation to the yields on investments on the valuation date, I can confirm that the bases used to value assets and liabilities are compatible.

Expenses

- 1.18 Investment management costs are assumed to be met out of future investment income. The valuation discount rate is therefore net of such costs. Administrative and other non-investment expenses are met by the Scheme and appropriate allowance has been made for these expenses in the contribution rate. BA meets the levies payable to the Pension Protection Fund.

Demographic assumptions

- 1.19 The demographic assumptions adopted for this valuation are detailed in the Appendix to the Statement of Funding Principles, and are reproduced in Appendix H of this Report together with a summary of how these were established by the Trustees.

2 Funding valuation results

- 2.1 As noted under paragraph 1.1, the main purpose of the current actuarial investigation is to review the financial position of the Scheme relative to its statutory funding objective and hence to determine the level of contributions that should be paid in order to ensure that this objective is met. In accordance with the Pensions Act 2004, this assessment has been based upon the method and assumptions specified by the Trustees and recorded in their Statement of Funding Principles (SFP) except that in this Section no allowance has been made for the cap on future earnings escalation in line with price inflation. This is considered in Section 3. A summary of the Scheme's funding objectives extracted from the SFP is provided in Appendix F and I have provided further detail on the method used to calculate the Scheme's Technical Provisions in Appendix G. These Technical Provisions are not the same as the cost of securing the benefits on discontinuance; this eventuality is covered in Section 4 of this Report.

Stage One – Past Service

- 2.2 The following statement compares the Scheme's Technical Provisions (before the changes considered in Section 3) in respect of service up to 31 March 2006 with the market value of the Scheme's assets. The liabilities for in service members include members who have opted to crystallise their benefits.

Valuation statement as at 31 March 2006	£m
Value of liabilities in respect of:	
Current beneficiaries	2,356
Deferred pensioners	906
In service members, in respect of service up to 31 March 2006	4,516
Accumulated AVCs/BAMPS	163
Total value of accrued benefits (the Technical Provisions)	7,941
Total value of assets	5,846
Shortfall	2,095
Funding level (assets ÷ liabilities)	73.6%

- 2.3 The table above shows that the assets currently held by the Trustees are £2,095 million less than the Technical Provisions. The corresponding shortfall as at the 2003 valuation was £928 million, with a funding level of 77.4%.
- 2.4 A broad analysis of the factors contributing to this increase in the shortfall is shown below. The table shows how the shortfall would have changed had the 2003 valuation assumptions been fulfilled in practice.

	£m
2003 shortfall	928
Interest on 2003 surplus	215
Effect of additional contributions agreed at 2003 valuation	(292)
Expected 2006 shortfall	851

- 2.5 However, the actual shortfall as at 31 March 2006 was £2,095 million, representing an increase of £1,244 million. This increase in shortfall has arisen for the following main reasons:

	Increase in shortfall	
	£m	
Net impact of change in market conditions of which:		
- Real investment returns higher than those assumed for the 2003 valuation	(1,543)	
- Effect of changes in market conditions on financial assumptions	<u>1,992</u>	449
Changes to pensioner mortality assumptions		521
Real salary increases higher than expected		127
Changes to commutation factors		98
Miscellaneous		49
Increase in 2006 shortfall		1,244

- 2.6 The movements in the market value of assets can produce results which are volatile over time. This makes it important to monitor the development of the Scheme's finances on a regular basis.

Stage Two – Normal Future Service Contribution Rate

- 2.7 Under the Rules, the Participating Employers are responsible for meeting the balance of the cost of providing the Scheme benefits, after allowing for the contributions paid by members. I have calculated these costs using the method and assumptions specified in the Statement of Funding Principles. The method is the same as that used in the previous valuation. The table below compares the normal Participating Employers' contribution multiples, before any adjustment for surplus or deficit from the 2003 valuation, with those derived from the current valuation.

	Multiple of members' standard contributions	
	2003	2006
General Staff	2.5	5.2
Air Cabin Crew	2.5	5.8
Pilots and Officers	3.8	7.0
Weighted Average	2.8	5.8

- 2.8 Allowance has been made for non-investment expenses (excluding the PPF levy) by including a multiple of 0.1 in the contribution multiples above.
- 2.9 The normal Participating Employers' contribution multiples have increased since the previous valuation for a number of reasons. These include the reduction in the assumed future investment returns and the changes to the demographic assumptions. There has also been some ageing of the active membership.

Stage Three – adjustment to normal future service contributions

- 2.10 BA has proposed and the Trustee has agreed to amend benefits and members' contributions from 1 April 2007. This affects the results of stage two of the process and therefore the adjustment to normal future service contributions is considered in Section 3 of the Report.

3

Changes to the benefits and contributions

- 3.1 As part of the overall plan to meet the valuation shortfall, BA has been considering and consulting on changes to the benefits for future service and to members' contribution rates. Following completion of this process BA has proposed and the Trustees have agreed to the following:
- a. Pensionable pay is to be capped in line with the Index of Retail Prices.
 - b. Air Cabin Crew, Pilots and Officers are to have an increase of 18.75% added to unabated pensionable pay applying to contributions and benefits accruing after 1 April 2007.
 - c. The pension formula will be set at 1/60th of Retiring Pay, and Normal Retirement Age will be 65 (*Plan 65*), for benefits accruing after 1 April 2007.
 - d. If members elect to pay a higher contribution rate Normal Retirement Age is 60 (*Plan 60*).
 - e. Members' contributions from 1 April 2007 will be 5.25% for Plan 65 and 8.50% for Plan 60; these rates reduce to 3.75% and 7.00% respectively if spouses' benefits are excluded.

Changes to Past Service Position

- 3.2 The introduction of the salary cap in 3.1 a. will result in a reduction in active members' past service liabilities and the Technical Provisions. This reduction has been calculated to be £372 million at the valuation date leaving a balance of Technical Provisions over assets of £1,723 million or a funding level of 77.2%. This funding level improves to 87.3% when allowance is included for the lump sum payments of £240 million and £560 million described in 3.4 below.

New Stage Two - Normal Future Service Contribution Rates from 1 April 2007

- 3.3 As a consequence of the benefit and contribution changes, revised future service contribution rates due from the Participating Employers have been determined using the method and assumptions specified in the Statement of Funding Principles. It has been agreed that these rates should now be expressed as a percentage of Pay for Contribution Purposes. The relevant rates payable monthly by the 19th day of the month following that to which they relate are as follows:

	Plan 60	Plan 65
General Staff	19.1%	18.1%
Air Cabin Crew	21.7%	20.7%
Pilots and Officers	25.9%	23.9%

Stage Three – Adjustments to the Contribution Rate in the Recovery Plan

- 3.4 BA has agreed to fund the remaining shortfall of assets below the Technical Provisions which was £1,723 million as at 31 March 2006. After taking into account the difference between contributions and liabilities accruing after 1 April 2006 along with interest accruing the additional contributions required from the Company have been determined to be as follows:

- i) A lump sum payment of £240 million on 9 February 2007;
- ii) A further lump sum payment of £560 million by 2 April 2007; and
- iii) Monthly payments for 9 years of £10.547 million commencing in April 2007 and increasing in line with Pensions Increase (Review) Orders every April thereafter, and payable by the 19th day of the month following that to which they relate.

3.5 BA will pay further sums up to £50 million in respect of each of its financial years ending 31 March 2007, 2008 and 2009. These sums will be paid if the Free Cash reported in BA's consolidated preliminary results exceeds specified levels (Free Cash is defined as cash and cash equivalents and other current interest bearing deposits as reported in BA's consolidated financial statements, excluding any cash or deposits which are, or are to be, hypothecated or pledged or are otherwise subject to a security charge or lien).

3.6 BA has arranged a guarantee of £150 million to be paid to the Scheme, in full or in part, in certain circumstances including BA's insolvency. The guarantee expires on 31 March 2010, but there are provisions for renewal depending on the financial position of the Scheme as at 31 March 2009. The amount of the guarantee will be reduced by any amounts paid under 3.5 above.

4 The position of the Scheme on discontinuance

4.1 The results in Section 2 and Section 3 are based on the assumption that the Scheme is ongoing, with members in service accruing further benefits each year, and benefits being linked to future pay levels. The methodology and assumptions adopted are consistent with this situation. In this section I consider what might happen if the Scheme were to be wound up as defined under Clause 21 of the Trust Deed. For example, the Scheme may wind up if BA terminates its liability to contribute or ceases to exist.

4.2 In the hypothetical situation of discontinuance, the Scheme would have accrued liabilities comprising:

- the pensions currently and prospectively payable to pensioners and deferred pensioners, and the contingent pensions payable to their dependants
- the accrued deferred pensions to which employed members would have become entitled if they had voluntarily left service at the discontinuance date
- increases in deferred pensions after the discontinuance date at the rates provided by statute and by the Rules
- guaranteed pension increases for the above pensions once in course of payment
- an allowance for expenses.

4.3 On discontinuance, the Trustees might seek to meet these accrued liabilities either by buying out the liabilities with an insurance company or by continuing the Scheme as a closed fund. Which of these outcomes is most likely on discontinuance depends on the financial position of BA, the level of assets held in the Scheme and the capacity of the insurance company buy out market. In the following paragraphs, I consider a number of eventualities.

Discontinuance when BA is solvent

4.4 If BA was solvent on discontinuance, recent legislation would impose an employer debt on BA equal to the Actuary's estimate of the full cost of securing all accrued benefits with an insurance company. The amount of the debt that would actually be received in practice would clearly depend on BA's ability to pay what could be a substantial sum of money. However, in theory, in this case all of the benefits would be met. On receiving this employer debt from BA, the Trustees might either buy out the Scheme's liabilities or run the Scheme as a closed fund.

Discontinuance when BA is insolvent

4.5 If the Scheme discontinued as a result of BA being insolvent then an employer debt similar to the situation described in 4.4 would become due. However, such a debt may have a low or even zero rate of recovery in the circumstances of insolvency. The existence of a guarantee as noted in paragraph 3.6 should increase the probability of achieving some recovery, but for the purposes of this Section of the Report I have not taken any credit for this.

4.6 The Scheme would then be tested against the conditions for entry to the Pension Protection Fund (PPF). If the Scheme's assets (including any debt recovery) were less than those considered necessary to secure PPF compensation in full, then the Scheme

would most likely be accepted into the PPF which would then take on responsibility for paying benefits at the PPF level. Alternatively, were the Scheme's assets more than sufficient to secure at least this level of benefits, then the most likely outcome would have been that the Trustees continued the Scheme on a closed basis or sought to buy out benefits from an insurance company. Details of the Scheme's position in each of these cases are considered later in this section of the Report.

Pension Protection Fund

- 4.7 The Government introduced the Pension Protection Fund (PPF) in April 2005 to ensure that pension scheme members receive a minimum level of benefit if the scheme sponsor becomes insolvent. A summary of the terms of the PPF is provided in Appendix E.
- 4.8 The Trustees are required by Section 179 of the Pensions Act 2004 to submit an assessment of the Scheme's discontinuance position, based on specified assumptions and accrued benefit entitlements similar in form to PPF compensation payments, to the PPF Board every three years. The results of my Section 179 valuation for the Scheme as at 31 March 2006 reveal that the Scheme's assets were approximately 77% of the liabilities on this measure. This means that had the Scheme discontinued as at the valuation date, it would most likely have been accepted into the PPF. The PPF would then take on responsibility for paying benefits to the members and would take on the assets of the Scheme in addition. At this point, the Trustees' responsibilities to the Scheme would cease.
- 4.9 As a consequence of this position, the "priority order" for benefit payments – ie the extent to which members would receive their full accrued entitlements – would simply be represented by the benefits payable from the Pension Protection Fund as set out in Schedule 7 of the Pensions Act 2004 (ie benefits 1 and 2 from the priority order in Appendix E).

Approximate cover on buy out

- 4.10 I have also examined the position if the liabilities of the Scheme were to be bought out with an insurance company. In order to estimate the Scheme's solvency position on this basis I have valued discontinuance liabilities using similar principles to those I believe an insurance company would use in setting buy-out costs. I have adopted a discount rate equal to the spot rates on gilts less 0.5% applicable at each future year of benefit outflow. I have also included a separate allowance for winding-up expenses, which has been calculated following a similar approach to that specified for PPF purposes. I have used the same mortality rates as those used for calculating the results in Section 2 and Section 3 in the expectation that an insurance company would accept the use of scheme-specific mortality for a scheme of this size.
- 4.11 It should be noted that the figure quoted in paragraph 4.12 below is only an estimate of the position at 31 March 2006 were the Trustees to have bought out the Scheme's accrued liabilities at that date. In practice, the Scheme is likely to be too large to be bought out based on the current market position and so the estimate reflects our understanding of the basis that might be used for a scheme that could be bought out. This estimate is a guide, and market changes both in interest rates and in demand and supply for this type of business mean that no one estimate can be relied on. Ultimately, the true position could only be established by completing a buy out.

- 4.12 The result of the calculations, based on the position at 31 March 2006, is to suggest that the cover for accrued benefits (the overall *solvency* level) would have been approximately 52% on this approach. This compares with a solvency level of around 54% in the valuation as at 31 March 2003, although that was carried out using different assumptions.
- 4.13 Had the Scheme been exactly 100% funded on the Technical Provisions basis (after the adjustments considered in Section 3 of this Report), it would have been around 67% funded on the basis used to estimate the solvency position of the Scheme.

Running the Scheme as a closed fund

- 4.14 The application of the relevant legislation in this area is currently unclear. However, if it were possible to run the Scheme as a closed fund on discontinuance, I would anticipate that the investment strategy would move to a lower risk basis consisting mainly of appropriate gilts. This would enable the Trustees to provide benefits with a very high level of security on a self-sufficient basis without further support from BA. This is in line with the Trustees' subsidiary funding objective as described in Appendix F. I have therefore assumed a discount rate for this purpose based on unadjusted gilt yields and made an appropriate allowance for the expenses of running a closed fund. The remaining assumptions are the same as those used in calculating the solvency position.
- 4.15 My calculations show that if it were decided (and possible) to proceed on this basis, the assets would have covered 59% of the value of accrued benefits at the valuation date. The fact that this cover is lower than the ratio of assets to Technical Provisions reflects the lower future return expected as a consequence of the change in the investment strategy.

5 Commentary on the results

- 5.1 As noted above, the assumptions used to determine the Scheme's *Technical Provisions* under Sections 2 and 3 or the Scheme's *solvency* position under Section 4 represent only one view of likely future events. Recent experience of UK pension schemes has highlighted how the financial position can be impacted by actual experience being different from the valuation assumptions, particularly in relation to both investment returns and post-retirement mortality.

Sensitivity to investment conditions

- 5.2 The financial assumptions made in determining the funding target and the associated contribution requirements are described in the Statement of Funding Principles. They cover, amongst other things, the approach used to determine the discount rates for the liability calculation and the investment returns that are assumed to be achieved on the Scheme's assets. The results of the valuation are particularly sensitive to the assumed level of the future returns that will be achieved on the Scheme's investments. In practice, the actual outcome will differ from the assumption.
- 5.3 The possible variation in outcomes is considerable given the substantial proportion of the assets expected to be invested in volatile assets such as equities which may not move in line with the assessment of the liabilities. The Trustees, members and the Participating Employers should therefore be aware of the sensitivity of the results to future investment conditions.
- 5.4 If investment returns are lower in the long term than expected, then the long-term cost of providing the benefits will be higher. Similarly, if investment returns fall short of the assumptions made in the valuation, then the funding position of the Scheme will worsen.
- 5.5 By way of example, if the yields available on fixed and index-linked bonds were to have fallen by 0.25% per annum at the valuation date, with a corresponding impact on the discount rate but without any change in other asset values, I estimate that the following changes in funding levels would have taken place.

	Technical Provisions funding level	Closed Fund funding level
Current position	77%	59%
0.25% pa fall in bond yields	76%	56%

At the same time, the normal joint contribution rate payable would have increased by around 0.6% of Pay for Contribution Purposes.

- 5.6 I have also prepared an illustration of the effect on the Scheme's financial position of sizeable movements in the equity market relative to the liabilities, assuming these occurred at the valuation date. These figures are based on the actual asset distribution as at the valuation date (around 69% of assets were held as equities) as set out in Appendix D. The figures assume no movement in the non-equity asset values and make no allowance for any adjustment to the assumed discount rate.

Equities relative to liabilities	Technical Provisions funding level	Closed Fund funding level
20% decrease in equity values	66%	50%
Current position	77%	59%
20% increase in equity values	88%	67%

- 5.7 In conclusion, given that investment conditions can be very volatile, particularly in the short term, there is a risk that the financial position of the Scheme could be worse and contributions calculated to be required under the funding plan will prove insufficient. Conversely, substantial increases in equity values relative to movements in the liabilities could significantly reduce the deficit.
- 5.8 ‘Catastrophic’ investment conditions which would produce significantly worse funding positions than those shown in the above table are also possible.

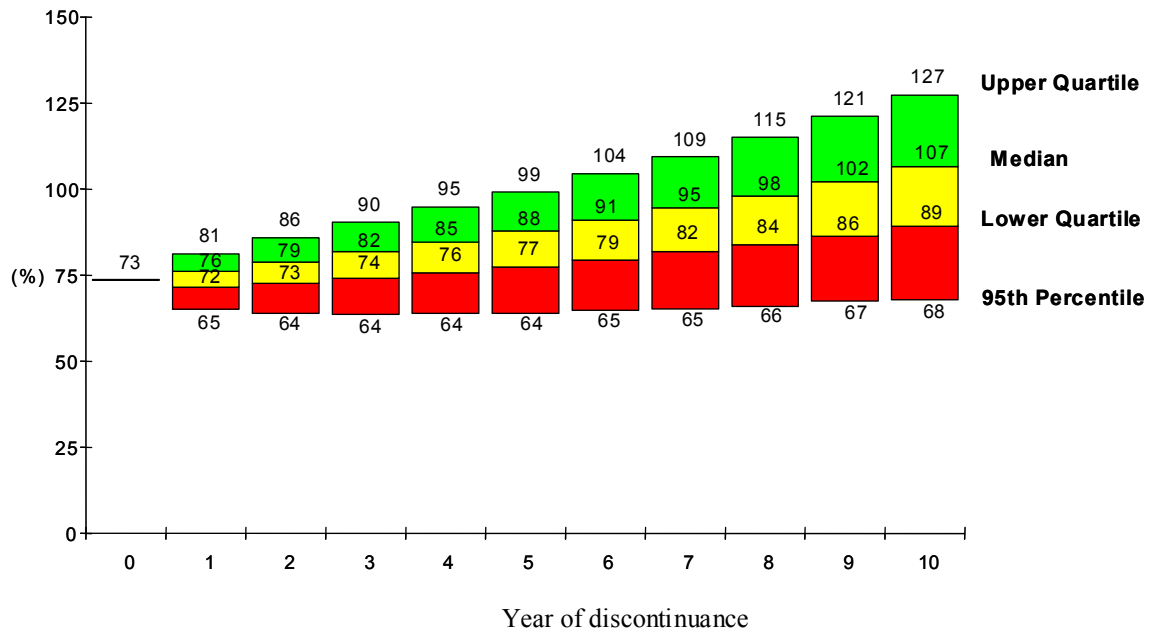
Sensitivity to mortality experience

- 5.9 A full pensioner mortality investigation is undertaken at each valuation as referred to in Appendix H. Clearly, the Scheme is susceptible to future variations in the mortality experience of its pensioners relative to the assumptions adopted. By means of an example, if I were to assume that the life expectancy of each Scheme member was one year longer than implied by the current ongoing funding assumptions, I estimate that the Scheme’s funding level compared to its Technical Provisions would fall from around 77% to approximately 75%. In addition, this would increase the contributions payable by the Participating Employers by around 0.5% of Pay for Contribution Purposes.

Future sensitivity projections

- 5.10 The above sensitivities illustrate how the valuation results might have appeared were market conditions at 31 March 2006 to have differed significantly from their actual levels. This does not, however, directly show how the Scheme’s position is expected to develop over time given the Scheme’s current investment policy to hold a substantial proportion of assets in relatively volatile investments such as equities.
- 5.11 The following chart illustrates how the Scheme’s closed fund position is expected to develop over time given the Trustees’ current investment policy as described in Appendix D. The financial position is illustrated assuming an approximate gilts discontinuance measure (calculated by adjusting the ongoing results to a single discount rate of 4.0% pa in line with short-term gilt yields at the valuation date and removing allowance for future salary increases). I have used a stochastic projection of the Scheme’s assets based upon Watson Wyatt’s standard global asset model as at 31 March 2006, allowing for further build up of benefits and the payment of normal future service contributions. The starting point takes credit for the lump sum payments described in paragraph 3.4 i) and ii). These have improved the starting funding level from 64% to 73% (the initial funding level of 64% is higher than the 59% in paragraph 4.15 due to the use of a single discount rate approximation for these projections). Regular shortfall payments are assumed to be paid broadly in line with the proposed Recovery Plan.

Projected funding level on closed fund basis



- 5.12 The chart shows the projected closed fund position if the Scheme were to continue in full force and then be discontinued at a given year in the next ten years. The chart highlights that there is a significant spread of possible outcomes after 10 years. For example, the median outcome (where 50% of outcomes are expected to be worse) is a funding level of 107%, whereas the “1 in 20” worst outcome (where 5% of outcomes are expected to be worse) is a funding level of 68%. This means that under the proposed Recovery Plan the shortfall disclosed at 31 March 2006 on the closed fund basis is expected to be extinguished within ten years under the current investment strategy. There is, however, a risk that the Scheme’s closed fund position will deteriorate from the present position.
- 5.13 The expected progression of the solvency basis (as determined for buying out benefits with an insurance company) will follow a similar pattern to the closed fund position above. The reason for this is that the discount rates in both cases relate to gilt yields and therefore the liabilities will move similarly. The above graph therefore indicates that the solvency position can also be expected to improve. For example, the median outcome after three years is estimated to be an overall solvency level of 66%, an improvement of 14% over the position at the valuation date. There is a possibility that this will improve the Scheme’s funding position to a level where it would not qualify for entry to the PPF. In this case, coverage of benefits in classes 3 and 4 of the priority order described in Appendix E would start to be available.

A Summary of the main benefits of the Scheme

The following summary does not reflect the benefit and contribution changes with effect from 1 April 2007. These are described in paragraph 3.1.

Definitions

Normal Retirement Age (NRA)	General Staff: 60; Pilots and Air Cabin Crew: 55
Pensionable pay	Remuneration designated by the Employer as pay for these purposes.
Retiring Pay	The average of members' pensionable pay for contribution purposes during the best two years of the last five years of pensionable service. Pensionable pay for contribution purposes is pensionable pay in excess of 1½ times the Lower Earnings Limit. For members under Part 2 of the Rules, pensionable pay for contribution purposes is 85% of pensionable pay or pensionable pay less 1½ times the Lower Pensions Limited if greater.
Pensionable service	Service in respect of which contributions have been paid to the Scheme.

Benefits

Retirement at NRA	General Staff – a pension of 1/56 th of Retiring Pay for each year of pensionable service. Pilots and Air Cabin Crew – a pension of 1/52 nd of Retiring Pay for each year of pensionable service.
Retirement on ill health	An immediate pension calculated as for retirement at NRA but including one half of potential future pension service as pensionable service.
Lump sum on retirement	On retirement, part of the pension may be exchanged for a lump sum.
Death after retirement	A spouse's pension of 2/3 ^{rds} of member's pension (accrued while Higher Rate contributions were made) which would have been in payment at the date of death assuming no pension was commuted at retirement. Children's allowances are also payable.
Death in service	A lump sum of three times pensionable pay is payable. A dependant's pension equal to 2/3 ^{rds} of the pension which the member would have received at NRA had he not died in service and including one half of future potential service for a Higher Rate contributor.

Leaving service A deferred pension is payable from NRA based on Retiring Pay at date of leaving and past pensionable service. Deferred pensions are revalued up to date of retirement in line with Statutory Revaluation Orders.

Pension increases in payment Pensions in excess of any Guaranteed Minimum Pension (GMP) are increased in line with the Pension Increases (Review) Orders, subject to a maximum of 5% a year.

GMPs arising from service after 5 April 1988 are increased in line with RPI, subject to a maximum of 3% a year.

Members' contributions	Higher Rate	Lower Rate *
General Staff	5.25%	3.75%
Pilots and Air Cabin Crew	6.50%	5.00%

In addition, members may elect to pay Additional Voluntary Contributions (AVCs) on the Trustees' published AVC terms.

* The Lower Rate is payable if spouses' benefits are excluded.

Members of the BAMPS Section of the Rules are provided with money purchase benefits and lump sum death benefits whilst in service of three times pensionable pay.

B Membership data

The data submitted to us for the purposes of the valuation is summarised below; the corresponding 2003 figures are shown for comparative purposes.

Membership data at this and the previous valuation date

	At 31 March 2006		At 31 March 2003	
	Number	Annual Pay £m	Number	Annual Pay £m
Members in service (FSS only) *				
Males				
General Staff	12,585	374.2	15,184	384.6
Air Cabin Crew	3,520	79.4	3,728	68.9
Pilots and Officers	2,496	167.5	2,720	147.8
	18,601	621.1	21,632	601.3
Females				
General Staff	6,587	173.8	8,537	186.3
Air Cabin Crew	8,127	184.5	9,158	168.9
Pilots and Officers	154	8.6	150	6.4
	14,868	366.9	17,845	361.6
Total members in service	33,469	988.0	39,477	962.9

	At 31 March 2006		At 31 March 2003	
	Number	Annual Pension £m	Number	Annual Pension £m
Current pensioners				
In own right	13,219	120.6	11,127	89.5
Widow(er)s	1,993	11.4	1,577	9.5
Dependants/Children	232	0.4	232	0.4
Total current pensioners	15,444	132.4	12,936	99.4
Total deferred pensioners	20,474	58.7	17,633	47.8

* in addition there were 191 (2003 : 193) members of BAMPS with combined entitlements of £3.8 million (2003 : £2.6 million).

C Financial transactions since 31 March 2003

Over the three year period to 31 March 2006, the Scheme has undertaken the following financial transactions:

Consolidated Revenue Account for the period 1 April 2003 to 31 March 2006

	£m	£m
Fund at 31 March 2003		3,186.3
Income		
Contributions from Employer - normal	617.2	
- additional	24.3	
Contributions from members - normal	146.4	
- AVCs	23.3	
Income from investments	380.7	
Transfer values received from other funds	8.1	
Funded pensions receivable	13.6	
Total income		1,213.6
Expenditure		
Benefits paid - pensions	345.2	
- commutation lump sums	73.3	
Lump sum death benefits	10.1	
Transfer values paid to other funds	42.9	
Refund of contributions and payment of State premiums	0.3	
Administrative expenses	14.3	
Investment management charges	9.6	
Total expenditure		495.7
Change in market values		1,941.8
Fund at 31 March 2006		5,846.0

The above details include information in respect of four external Additional Voluntary Contribution Schemes. They are run for members who transferred from the British Caledonian Group Pension and Life Assurance Scheme, Davies & Newman Holdings Plc Pension and Life Assurance Scheme and Dan Air Service Ltd Pension and Life Assurance Scheme. The value of these funds at 31 March 2006 is £1.3 million.

D Asset information

Summary of Investments held at 31 March 2003 and 31 March 2006

	Market Value as at 31 March 2003		Market Value as at 31 March 2006	
	£m	%	£m	%
UK equities	1244.2	39.1	2010.0	34.4
Overseas equities	767.9	24.1	2032.9	34.8
Index-linked securities				
- UK public sector	373.5	11.7	500.3	8.5
- UK other quoted	2.5	0.1	3.1	0.0
- Overseas sterling quoted	86.0	2.7	61.3	1.1
Fixed interest securities				
- UK public sector	215.4	6.8	257.1	4.4
- UK other quoted	143.6	4.5	225.5	3.9
- Overseas sterling quoted	61.7	1.9	61.2	1.0
Private equity	-	-	3.9	0.1
Property	219.5	6.9	398.4	6.8
Other investments	19.9	0.6	16.2	0.3
Cash/net current assets	49.9	1.6	274.8	4.7
Total Fund	3184.1	100.0	5844.7	100.0

These figures exclude information in respect of four external Additional Voluntary Contribution Schemes. They are run for members who transferred from the British Caledonian Group Pension and Life Assurance Scheme, Davies & Newman Holdings Plc Pension and Life Assurance Scheme and Dan Air Services Ltd Pension and Life Assurance Scheme. The value of these funds at 31 March 2006 was £1.3 million.

Strategic asset allocation

The Trustees have a Scheme-specific strategic investment policy in the form of the following fixed benchmark allocation.

	Benchmark allocation at 31 March 2006	Current benchmark allocation
	%	%
UK equities	32.5	31.5
International equities	32.5	31.5
Index-linked bonds	14.0	14.0
Fixed interest bonds	13.0	13.0
Property	7.0	8.0
Commodities	-	1.0
Cash	1.0	1.0
Total	100.0	100.0

E Legislative changes since 31 March 2003

Legislative changes – Pensions Act 2004 (and associated Regulations)

Since the previous valuation the government enacted the Pensions Act 2004 which introduced new requirements on the funding of UK defined benefit pension arrangements and several other measures that directly or indirectly affect the Scheme.

Scheme funding

The Pensions Act 2004 replaced the prescriptive statutory funding test (the ‘Minimum Funding Requirement’) with a scheme-specific standard for actuarial funding valuations with an effective date after 21 September 2005. The legislation was supplemented with regulations and codes of practice. This is the first actuarial valuation of the Scheme under this new funding regime. Central to the new funding regime are:

Statutory Funding Objective (SFO) – this is a requirement that the Scheme has appropriate and adequate assets to meet its *Technical Provisions*. The Technical Provisions mean the Actuary’s assessment, calculated on the scheme-specific assumptions determined by the Trustees, of the amount required to meet the Scheme’s liabilities as they fall due

Statement of Funding Principles (SFP): this is a document prepared by the Trustees which must set out their policy for ensuring that the SFO is met. That is, it must set out the Trustees’ choice of methods and assumptions for determining the Scheme’s Technical Provisions, after taking advice from the Actuary. The regulations require the Trustees to reach agreement with the Participating Employers on the content of the SFP.

Under Rule 5(c), the Actuary had the power to determine the contributions that should be paid to the Scheme. Under the new funding regime, the Actuary no longer has the power to determine the contributions to be paid to the Scheme and instead the Trustees and the Participating Employers must reach an agreement on the contributions to be paid.

The main purpose of the actuarial funding valuation is then to assess whether the Scheme meets its Technical Provisions at the effective date of the valuation, based upon the method and assumptions specified in the SFP. The Actuary has to certify that the calculation of the Technical Provisions at the valuation was calculated in accordance with the prescribed requirements.

It is important to note that the legislation does not require schemes to fund at a level sufficient to meet the buy-out cost of the liabilities, or even the buy-out cost of the ‘protected liabilities’ under the Pension Protection Fund (PPF). The Trustees are required, however, to obtain the Actuary’s estimate of the Scheme’s solvency position at the effective date of the valuation.

If the valuation reveals that the Scheme does not have sufficient assets to cover its Technical Provisions, the Trustees are required to prepare a *Recovery Plan* to bring the Scheme back to full funding (i.e. the assets to meet the Technical Provisions). The Recovery Plan must be based upon advice from the Actuary and have regard to the nature and circumstances of the Scheme. It must also be agreed with the Participating Employers.

On receiving the actuarial valuation report, the Trustees and the Participating Employers have to agree a Schedule of Contributions which specifies the contributions to be paid to the Scheme by the members and the Participating Employers and the dates by which they are required to be paid. This

Schedule must also be agreed with the Participating Employers and must be certified by the Actuary.

Pension Protection Fund (PPF)

The Pensions Act 2004 introduced the Pension Protection Fund (PPF) with effect from 6 April 2005. The PPF is intended to ensure that members of defined benefit occupational pension schemes can be assured that they will receive a minimum proportion of their accrued retirement benefit, if their employer's business fails. That is, on an insolvency event of the employer the trustees of a pension scheme can apply for admission to the PPF and if it meets prescribed criteria (in particular, but not limited to, the scheme having insufficient assets to secure the minimum level of benefits on a prescribed actuarial basis) then the PPF will absorb the assets of the Scheme and provide a benefit currently as described below:

- For non-pensioners: a deferred pension equal to 90% of the pension built up to date, subject to a maximum amount and payable on attainment of Normal Pension Age.
- For pensions in payment: where the member is younger than Normal Pension Age and retired in normal health, 90% of the pension in payment subject to a maximum amount which varies by age. For other pensioners (or dependants) the pension in payment.
- Deferred pensions are increased in line with price inflation (capped at 5%) between the assessment date and Normal Pension Age.
- In payment, pensions built up before 6 April 1997 receive no increases in payment. Pensions built up on or after that date will increase in line with price inflation (capped at 2.5% a year).
- A 50% survivor's pension is provided if a survivor's pension was provided under the scheme rules.

In the above, Normal Pension Age is essentially the earliest age at which members can receive an unreduced pension under the scheme rules. In the case of the Scheme, this is generally age 55 for Flight Crew and age 60 for other members. After 1 April 2007, this may change depending on each member's choice of Plan 60 or Plan 65.

Consequently, the PPF does not provide benefits at the same level as those provided by the Scheme.

The PPF is funded through a combination of scheme-based and risk-based levies on UK occupational defined benefit pension schemes; although in the event of it having insufficient funds to meet its liabilities it can decide to reduce the compensation payments being paid to ex-pension scheme members. As part of the assessment of the risk-based levy, pension scheme trustees are required under Section 179 of the Pensions Act 2004 to submit routinely an assessment of their scheme's discontinuance position, based upon assumptions specified by the PPF and accrued benefit entitlements in a similar form to the compensation payments that could be provided by the PPF.

The government established the PPF Board to oversee the fund and also to raise annual levies with defined benefit arrangements to finance its liabilities and its running costs. The government also introduced a Pensions Regulator, one of whose roles is to ensure the security of the PPF.

Statutory Priority Orders

On buying out the Scheme's liabilities, the Scheme benefits would have been secured in the priority order specified in the Trust Deed and Rules, as overridden by the Pensions Act 1995 and associated regulations. With effect from 31 August 2005, the benefits would have needed to be secured in broadly the following order (after allowing for expenses and any potential debts to third parties).

1. Benefits relating to pension annuities secured by the Scheme before 6 April 1997.
2. The cost to the Scheme of securing the liabilities for pensions and other accrued benefits that would be payable by the PPF (if the Scheme were eligible for entry to the PPF).
3. Benefits in respect of defined benefit AVCs not already covered above (money purchase liabilities are to be excluded from the priority order and should therefore be secured in full).
4. All other pensions and benefits provided by the Scheme, including pension increases (where these exceed those under the PPF).

Other

The Pensions Act 2004 introduced a number of other measures, including:

- It provided the framework for implementing the European Union Pensions Directive in relation to cross-border arrangements.
- For benefits built up after 5 April 2005, the statutory minimum annual increase to pensions in payment is price inflation subject to a cap of 2.5%. The Rules of the Scheme currently provide a higher level of increase to pensions in payment.
- There were a number of measures relating to the pensions aspects of commercial transactions and business reorganisations.
- There were minor modifications to the provisions covering contracted-out rights.

F Funding objectives

This Appendix is an extract from the Scheme's Statement of Funding Principles dated 7 February 2007 that describes the Trustees' chosen funding objectives on which the results of Section 2 of this Report were based.

Statutory funding objective

The statutory funding objective is that the Scheme should have sufficient and appropriate assets to cover its Technical Provisions, and this statement sets out the Trustees' policy for securing that this objective is met.

Subsidiary funding objectives

In addition to the statutory funding objective, the Trustees have a subsidiary funding objective which is to be able to provide benefits in accordance with the Scheme Rules with a very high level of security on a self-sufficient basis without reliance on further support from BA. For this purpose the Trustees will calculate the value of the liabilities allowing only for investment returns from risk-free assets such as gilts, and will include suitable loadings to cover risks and expenses. The Trustees will have regard to the Scheme's anticipated progress towards meeting this subsidiary objective when deciding on funding matters and BA acknowledges that over time the calculation of Technical Provisions will converge towards the liabilities determined in accordance with this subsidiary objective.

Technical Provisions

Method

The Trustees and BA have agreed that the Technical Provisions for the Scheme at any given date are to be calculated as the capital value of the prospective benefits arising from service completed before that date, including allowance for prospective salary increases for those members in active service at that date. This method of calculating Technical Provisions is commonly known as the projected unit credit method.

Assumptions

The Trustees and BA have further agreed that:

- the discount rate used to calculate the capital value of future cash flows will be a prudent estimate of future investment returns on the assets of the Scheme, allowing for expected changes in the investment policy over time;
- the estimate of future investment returns together with the remaining financial assumptions, in particular future price inflation, will take into account information available in respect of the relevant investment markets at the effective date of the actuarial valuation;
- demographic assumptions will have regard to an analysis of recent changes in the Scheme membership as well as relevant statistics applicable to similar pension schemes, and the Trustees' and BA's views about how these may change in future.

Taken together, the assumptions adopted at a particular date will be prudent and consistent with the Trustees' desired level of confidence that assets equal to the Technical Provisions will prove adequate to meet benefits already accrued as they fall due without the need for further contributions.

Discretionary Benefits

There are a number of areas where the benefits payable are subject to some exercise of discretion on the part of the Trustees and/or BA, the principal details of which are set out below:

- At BA's request, and upon payment to the Scheme of any contributions advised by the Actuary to be necessary, the Trustees shall increase or alter any benefit or provide additional benefits under the Scheme. The Trustees and the Company have agreed that such discretionary benefits will not be taken into account in the calculation of Technical Provisions, but that the capital value of any such benefits granted would be paid in full by BA at the time the discretion is exercised.
- Aside from these general provisions there is no requirement for either the Trustees or BA to consider granting discretionary increases to pensions in deferment or in the course of payment, which receive guaranteed levels of increases as specified in the Rules of the Scheme. Consequently for the purposes of calculating the Technical Provisions, no allowance for discretionary pension increases is made.
- There are a number of options that enable Members to convert the benefits from one form into another subject to the Trustees' consent, such as on early retirement, crystallisation (late retirement), ill-health retirement, or the commutation of pension into cash at retirement. Following completion of formal valuations it is anticipated that the terms for most of these options will be reviewed and updated to be cost neutral on the Technical Provisions basis, and so the Trustees and BA have agreed that no allowance for the exercise of these options will be made in the determination of Technical Provisions. However, it is anticipated that the terms applying for cash commutation will continue to differ from those on the Technical Provisions basis, and so the Trustees and BA have agreed to make allowance for the commutation of some pension into cash in the calculation of Technical Provisions.

G Description of the valuation method

The method and assumptions used to determine the Scheme's Technical Provisions are specified in the Statement of Funding Principles dated 7 February 2007. This Appendix explains how those Principles have been implemented for the purpose of the actuarial valuation of the Scheme as at 31 March 2006.

Funding method

The actuarial valuation involves projecting the benefits payable in future to members and their dependants under the Rules of the Scheme. Benefits are payable on retirement, death or leaving service. The amount of the benefit payable depends on the length of pensionable service, the level of pensionable salary when the event occurs and the pension increases subsequently given. In projecting these payments, assumptions are made about the likelihood of a benefit becoming payable at any future date (the demographic assumptions) and about members' future salary escalation and increases to pensions (the financial assumptions).

In many respects the valuation is similar to an estimate of each future year's Scheme revenue account, based on the information available at the valuation date. It also includes assumptions about the future progress of the benefit outgo and the Scheme's income. However, if the results of these calculations were presented as a series of cash flows for each of the 70 or more future years in which they occur, it would not be readily apparent whether the Scheme's current and future resources were adequate to cover the expected benefits. In order to make a clear comparison between the expected outgo and income, each item of income and expenditure is discounted to the valuation date at the assumed rate of return (or discount rate).

The valuation method used involves the separation of benefits earned to date (and the assets accumulated to cover those benefits) from benefits arising in respect of future service. The long-term funding objectives are that accumulated assets should equal the past service liabilities and that the normal contribution rate should cover future service benefits. The valuation is accordingly made in three stages, which are described below.

Stage One - Past Service

I first calculate the accrued benefits, ie those earned for service before the valuation date. Accrued benefits include the total benefit for pensioners and deferred pensioners, because all their Pensionable Service was completed before the valuation date. For current members, accrued benefits are the prospective benefits for service up to the valuation date, allowing for future salary increases. I discount the expected future payments of accrued benefit at a prudent rate of return appropriate to the valuation of assets at market value; this rate is determined by the Trustees in accordance with the Statement of Funding Principles. The resulting capital value of the liabilities (the *Technical Provisions*) is the market value of the assets which would cover them.

If the assets equalled the Technical Provisions it would be expected that, if the Scheme were to be terminated, but employment continued, there would be sufficient money to provide the accrued benefits as and when they fell due if the assumptions made were borne out in practice. The calculation includes provision for the effect of future salary increases. Stage one therefore establishes the extent of any imbalance between the amount of money required to provide benefits which have been accrued and the assets actually held at the valuation date. It should be noted that a level of 100% or more on this basis does not necessarily imply that the assets would be sufficient to secure the benefits with an insurance company in the event that the Scheme is wound up.

Stage Two - Normal Contribution Rate

The second stage is to calculate the normal future service contribution rate. This is the rate required to meet the cost of benefits of current employed members for service after the valuation date. Under the method adopted, average contribution rates are calculated for each category of member which, expressed as a percentage of the pensionable pay (defined for contribution purposes) of the relevant members, would be adequate to meet the cost of benefits earned in the year following the valuation date.

In calculating the normal contribution rate, an appropriate allowance is made for the probability that the member remains in the Scheme until retirement, according to the chosen assumptions. The retirement pension payments are then discounted to the valuation date at the rate of return referred to above in order to arrive at the capital cost of normal retirement benefits. Benefits payable at other ages are evaluated in a similar way according to the nature of the event giving rise to the benefit (death, leaving service or ill-health retirement).

Stage Three - Adjustments to Contribution Rate

The final stage is to adjust, for a temporary period, the normal contribution rate determined under stage two to allow for any imbalance (positive or negative) between the value of the accrued benefits and the market value of the accumulated assets, as disclosed by stage one. If there is a deficit, the proposed method of elimination must be detailed in a *Recovery Plan* that the Trustees will submit to the Pensions Regulator.

Stability of contributions

The funding method described above is generally referred to as the “projected unit” method. Only the membership at the valuation date is taken into account and there is therefore no allowance for future entrants.

The normal contribution rate will not be substantially affected if the membership profile remains broadly similar in terms of age and gender. However, it will be affected if the distribution of members changes significantly from one valuation to another. As the Scheme is closed to new members it may be expected that the rate will rise over time as the average age of the membership increases.

As with virtually all funding methods, the stability of pension contributions is affected by any past service adjustments and volatility from this source may well exceed variations in the normal contribution rate. The actual effect on contributions will depend on the period over which any imbalance is to be rectified.

Actuarial assumptions

In order to make the calculations described above, a number of assumptions need to be made about future events. These include both demographic and financial assumptions, which are specified in the Statement of Funding Principles, and summarised in Section 1 and Appendix H.

A small change in the relative levels of the financial assumptions can have a significant effect on the value placed on the estimated benefit outgo and Scheme income. The results are particularly sensitive to the real discount rate and post-retirement mortality rates assumed. The sensitivities to these actuarial assumptions are shown in Section 5 of this Report.

H Demographic assumptions

The demographic assumptions agreed between the Trustees and BA for assessing the Scheme's Technical Provisions are summarised below.

In service decrements and promotional salary increases

For each separate category of active member, various assumptions are made about the rates of decrement from active membership on account of withdrawal (resignation), death or ill-health retirement at each age. In addition, age-related increases to unabated pensionable pay arising from promotion and service increments are assumed. Sample rates for the separate categories of active members are shown in the tables below.

Post-retirement mortality

The post-retirement mortality assumption for males, which is calibrated against the Scheme's experience, is based on the standard 80-series tables issued by the CMIB projected to calendar year 2006 and rated down by two and a half years. The post retirement mortality assumption for females is based on the 00-series tables issued by the CMIB for combined retirements (age and ill health) projected to calendar year 2006 on the medium cohort improvement factors and rated down by one year. There is insufficient data to carry out a proper review of mortality rates for females and so I have used a table based on the experience for the Airways Pension Scheme as a close proxy.

In addition allowance is made for future improvements in rates of mortality from calendar year 2006 by reducing the rates of mortality from the base tables described above according to the medium cohort improvement factors issued by the CMIB.

Pre-retirement mortality for deferred pensioners

Consistent with post-retirement mortality assumptions.

Spouses' and dependants' pensions

The proportion of members who die prior to retirement assumed to give rise to a spouse's or dependant's pension is dependent on age but is around 90% for men and 80% for women. In retirement, members' current marital status is assumed to remain unchanged, other than through the spouse subsequently pre-deceasing the member.

Age difference between members and dependants

Prior to retirement, members are assumed to have an age difference (male – female) of up to three years depending on age. Members in retirement are assumed to have an age difference (male – female) of three years.

Allowance for option of members to commute pension for cash at retirement

Members are assumed to commute 25% of their pension for cash at retirement. The commuted pension is assumed to be converted to cash on the revised terms that the Trustees have decided to adopt with effect from 1 April 2007 following advice from the Actuary.

In service decrements and promotional salary increases: Flight Crew

Age	Sample rates of decrement per 1,000 members at each age				Assumed percentage increase in pay to the next year of age
	Withdrawal	Death		Ill-health retirement	
		Men	Women		
25	10	0.4	0.2	-	7.1
30	10	0.4	0.2	0.5	4.3
35	10	0.4	0.3	1.2	3.5
40	10	0.6	0.5	2.5	3.1
45	10	1.1	0.8	5.0	2.5
50	-	2.0	1.2	5.0	1.3
55	-	3.5	1.9	5.0	0.7
60	-	6.2	3.1	-	-

Note that all co-pilots are assumed to attain command before leaving the Scheme.

In service decrements and promotional salary increases: Cabin Crew

Age	Sample rates of decrement per 1,000 members at each age					Assumed percentage increase in pay to the next year of age
	Withdrawal		Death		Ill health retirement	
	Men	Women	Men	Women		
25	50	56	0.5	0.2	0.7	6.9
30	35	50	0.5	0.2	0.9	3.0
35	20	38	0.5	0.3	1.9	1.7
40	10	27	0.8	0.5	3.1	1.7
45	-	16	1.4	0.8	3.8	1.5
50	-	5	2.6	1.2	4.5	1.5
55	-	-	4.7	1.9	12.0	-
60	-	-	8.2	3.1	22.0	-

In service decrements and promotional salary increases: Ground Staff (GSS and Engineering)

Age	Sample rates of decrement per 1,000 members at each age			Assumed percentage increase in pay to the next year of age
	Withdrawal	Death	Ill-health retirement	
25	70	0.5	1.0	9.2
30	56	0.5	1.3	2.1
35	45	0.6	1.9	1.8
40	36	0.9	1.9	1.8
45	30	1.6	2.2	1.7
50	11	3.0	3.1	1.5
55	-	5.3	6.3	1.5
60	-	9.1	9.7	1.4

In service decrements and promotional salary increases: Ground Staff (Other)

Age	Sample rates of decrement per 1,000 members at each age						Assumed percentage increase in pay to the next year of age
	Withdrawal		Death		Ill health retirement		
	Men	Women	Men	Women	Men	Women	
25	210	126	0.5	0.2	1.0	1.0	5.2
30	145	99	0.5	0.2	1.0	1.0	3.6
35	100	77	0.5	0.3	1.0	1.0	2.8
40	69	54	0.8	0.5	1.0	1.0	1.5
45	47	36	1.4	0.8	1.5	2.0	1.2
50	12	18	2.6	1.2	2.7	4.4	0.9
55	-	-	4.7	1.9	5.8	12.0	0.9
60	-	-	8.2	3.1	9.5	22.0	0.7

Intervaluation experience

The Trustees' decision to calculate the Scheme's Technical Provisions based upon the above assumptions relied upon advice that they received from me about the experience of the Scheme over the period since 31 March 2003 and general expectations about how this might develop in future.

At successive valuations I analyse the experience since the previous valuation, as far as the available data permits, to see whether changes need to be made to these assumptions. My investigation of the Scheme's experience in the three-year period to 31 March 2006 suggested:

- The rate at which salaries increase due to members' general career progression was shown to be higher than assumed at the previous valuation for male and female Cabin Crew, male GSS and engineering grades and female general staff. Adjustments were made to the existing assumptions to reflect the experience.
- The withdrawal experience for male general staff (excluding GSS and engineering grades) reflected higher turnover than previously assumed and appropriate increases were made to the assumed rates for this valuation.
- The ill-health retirement experience was in line with that assumed except for male Cabin Crew where the experience was somewhat lighter than expected. A change was made to reflect the experience for these members.
- The death-in-service rates assumed at the previous valuation were in line with the experience and no change was considered necessary for this valuation.
- The male pensioner mortality experience relative to the mortality rates adopted for the 2003 valuation revealed that there had been fewer deaths than expected. It was found that the 80-series base table which had been adopted for the 2003 valuation provided a better fit across all ages than more recent tables produced by the CMIB. The 80-series table was therefore retained but with a rating down of two and a half years in age.
- The female pensioners', widows' and widowers' experience data for NAPS is too sparse to deduce the underlying mortality. It was decided to refer to the APS experience for the female pensioners' and widows' categories and the same mortality rates were adopted for NAPS. For widowers the male pensioner mortality was considered to be appropriate.

- Investigations were also made into the expected trend in mortality by examining the pensioner mortality experience over the six years preceding 31 March 2006. The investigation suggested that mortality had been improving although there was some uncertainty as to the extent of the year-by-year improvement. It was decided to adopt medium cohort improvement rates.

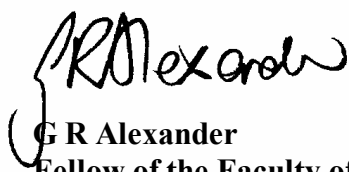
Certificate of Technical Provisions

Actuarial certification for the purposes of regulation 7(4)(a) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005

Name of scheme: **The New Airways Pension Scheme**

Calculation of Technical Provisions

I certify that, in my opinion, the calculation of the Scheme's Technical Provisions as at 31 March 2006 is made in accordance with regulations under section 222 of the Pensions Act 2004. The calculation uses a method and assumptions determined by the Trustees of the Scheme and set out in the Statement of Funding Principles dated 7 February 2007.



G R Alexander
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29 March 2007

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