

# Annual Report and Accounts 2007

Airways Pension Scheme

**Year ended  
31 March 2007**

# Annual Report and Accounts

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# Chairman's Review

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The last year was certainly eventful. Our main focus of the year was the three-yearly actuarial valuation. The results of the valuation as at 31 March 2006 showed that APS remains in good shape with a small non disposable surplus of £22 million. As part of the valuation process we undertook a thorough investment strategy review and used our enhanced powers to negotiate with British Airways for it to provide a guarantee of £230 million to be paid to the Scheme in the event of its insolvency. British Airways has no part to play in triggering the guarantee. The Trustees alone have the power to call on the funds if British Airways becomes insolvent. We believe that the actions we have taken during the valuation process have significantly improved the underlying security of the Scheme.

Many of the provisions of the Pensions Act 2004 and Finance Act 2004 have now come into effect and the Trustees continued their work on the various regulations and codes of practice. These cover areas such as the process for the appointment of Member Nominated Trustees, disclosure regulations and methods of internal controls and risk management. The Trustees have completed a comprehensive review of the current Member Nominated Trustee arrangements and have decided to include an additional Pensioner elected Trustee together with a further Employer appointed Trustee. This will increase the Trustee board from 10 to 12. We have also decided to increase the length of the term of office in recognition of the extra training now required.

## Headline Results

Over the past year there has continued to be a decrease in the net asset value of the fund from £6,638.1 million at the start of the year to £6,520.0 million on 31 March 2007 as benefits paid has exceeded the 'inflow' of contributions and investment returns. Michelle McGregor Smith, CEO BAPIML, provides more information on investment conditions during the year in the Investment Report which is found on page 12.

## Valuation vs Annual Report & Account Results

It is important to distinguish between the results of the actuarial valuation and the Annual Report and Accounts. The Accounts describe the financial position of the fund on a particular day, in this case 31 March 2007. The valuation as at 31 March 2006 is a separate exercise and is a detailed investigation into whether, over the long term, the Scheme is likely to be able to pay the benefits that are due to be paid under the Scheme Rules.

## The 2006 Valuation and Funding Process

The 2006 valuation was the first under the requirements of the Pensions Act 2004, which introduced significant changes to the scheme funding process. Unlike the previous funding standard (the Minimum Funding Requirement which was introduced by Pensions Act 1995), this new Act does not prescribe a set level of scheme funding. Instead trustees and employers are required to agree a scheme specific funding target and period for making up any deficit, by taking account of a company's financial strength and ability to pay and the Scheme's need to be appropriately funded.

Under the new Act it is the APS Trustees and British Airways rather than the Actuary who establish the level of future contributions that British Airways will pay. The Actuary continues to have a key role in advising the Trustees and also needs to certify that certain outcomes of the funding process do not fall below the level he would have calculated had he retained responsibility for the funding process and Michael Pardoe, as Actuary to the Scheme, has confirmed this.

As a result of negotiations British Airways has agreed to pay contributions of approximately £25 million a year to cover the costs of future pension build up for active members and will also pay the annual Pension Protection Fund (PPF) levy expected to be £0.8 million this year.

# Chairman's Review

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## Board Matters

As well as dealing with the valuation process the Trustees have also dealt with day to day operational, investment and governance matters. Please refer to the Trustees' report for a full account of these activities.

Since my last report, Andrew Sentance retired as an Employer representative on 30 September 2006 and was replaced by Steve Gunning from 2 November 2006. I would like to take this opportunity to thank Andrew for his contribution during his period of office and wish him well for the future. I would also like to welcome Steve to the Board.

## The Year Ahead

Even though we completed some major tasks last year there is still much to be done. In particular, we will continue to monitor the Scheme funding position and if necessary adjust the investment allocation to ensure continued security of benefits. We also expect to make further changes to the Scheme Rules in respect of the introduction of a salary sacrifice scheme and flexible retirement.

I know from talking with chairmen of other large schemes that many of them are still struggling to finalise their valuation processes. We have now completed this important and difficult task and, therefore, in closing I would like to convey my continued gratitude to the Trustees and their advisers for the enormous amount of work completed during the last year. I would also like to give my thanks to the teams at BAPSL and BAPIML, who support the work of the Trustees, for their continued commitment and hard work. As I stated last year, it is only through the concerted team effort of our staff and our advisers that we as Trustees have been able to achieve the progress described in this report.

**ROGER MAYNARD**  
Chairman of Trustees

June 2007

# Trustees and Advisers

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## Appointed by British Airways

**Roger Maynard**  
Director of Investments  
and Alliances

**Robert Boyle**  
Commercial Director

**Ruth Cassidy**  
Head of Im Business  
Control

**Paul Douglas**  
Head of Flight Operations

**Steve Gunning**  
MD BA World Cargo

## Member Elected

**Allan Bromwich**  
Technician

**Thomas Mitchell**  
Support Analyst

**Clifford Pocock**  
Retired

**Michael Post**  
Retired

**Stuart Scott**  
Retired

## Retired during the year

**Andrew Sentance**  
BA appointed

## Advisers

**Scheme's Actuary**  
Michael Pardoe  
Watson Wyatt Ltd

**Legal Advisers \***  
Eversheds LLP

**Bankers**  
Bank of New York

**External Custodian**  
State Street Bank  
and Trust Co

**Auditors**  
KPMG LLP

**Independent Investment Advisers**  
Andrew Threadgold  
Geoff Lindey  
Colin Maltby

**Financial Advisers**  
PricewaterhouseCoopers LLP

## Administration

**British Airways Pension Services Ltd**  
John Birch  
Managing Director & Scheme Secretary

## Investment Management

**British Airways Pension Investment  
Management Limited**  
Michelle McGregor Smith  
Chief Executive Officer

The Airways Pension Scheme – Scheme Number: 2/42994/N

\* In addition to the Scheme's principal advisers, Messrs Macfarlanes are legal advisers to the Schemes in respect of certain investment activities, Messrs Forsters LLP are legal advisers in relation to some property transactions and Mercer Human Resource Consulting Limited are advisers in respect of the management of currency transactions.

This report provides information about the management of the Scheme and sets out the main activities we have undertaken during the year. There are sections on Investment, Scheme Governance, Member Services and Benefits. The Benefits section includes information on the new pensions legislation which has been introduced and there is also information about annual pension increases. The final section contains general information about the Trustees' responsibilities.

## INVESTMENT

### Investment Policy

In last year's report we explained that towards the end of 2005 we considered that market movements, particularly strong equity performance, and the associated effect on the estimated funding position of the Scheme implied that it would be appropriate to accelerate the planned reduction in the exposure to equity assets. In essence, it was considered that the level of investment risk which the Fund was taking should be reduced given the relatively modest returns required for the Scheme to be able to meet its liabilities. It was agreed that the asset allocation benchmark be amended so that the unprotected equity component of the Fund reduce from 28% to 15% effective from 1 April 2006. The first 1% of this reduction represented a pre-planned move from equities to index-linked gilts. The remaining reduction was achieved by holding a strategic cash allocation of 5%, a 1% allocation in commodities and ensuring that 6% of the equity portfolio is protected through the use of derivatives instruments. The investment in commodities is made through the use of derivative instruments or funds. As part of the valuation process we reviewed the investment allocation again and concluded that the current position remains appropriate in the short to medium term.

We further reviewed the allocation in June and agreed to invest both the 6% protected equity holding and the strategic cash holding in index-linked gilts.

We will continue to monitor the Fund's investment allocation carefully and take action as opportunities arise.

### Statement of Investment Principles (SIP)

A revised SIP was adopted with effect from 1 April 2006 which reflected the changes to the strategic asset allocation policy and the decision to change the property performance benchmark to the IPD Quarterly Universe. A further revision was adopted in June 2007 following the decision to purchase index-linked gilts.

A copy of the SIP is available on request from the Secretary's office or can be accessed on the [www.mybapension.com](http://www.mybapension.com) website.

### Measuring Performance

In accordance with the Myners' Principles the Trustees have adopted a customised benchmark as this ensures that the investment performance objectives are related directly to the circumstances of the Fund and not to some other measure such as the performance of other funds whose liability profiles might be quite different to APS. The Trustees monitor the Fund's performance by comparing the returns that APS achieves against this benchmark.

The performance of each asset category is measured against an index. For example, the UK equity portion of the fund is measured relative to the performance of the FTSE All Share Index.

British Airways Pension Investment Management Limited (BAPIML) is the in-house investment manager to APS. BAPIML's expenses are charged to the Scheme at cost and we delegate routine or day to day investment decisions to them. The Trustees have set BAPIML the target of performance of 0.3% per annum above the weighted average of the agreed strategic benchmark over a rolling five year period, though we will continue to monitor performance over a range of different time periods.

Over the period under review BAPIML have just outperformed the benchmark. However in terms of the five year performance target, BAPIML performance of 7.39% compared to the benchmark of 7.42% as assessed over a rolling five year period fell short of the 0.3% out-performance target. A more detailed explanation of the factors which contributed to investment performance during the period under review can be found on page 12.

# Trustees' Report

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## Security of Assets

The Custodian Trustee of APS, British Airways Pension Trustees Limited, holds the assets of the Scheme on behalf of the Trustees. However, physical custody of the Scheme's securities (i.e. stocks and shares) has been delegated to independent external custodians, State Street Bank and Trust Company.

## Scheme Funding

Under the provisions of the Pensions Act 2004 the 2006 APS valuation process complied with a new funding regime. Unlike the previous funding standard, the Minimum Funding Requirement (which was introduced by the Government in the Pensions Act 1995), this regime does not prescribe a set level of scheme funding. Instead trustees and employers need to agree a scheme specific funding target by reference to a company's financial strength and ability to pay and the scheme's need to be appropriately funded. The agreed policy is then set out in a Statement of Funding Principles.

In the past the Scheme Actuary has determined the contribution rate but under the new legislation this role has changed to one where he provides an "underpin" certificate. For the 2006 valuation the new funding regime was agreed between the Trustees and British Airways and the Actuary certified that the agreement did not produce a contribution rate lower than the level he would have calculated had he retained responsibility for setting the contribution rate.

The Regulator has published guidance on the requirements of the scheme funding legislation and sets out expected standards of conduct and practice. The Regulator has powers to supervise the funding process, intervene if agreement cannot be reached and challenge agreements that are reached between trustees and employers. The Regulator's own objectives include protecting scheme members' benefits and preventing schemes being transferred into the new statutory pensions 'safety net' - the Pension Protection Fund (PPF).

The PPF is in effect an insurance scheme, introduced to provide a level of protection for the benefit of members of defined benefit schemes which are in deficit and where the

sponsoring employer becomes insolvent. Only schemes which are less than 100% funded on a PPF basis at the time of insolvency would be considered for admission to the PPF. APS is over 100% funded on a PPF basis. Notwithstanding that the current PPF level of funding would preclude entry to the PPF APS is required to pay a PPF levy.

As outlined last year, and in accordance with the Regulator's guidance on determining scheme funding, as part of the 2006 valuation process we appointed PricewaterhouseCoopers LLP (PwC) to conduct an independent assessment of British Airways' financial position and prospects and the ability to pay contributions. This was a significant exercise and the Trustees met with PwC on a number of occasions to receive reports on their work.

Under the Pensions Act 2004 the Trustees are required to be prudent when setting assumptions with emphasis on what would happen if British Airways was no longer able to support the Scheme. Using observed market trends, the expected future returns (the discount rate) was revised from 5.4% in 2003 to 4.5% in 2006. Life expectancy has continued its upward trend and is now 2.2 years longer than was assumed in 2003 for a 60 year old.

Using the collated information the Trustees were able to negotiate an arrangement with British Airways so that APS is provided with a guarantee (provided by a suitable external provider) to the value of £230 million. The Trustees will rely upon this facility if British Airways were to become insolvent. British Airways has no part to play in triggering the guarantee and therefore the Trustees alone have the power to call on the funds if British Airways becomes insolvent.

The Trustees reached agreement with British Airways that it will continue to pay Employer contributions at a rate of approximately £25 million a year to cover the cost of future pension accrual.

At the conclusion of the Scheme funding process a new Schedule of Contributions and a Statement of Funding Principles were agreed with British Airways and copies of these are available on the Scheme website.

## SCHEME GOVERNANCE

The Trustees confirm that they have considered the key risks affecting the Scheme and employ effective controls to mitigate these risks.

### Compliance with the Myners Principles

The Trustees have reviewed their compliance with the Myners Principles in detail and are confident that they have implemented appropriate arrangements to maintain compliance. Following the review the Trustees have agreed that information on how BAPIML exercised votes resulting from shares held on behalf of the Trustees will be published on the website.

### Trustee Arrangements

Following the Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations 2006 and the publication of the Regulator's code of practice, the Trustees undertook a review of the existing Trustee arrangements. The changes are detailed below:

- With effect from 1 October 2007, the number of Trustees administering the Scheme will increase from 10 to 12 Trustees.
- Two of the Trustees are elected by active members of the Scheme. Each will come from different occupational groups unless there are insufficient nominations to achieve this. These Trustees must be active members of APS.
- With effect from 1 October 2007, the number of Trustees elected by pensioner members\* of the Scheme who must be pensioner members\* of APS will increase from three to four.
- With effect from 1 October 2007, the number of Trustees appointed by BA will increase from five to six in order to maintain the 50:50 ratio with Member Nominated Trustees.
- With effect from 1 October 2007 the terms of office will increase to a minimum of five years and a maximum of

five and a half years in recognition of the investment in training undertaken by the Trustees.

- Currently, nominations for the elected Trustees must be supported by at least 20 members in the relevant constituency. For Trustees standing for office from 1 October 2007 the supporters required will be reduced to 10.

Although APS and the New Airways Pension Scheme (NAPS) have separate Trustee Boards, much of the business of the two Schemes is common, and in most cases we have the same advisers. Most Main Board and Committee meetings have been held in tandem although each Trustee Board reaches its decisions independently.

Much of our work is undertaken by Trustee Committees who are able to review matters in detail before making recommendations to the Main Board where the majority of Trustee decisions are made. Each Committee operates under clear Terms of Reference which govern its activities. A description of the work undertaken by each Committee is set out below:

**Governance Committee:** This Committee meets quarterly and is principally concerned with legislative compliance and risk management. It monitors the management of the risks to which the Scheme is exposed and audit activity (including the work of both the external and internal auditors appointed by the Trustees). It is also responsible for the establishment of training programmes, the annual reviews of the performance of the Scheme Advisers and internal procedures such as ballot processes. The Committee also reviews any Internal Dispute Resolution Procedure (IDRP) cases previously considered by the Operations Committee. During the year the Committee's work also included consideration of the new Codes of Practice relating to Trustee Knowledge and Understanding, Notifiable Events, Reporting Breaches of the Law and Internal Controls. The Committee met four times during the year.

\* For this purpose 'pensioner members' do not include pensioners whose benefits have not yet come into payment, contingent beneficiaries and pensioners receiving only Equivalent Pension Benefits under the National Insurance Acts.

# Trustees' Report

## Trustee Arrangements (continued)

**Investment Committee:** This Committee usually meets five times a year. The Committee, which is supported by three independent investment advisers, deals with investment approval and reporting arrangements, the monitoring of investment performance and consideration of the various investment options available to the Scheme. Much of the Committee's work during the year was dealing with the new Scheme Funding Regime and the Committee also undertook the detailed investment review, including consideration of alternative investments, which resulted in the reduction to the equity allocation and the revised Statement of Investment Principles. The Committee actually met six times during the year.

**Operations Committee:** This Committee meets monthly to consider matters requiring Trustees' discretion (e.g. payment of death-in-service benefits) and second stage applications under the Internal Dispute Resolution procedures. In addition the Committee considers any proposed Rule changes, oversees the Scheme's communication strategy, monitors levels of service, considers the annual budget and monitors expenditure. The Committee continues to undertake the review of ill health pensions in payment, to ensure that continuation of the pension is in accordance with the Rules. Several ill health pensions have been

suspended where the beneficiaries are no longer incapacitated or who have failed the pay test. The Committee continued to monitor the implementation of a new pensions administration computer system and considered a wide range of matters arising from the new legislation contained in both the Pensions Act 2004 and the Finance Act 2004. The Committee met 12 times during the year.

## Performance of Trustees

Attendance records for Trustee and Committee meetings have been maintained and are shown at the bottom of this page.

On several occasions those Trustees not able to attend a meeting appointed an alternate to speak, and if necessary, exercise their vote. In addition, some Trustees attended, as observers, meetings of Committees to which they are not formally appointed, such occurrences are not included in the attendance list.

There have been 11 Main Board meetings during the year, an unusually high number reflecting the amount of discussion associated with the Scheme funding process. Main Board meetings are usually scheduled to take place quarterly.

Trustee	Governance Committee	Investment Committee	Operations Committee	Main Board	Period of Appointment
Roger Maynard (Chairman)	4/4	-	-	11/11	Whole year
Robert Boyle	-	5/6	-	9/11	Whole year
Allan Bromwich	-	6/6	11/12	11/11	Whole year
Ruth Cassidy	-	-	10/12	11/11	Whole year
Paul Douglas	4/4	-	11/12	11/11	Whole year
Steve Gunning	-	2/2	-	4/4	From Nov 2006
Tom Mitchell	-	-	12/12	8/11	Whole year
Capt Cliff Pocock	3/4	-	-	10/11	Whole year
Capt Mike Post	-	6/6	-	11/11	Whole year
Stuart Scott	4/4	-	-	11/11	Whole year
Andrew Sentance	-	4/4	-	5/5	To Sept 2006

## Trustee Training

Training plans are in place which take account of both the particular needs of each Trustee and the Committees on which they serve. Newly appointed Trustees are provided with a comprehensive induction programme during the first three months of their term of office.

Training is provided via a number of routes. Where appropriate the Actuary and other advisers provide training to some or all of the Trustees either in routine Main Board and Committee meetings or in specially arranged events. External training courses are also utilised and individual Trustees are encouraged to consider their own training requirements and to request places on suitable courses. Bespoke training is provided at Whitelocke House to supplement external courses and seminars, if required.

The Regulator's Code of Practice on Trustee Knowledge and Understanding has formalised the knowledge requirements for trustees and all of the Trustees attended courses leading to qualification for the Pensions Management Institute Trustee Certificate of Essential Pensions Knowledge. The majority of Trustees have obtained this certificate and our recently appointed Trustees are making good progress towards qualification.

## Adviser Reviews

We have adopted a process of annually reviewing the performance of all Scheme advisers. Each of the primary Scheme appointments, being the Legal Adviser, the Auditor and the Actuary, will usually be subjected to a comprehensive appraisal of services as part of a rolling three year programme. As a result of the amount of time required for the scheme funding process we postponed some reviews scheduled for 2006. Those reviews, along with those scheduled for 2007 have now been held and all appointments have been confirmed for further periods.

## MEMBER SERVICES

### Member Communications

Member communications have been focussed on keeping members advised of the valuation process, the changes to actuarial factors used in calculating benefits and to the increased scope for employee contributions from April 2007. The latest 'In Focus' was sent to members in May 2007 and covered the final valuation results, rule changes and the Summary Funding Statement.

### Administration Systems

Our new pension administration system was implemented in August 2006. A future development will facilitate greater member access to benefits online. It is expected to deliver these improvements during 2008/9.

## LEGISLATIVE AND OTHER CHANGES

### The Finance Act 2004 and the Pensions Act 2004

Many of the changes introduced by these significant pieces of legislation came into effect, in most cases, on 6 April 2006 (A-Day). The August 2006 edition of In Focus provided members with a review of the effects of the changes on both the Scheme and individual members.

### Pension Protection Fund Levy (PPF)

As Trustees, we are responsible for paying the levy but the legislation does allow us to seek payment from British Airways or pass on the cost of the levy to the membership. Although it was not obliged to do so, British Airways again paid the levy of approximately £0.75 million in 2006/7. We have negotiated with British Airways that it will pay the levy this year (which is expected to be approximately £0.8 million) and each subsequent year.

### Internal Dispute Resolution Procedure (IDRP)

The Trustees are required by law to operate an IDRP. This is a mechanism by which a member may request a designated person to adjudicate on a disagreement with their scheme. The Trustees have appointed John Birch, Managing Director of BAPSL, as the designated person to deal with the first stage adjudication. Complaints made under this procedure must be in writing and a leaflet

# Trustees' Report

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## IDRP (continued)

giving full details is available from Whitelocke House or on our website.

## Scheme Changes

There were several changes to the Scheme's Trust Deed and Rules during the year. Changes were made to reflect the requirements of the Finance Act 2004. As part of the preparations for the valuation and funding negotiations the Trustees undertook a review of the committee governance and this also resulted in some changes to the arrangements for dealing with potential conflicts of interest and the appointment of alternates.

Further changes effective from 1 April 2007 are:

- The maximum pension contribution limit has been raised, with effect from the 2007/8 tax year, from 15% to 30% of pay.
- The Scheme no longer offers the variable pension option. This option was designed to provide those retiring before State Pension Age (SPA) with broadly the same level of income throughout retirement by giving a higher APS pension up to SPA and then a lower APS pension thereafter so that the total income remained the same taking account of the State Pension. This change does not affect Pensioners who are already participating in the option.
- The Trustees have adopted new actuarial factors, which will affect those with options/benefits coming into effect after 1 April 2007.
- Subject to certain conditions it is now possible for a Member over the age of 50 to draw pension while remaining in employment with British Airways by opting out of the Scheme. This change is in advance of potential flexible retirement arrangements, which will be considered in conjunction with British Airways later in the year.
- Members wishing to transfer their pension benefits to another scheme can now retain the Guaranteed

Minimum Pension (GMP) element in the Scheme if the transfer is made to an external arrangement which is unable to accept the GMP.

- Appropriate changes to the Rules have been made to reflect recent age discrimination legislation.

## Participating Companies

British Airways Connect Limited ceased to participate in the Scheme from 5 March 2007 and British Airways Travel Shops Limited ceased to participate from 31 August 2006. As a result of the Employer Debt Regulations pertaining to the Finance Act 1995 the withdrawal of these participating employers has resulted in British Airways being required to pay Exit Debts to extinguish the deficit associated with membership of the scheme. Deeds have been executed documenting the cessation in the Scheme of both companies.

BAPIML, which has only ever employed two APS members, ceased to employ its final APS member on 29 June 2006 and consequently ceased to participate in the Scheme from that date. Formalities regarding the cessation are yet to be finalised.

## PENSION ADMINISTRATION MATTERS

### Ill Health Review

In 2005 we started a pilot exercise to review a defined sample of ill health pensions in payment which included assessing the continued medical incapacity of the recipient. A review of the cases considered has led to a defined ill health pension review process, which is ongoing. The process allows the Trustees to consider cases in a consistent manner.

### Cash Equivalent Transfer Values

Transfer values paid during the year were calculated and verified in the manner prescribed by the regulations under Section 97 of the Pension Schemes Act 1993. Discretionary benefits are not included in the calculation of transfer values.

## Pension Increases

Scheme Rules provide that the annual increase shall be the percentage specified in the Pensions Increase (Review) Orders. Each Order reflects the rise in the Retail Prices Index over a twelve-month period measured up to the end of September each year. Increases apply to all pensions payable under the Rules of APS (whether in deferment or actually in payment) except where the member remained in active service after 31 December 1973 and did not transfer to Part VI of the Scheme. People in this latter category receive increases in line with price inflation up to 5% a year in respect of any part of the pension relating to pensionable service after 31 March 1997. The Pensions Act 2004 reduced increases on pensions in payment for people in this category to inflation up to 2.5% in respect of service after 5 April 2005. Dependants in receipt of pensions derived from a deceased member in this category do receive increases at the rate shown in the Orders, but only up to 5% a year.

In accordance with the 2006 Order, pensions were increased by 2.7% on 10 April 2006 and, in accordance with the 2007 Order, by 3.6% on 9 April 2007.

All pension increases are a right under the Scheme and are not discretionary.

## STATEMENT OF TRUSTEES' RESPONSIBILITIES

The audited financial statements are the responsibility of the Trustees. They have been prepared and audited in accordance with regulations made under Sections 41(1) and (6) of the Pensions Act 1995 and UK Accounting Standards. Pension scheme regulations require the Trustees to make audited financial statements for each scheme year available to the Scheme's beneficiaries and certain other parties. These statements must:

- show a true and fair view of the financial transactions of the Scheme during the scheme year and of the amount and disposition at the end of that year of the assets and liabilities, other than liabilities to pay pensions and benefits after the end of the scheme year; and

- contain the information specified in the Schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including a statement as to whether the financial statements have been prepared in accordance with the Statement of Recommended Practice 'Financial Reports of Pension Schemes'.

The Trustees have delegated the preparation of the financial statements to the Secretariat of the Scheme. The Trustees have agreed suitable accounting policies, to be applied consistently, making any estimates and judgements on a prudent and reasonable basis.

The Trustees are responsible for making available each year, commonly in the form of a Trustees' Annual Report, information about the Scheme prescribed by pensions legislation which they should ensure is consistent with the financial statements it accompanies.

The Trustees have certain responsibilities in respect of contributions which are set out in the Statement of Trustees' Responsibilities accompanying the Trustees' Summary of Contributions.

The Trustees have general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to them to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities.

This Report was approved by the Board of Trustees on 27 June 2007 and was signed on their behalf by:

**John Birch**  
Secretary

# Investment Report

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## REVIEW OF THE YEAR

Many of the themes of 2005/6 remained important drivers of economic activity and asset performance into 2006/7. As expected, most regions exhibited slowing economic growth in the later months of 2006, a consequence of tighter monetary policy and the restraining influence of higher oil and commodity prices. U.S. consumers were subdued by the squeeze on disposable incomes and the bursting of the housing bubble. However, the overall level of economic growth has been better than most commentators had expected, with China and other emerging economies supporting growth in other regions.

The pace of industrialization in the emerging economies and the requirements for infrastructure build globally further boosted the demand for commodities and machinery. Europe continued to demonstrate the benefits of restructuring as well as export driven growth. Global economic growth was broad based with record numbers of countries recording real GDP growth of over 4%, the highest since 1980, with few economies in recession, the lowest over the same timeframe.

Buoyant economic growth and rising inflation led central banks to raise interest rates to higher levels than expected by most commentators. However, real interest rates remain low around the world.

In this environment companies profits and cashflows remained healthy. Earnings have continued to surprise on the upside keeping price earnings ratios little changed and leaving further scope for re rating. As we expected, companies have applied these cashflows to capital expenditure projects, dividends and share buybacks and increasingly, merger and acquisition activity. Levels of merger and acquisition activity have surpassed previous records and this has pushed equity markets higher.

A significant driver of asset price performance has been excess liquidity. As well as corporate cash flows this comes from a number of sources: the investment of central bank reserves from countries with trade surpluses, the deployment of the oil and commodity producer's profits in a variety of assets, credit creation and the actions of hedge

funds combined with the investment of private equity cash flows. These factors are all working to keep real interest rates low.

In general Bond markets struggled to beat cash returns for most of the year as rising inflation concerns combined with the already very low absolute levels of yields held back returns. Property assets performed well once again reflecting buoyant occupancy and rental growth as well as investment demand compressing yields.

On a tactical basis the Fund remained overweight equities and underweight bonds. This was driven by the Fund Managers' assessment of the economic environment and the attractive relative valuations of equities when compared to fixed interest and index-linked bonds.

## Asset Allocation and Benchmarks

The Fund's tactical asset allocation and associated strategic benchmark for the major asset classes are shown in the table on the next page.

At the beginning of the year, the equity benchmark weighting was reduced by 7% and the introduction of strategic cash was implemented as a separate asset class (this is detailed on page 5). A benchmark allocation of 1% was introduced to commodity instruments. These were planned diversifications away from equities agreed by the Trustees in 2005. A further increase of 2% in the property benchmark is planned for 1 April 2007.

Contributions received from BA plc in February were invested in line with the prevailing tactical asset allocation albeit with a slight increase in the tactical weighting to bonds and an increase in the underweighting in property, reflecting lower expected returns after strong performance from this asset class.

The Trustees and their Advisers have set bandwidths around the strategic benchmarks shown opposite. These allow BAPIML to make tactical asset allocation decisions to take advantage of valuation differentials between asset classes which may occur from time to time. The actual allocation shown was within these bandwidths.

# Investment Report

Asset Category	Actual % 31 Mar 2007	Benchmark % 31 Mar 2007	Actual % 1 Apr 2006	Benchmark % 1 Apr 2006
<b>Equities</b>	<b>24.5</b>	<b>21.0</b>	<b>29.8</b>	<b>28.0</b>
UK	12.8	10.5	14.0	14.0
International	11.7	10.5	15.8	14.0
<b>Bonds &amp; Cash</b>	<b>62.8</b>	<b>68.0</b>	<b>64.0</b>	<b>67.0</b>
UK Fixed	10.7	14.0	10.4	14.0
Overseas Fixed	1.4	-	1.6	-
UK Index-Linked	46.5	53.0	44.6	52.0
Overseas Index-Linked	3.3	-	3.6	-
Cash	0.9	1.0	3.8	1.0
<b>Strategic Cash</b>	<b>4.6</b>	<b>5.0</b>	-	-
<b>Commodities</b>	<b>0.6</b>	<b>1.0</b>	-	-
<b>Property</b>	<b>7.5</b>	<b>5.0</b>	<b>6.2</b>	<b>5.0</b>
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

## Performance

There were two distinct phases in markets during the year. After a strong equity rally into May 2006, a weaker bond market and concerns over rising inflation risks led equity investors to take profits. This was partly in anticipation of central banks continuing to raise interest rates and restrict economic activity. In the autumn equity markets rallied as economic growth and inflation pressures appeared to have moderated. The equity rally has continued into 2007, fuelled by takeover activity whilst bond yields have continued to rise.

Asset class performance was more mixed than in recent years. Most equity markets produced positive local currency returns in the teens, however a fall in the US dollar undermined sterling returns from US dollar assets, restraining overseas equity returns to sterling based investors. The Fund's UK equities returned 10.1% beating the overseas equity returns of 2.4%, excluding the gains from hedging part of the overseas holdings. In the UK, merger and acquisition activity was particularly strong, boosting returns. The higher risk emerging and Asian markets performed particularly well with Japanese equities falling even before taking into account losses from Yen

weakness. The European equity markets exhibited healthy returns reflecting better profits and economic growth gathering pace after years of restructuring. Bond markets struggled to match cash returns for most of the year, under pressure from inflation worries and rising interest rates pushing yields higher.

The index-linked bond benchmark returned 2.6%, however longer dated fixed interest issues produced negative returns. As we commented last year, bonds appeared expensive versus historic measures given the economic backdrop and the Fund return was improved from being underweight the asset class.

Overall, the Fund benefited from the tactical asset allocation towards equities and away from bonds, broadly maintaining the stance of the last three years. Equity stock selection was negative in broad terms due to the Fund Managers holding higher weightings in growth and less economically sensitive stocks when cyclical growth was more plentiful than expected, combined with the boom in merger and acquisition activity pushing up valuations of some companies beyond our expectations. Property assets continued to perform well, returning 16.4% versus the benchmark return of 15.8%.

# Investment Report

## Fund's 10 Largest Holdings as at 31 March 2007

Stock Name	Security Type	£M	% Portfolio
UK Treasury 2.5% Index-Linked 2020	Government Bond	1,201.8	18.4
UK Treasury 2.5% Index-Linked 2016	Government Bond	719.7	11.0
UK Treasury 1.25% Index-Linked 2017	Government Bond	287.9	4.4
UK Treasury 5% 2025	Government Bond	164.9	2.5
UK Treasury 2.5% Index-Linked 2024	Government Bond	161.7	2.5
UK Treasury 1.25% Index-Linked 2027	Government Bond	156.9	2.4
UK Treasury 5% 2008	Government Bond	149.9	2.3
UK Treasury 0% 2007	Government Treasury Bill	148.5	2.3
UK Treasury 4.25% 2032	Government Bond	131.8	2.0
US Treasury 3.875% Index-Linked 2029	Overseas Government Bond	92.8	1.4

During the period under review, the Fund just outperformed the strategic benchmark returning 3.69%. The longer term performance is shown in the table below.

	2007	2005	2003	1998
		/2007	/2007	/2007
	1 year	3 years	5 years	10 years
	%pa	%pa	%pa	%pa
APS	3.69	9.36	7.39	7.71
Benchmark	3.68	9.32	7.42*	7.55*

\* Combination of WM50 industry peer group and a customised BA strategic benchmark adopted in 2002.

### Additional Voluntary Contributions (AVCs)

The Mixed Portfolio Fund recorded a return of 6.9%, underperforming the strategic benchmark return of 8.0%. The external AVC comparators returned 7.79%. The returns were driven by similar factors to those described above with positive asset allocation more than offset by negative stock selection. Over the longer term the Fund continued to exceed the returns of these external providers when measured on a 3, 5 and 10 year basis.

In the year to 31 March 2007 the Short Dated Gilt Fund returned 4.77% and the Equity Biased Fund returned 15.7%.

### Outlook

The economic environment continues to be healthy and broadly positive for equities. Many of the trends driving recent returns are expected to continue through 2007. The investment of excess liquidity will support equities and real assets in particular with bonds restrained by increased supply and uncertainty over inflation. We expect continued differentiation of returns as real interest rates may rise reflecting the diversion of some of these cashflows away from bonds and into physical assets.

There is considerable debate around the outlook for inflation, interest rates and growth in the second half of 2007, especially in the U.K and the U.S with some concern that higher interest rates are needed to cool inflation pressures and asset price bubbles. At the current time, confidence indicators suggest that the U.S. slowdown has been contained. In the UK, higher rates are a consequence of further house price appreciation and inflation above the Monetary Policy Committee target range. Whilst the central expectation is for inflation to fall back in the latter half of the year, 'stubborn inflation' would hamper policy makers' room for manoeuvre not just in the U.K. but around the world.

Elsewhere there is concern whether the world economy can survive unscathed a more aggressive slowing of the Chinese and other emerging economies, should this occur.

# Investment Report

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The Fund continues to hold higher than benchmark weightings in equities and lower than benchmark weight in bonds. Given the economic backdrop, equity markets continue to be good value relative to bonds but it should be noted they have risen substantially from the March 2003 lows and are moving closer to the Fund Manager's expectations of fair value based on the long-term relationship between bonds and equities. In recent weeks we have reduced the weighting in equities and increased cash after strong relative performance. Bond Yields have risen and shorter dated bonds are now close to levels which may prove attractive should inflation and economic growth moderate in the second half of 2007.

## **Corporate Governance**

The Fund Managers follow the Institutional Shareholder Committee principles, monitoring and engaging with companies on aspects of corporate governance and exercising voting rights in all regions through the custodian. In the U.K. in particular, research on aspects of corporate social responsibility including environmental factors is also taken into account to assess impacts on shareholder value. The outcomes of these programmes are reported back to the Trustees on a regular basis. A full description of the policy and the Fund Managers Voting record along with a list of the major holdings will be published on the Member website.

# Independent Auditors' Report

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## **Independent Auditors' Report to the Trustees of the Airways Pension Scheme**

We have audited the financial statements of the Airways Pension Scheme for the year ended 31 March 2007 which comprise the fund account, the net assets statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the scheme trustees, as a body, in accordance with the Pensions Act 1995 and Regulations made thereunder. Our audit work has been undertaken so that we might state to the scheme trustees those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the scheme trustees, as a body for our audit work, for this report, or for the opinions we have formed.

## **Respective Responsibilities of Trustees and Auditors**

As described in the Statement of Trustees' Responsibilities on page 11, the scheme trustees are responsible for obtaining an annual report, including audited financial statements prepared in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements show a true and fair view and contain the information specified in the Schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. We also report to you if, in our opinion, we have not received all the information and explanations we require for our audit.

We read the trustees' report and other information contained in the annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

# Independent Auditors' Report

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## Basis of Audit Opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by or on behalf of the trustees in the preparation of the financial statements, and of whether the accounting policies are appropriate to the scheme's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion the financial statements:

- show a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the financial transactions of the Scheme during the scheme year ended 31 March 2007 and of the amount and disposition at that date of its assets and liabilities (other than liabilities to pay pensions and benefits after the end of the scheme year); and
- contain the information specified in Regulation 3 of, and the Schedule to, the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995.

**KPMG LLP**  
**Chartered Accountants**  
**Registered Auditor**

27 June 2007  
8 Salisbury Square  
London  
EC4Y 8BB

# Fund Account

	Note	2007 £'m	2006 £'m
<b>Contributions and Benefits</b>			
Contributions Receivable	3	35.6	34.2
Transfers In	4	0.2	0.2
		<hr/>	<hr/>
		35.8	34.4
Benefits Payable	5	(348.0)	(319.1)
Leavers	6	(35.9)	(26.5)
Administration Expenses	7	(3.1)	(2.5)
		<hr/>	<hr/>
		(387.0)	(348.1)
<b>Net (withdrawals) from Dealing with Members</b>		(351.2)	(313.7)
<b>Return on Investments</b>			
Investment Income	8	170.2	138.4
Change in Market Value of Investments	9	66.9	781.3
Investment Management Expenses	7	(4.0)	(3.7)
		<hr/>	<hr/>
<b>Net Return on Investments</b>		233.1	916.0
		<hr/>	<hr/>
<b>Net Increase in Funds</b>		(118.1)	602.3
<b>Net Assets of the Scheme</b>			
At 1 April 2006		6,638.1	6,035.8
		<hr/>	<hr/>
At 31 March 2007		6,520.0	6,638.1

# Net Assets Statement

	Note	2007 £'m	2006 £'m
<b>Investments</b>			
Fixed Interest Securities		1,328.5	1,014.0
Index-Linked Securities		2,988.6	2,923.0
Equities		1,523.9	1,901.1
Private Equity		10.1	-
Private Equity Unitised Fund		58.5	65.0
Property		21.1	-
Property Unitised Fund		465.9	408.6
AVC Mixed Portfolio Fund		22.7	29.2
Other Investments		47.1	47.7
Cash		60.6	250.5
<b>Total Investments</b>	10,11,12,13	<b>6,527.0</b>	<b>6,639.1</b>
Net Current Liabilities		(7.0)	(1.0)
<b>Net Assets of the Scheme at 31 March 2007</b>		<b>6,520.0</b>	<b>6,638.1</b>

These accounts were approved by the Board of Trustees on 27 June 2007 and were signed on their behalf by:

Roger Maynard                      Management Trustee

Allan Bromwich                      Management Trustee

John Birch                              Secretary

# Notes to the Accounts

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## 1. Basis of Preparation

These accounts summarise the transactions of the Airways Pension Scheme (APS) for the year ended 31 March 2007 and they give details of the net assets at the end of that period. The accounts do not take account of obligations to pay pensions and other benefits in the future. The actuarial position of the Scheme, which does take account of such obligations, is dealt with in the statement by the Actuary on page 32 of this annual report and should be read in conjunction with them.

The accounts of APS have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 and with the guidelines set out in the Statement of Recommended Practice (SORP), Financial Reports of Pension Schemes.

## 2. Accounting Policies

### a. Contributions

Members' normal and employers' normal and additional contributions are included in the accounts on an accruals basis as laid down in the Rules of the Scheme ("the Rules") and are paid according to rates recommended by the Scheme Actuary and in accordance with the Schedule of Contributions. Members' contributions are accounted for when deducted from pay.

Section 75 debts are included on an accruals basis if the liability is known.

### b. Investment Income

Income from equity, fixed interest and index-linked securities including recoverable taxation, is included in the accounts on the date when securities are quoted ex-dividend and after deducting investment-handling charges. Income from cash deposits is included on a cash basis.

### c. Scheme Benefits and Withdrawals

Scheme benefits and withdrawals are included in the accounts in respect of entitlements up to the year end in accordance with the Rules. Transfers in and out are accounted for on a cash basis.

# Notes to the Accounts

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## **d. Investments**

Listed securities are valued using either the mid market closing prices or last dealt prices quoted on recognised Stock Exchanges as at the year end.

Bonds are valued at the quoted price exclusive of interest accrued. The values for 2006 have been restated to reflect this.

Specialist unit trusts are valued by reference to the latest published prices available at the year end.

Stock index futures are valued at market prices at the year end and have been included within the relevant category of investment on the basis of associated economic exposure. All gains and losses on contracts are included in the net movement in market value of investments.

Option contracts are valued at market prices at the year end.

The Swap agreements are valued at the anticipated net present value of all net future cash flows occurring over the duration of the contract.

Forward foreign exchange contracts are valued at the appropriate forward rate at the year end.

Private Equity investments are valued by reference to the net assets as disclosed in the latest available financial statements and are adjusted for any cash movements if the date differs from the fund year end. Where financial statements are not available these are valued at cost in line with BVCA guidelines.

## **e. Unitised Funds**

The investment assets of the Property Fund, the Private Equity Fund and the Additional Voluntary Contribution Mixed Portfolio Fund are included in the accounts at the market value of units held by the Scheme at the year end.

Property investments in the unitised funds are included at year-end open market valuations and have been externally valued by Atis Real Weatherall and Cushman and Wakefield. Indirect property holdings are valued at the latest valuation provided by each of the external managers.

Income from property rentals in the unitised funds is included on an accruals basis and is net of outgoings including managing agents' fees.

## **f. Foreign Currencies**

The market values of overseas investments and current assets and liabilities denominated in foreign currencies are translated into sterling at rates of exchange ruling at the year end. The gains/losses arising from foreign currency transactions are included in the change in market value of investments.

Investment income denominated in foreign currencies is recorded in sterling at actual exchange rates as at the date of receipt.

# Notes to the Accounts

## 3. Contributions Receivable

	2007 £'m	2006 £'m
<b>Employer</b>		
Normal	18.2	21.5
Augmentations	9.5	3.2
Section 75 Debts	0.2	-
<b>Employee</b>		
Normal	5.5	6.5
Additional Voluntary	2.2	3.0
	<u>35.6</u>	<u>34.2</u>

As advised by the Actuary additional funding was required from BA for augmentations. Further details regarding contributions are included in the Summary of Contributions on page 31.

Section 75 contributions were received from British Airways Travel Shops of £142,300 and an accrual is included for BA Connect of £22,987.

## 4. Transfers In

	2007 £'m	2006 £'m
Individual Transfers in from other Schemes	0.2	0.2
	<u>0.2</u>	<u>0.2</u>

## 5. Benefits Payable

	2007 £'m	2006 £'m
Pensions	(309.7)	(297.0)
<b>Commutations</b>		
- Normal	(26.4)	(16.3)
- Addition Voluntary Contributions	(10.8)	(5.4)
Lump Sum Death Benefits	(1.1)	(0.4)
	<u>(348.0)</u>	<u>(319.1)</u>

## 6. Payment to and on Account of Leavers

	2007 £'m	2006 £'m
Individual Transfers to other Pension Schemes	(35.9)	(26.5)
	<u>(35.9)</u>	<u>(26.5)</u>

# Notes to the Accounts

## 7. Administrative and Investment Management Expenses

Administrative and Investment Management expenses are met by the Scheme. The Airways Pension Scheme bears 30% of the costs of BAPSL and 50% of BAPIML except where a cost relates specifically to the Scheme.

## 8. Investment Income

	2007 £'m	2006 £'m
Income from Fixed Interest Securities	63.7	57.9
Income from Index-Linked Securities	58.2	42.4
Asset Swap Collateral Adjustment *	-	(20.8)
Net Dividends from Equities	41.6	54.6
Income from Cash Balances	6.1	3.7
Rental Income	0.1	-
Other Income	0.5	0.6
	<u>170.2</u>	<u>138.4</u>

\* Adjustment in respect of asset Swap collateral which was reported as index-linked securities income in previous years.

## 9. Change in Market Value of Investments

	Opening Value £'m	Purchase Cost £'m	Sale Proceeds £'m	Change In MV £'m	Closing Value £'m
Fixed Interest Securities	1,014.0	1,452.8	(1,054.4)	(83.9)	1,328.5
Index-Linked Securities	2,923.0	269.0	(202.3)	(1.1)	2,988.6
Equities	1,901.1	738.5	(1,158.5)	42.8	1,523.9
Private Equity	-	10.9	(0.6)	(0.2)	10.1
Private Equity Unitised Fund	65.0	9.6	(23.7)	7.6	58.5
Property	-	19.3	-	1.8	21.1
Property Unitised Fund	408.6	20.3	(27.9)	64.9	465.9
AVC Mixed Portfolio Fund	29.2	1.8	(9.7)	1.4	22.7
Other Investments	47.7	0.1	-	(0.7)	47.1
Cash	250.5	-	(224.2)	34.3	60.6
<b>Total Investments</b>	<u>6,639.1</u>	<u>2,522.3</u>	<u>(2,701.3)</u>	<u>66.9</u>	<u>6,527.0</u>

The change in market value of investments include all increases and decreases in the market value of investments held at any time during the year including profits and losses realised on sales of investments during the year.

The change in market value of the Property Fund, the Private Equity Fund and the AVC Mixed Portfolio Fund is derived from the increase in the unit price of the units held in these funds by the Scheme. This reflects both the movement in the market value of the underlying investments of each fund and the related investment income. The change in market value includes income of £17.6m (2006: £17.5m) Property Unitised Fund, £0.3m (2006: £0.9m) Private Equity Fund and £0.8m (2006: £0.9m) AVC Mixed Portfolio Fund.

# Notes to the Accounts

## 10. Investments

	2007 £'m	2006*** £'m
<b>Fixed Interest Securities:</b>		
UK Public Sector Quoted	513.9	368.0
UK Other Quoted **	688.2	543.1
Overseas Quoted	126.4	102.9
	<u>1,328.5</u>	<u>1,014.0</u>
<b>Index-Linked Securities:</b>		
UK Public Sector Quoted	2,558.3	2,486.3
UK Other Quoted	174.3	171.7
Overseas Quoted	214.8	236.4
Index-Linked Swap Arrangement **	41.2	28.6
	<u>2,988.6</u>	<u>2,923.0</u>
<b>Equities:</b>		
UK Quoted	778.2	1,048.0
Futures Contracts on UK Quoted Equities	-	(122.6)
Overseas Quoted	755.9	1,075.2
Futures Contracts on Overseas Quoted Equities	(10.2)	(99.5)
	<u>1,523.9</u>	<u>1,901.1</u>
<b>Private Equity</b>	10.1	-
<b>Private Equity Unitised Fund</b>	58.5	65.0
<b>Property*</b>	21.1	-
<b>Property Unitised Fund</b>	465.9	408.6
<b>AVC Mixed Portfolio Fund</b>	22.7	29.2
<b>Other Investments</b>	47.1	47.7
<b>Cash</b>		
Cash Deposits	89.2	56.0
Amount due in respect of Collateral Backing Index-Linked Swap Contract	(40.1)	(27.6)
Cash Collateral held by Counterparties for Commodity Swaps	1.3	-
Cash Backing for Open Futures Contracts	10.2	222.1
	<u>60.6</u>	<u>250.5</u>
<b>Total</b>	<u>6,527.0</u>	<u>6,639.1</u>

\* During the year the Scheme made a direct investment in Property.

\*\* £235.8m classified within the Index-Linked Swap arrangement last year has been reclassified as UK other quoted.

\*\*\* An adjustment has been made to 2006 to reflect the change in bond pricing to not include accrued interest.

# Notes to the Accounts

Individual investments which comprise greater than 5% of the Net Assets of the Scheme are the Treasury 2.5% index-linked 2016 gilt stock which represents 11% of the Net Assets of the Scheme, and Treasury 2.5% 2020 gilt stock which represents 18.4%.

Included in the investments are securities loaned as at 31 March 2007 of £1,197.7m (2006; £959.3m). The loans are covered by collateral dependent on the types of securities loaned and collateral used. If the collateral is in the same currency as the loaned securities collateral of 102% of the aggregate market value is required. If the collateral is not all denominated in the same currency as the loaned securities 105% is required. The only exception is for fixed income loans for which the principal trading market is outside the United States where the collateral requirement is 100%.

## 11. Property

During the year the fund has invested in the Tesco Red Limited Partnership that has been established to hold a portfolio of Tesco retail units.

The scheme's interest in the Tesco Red Limited Partnership has been accounted for as an associate using the equity method.

British Airways Pension Trustees Ltd (BAPTL) holds 100% of the units in a Jersey Property Unit Trust (JPUT) of which 30% are held in the name of British Airways Pension APS Nominees Limited and 70% are held in the name of British Airways Pension NAPS Nominees Limited. The JPUT holds 49.95% interest in The Tesco Red Limited Partnership UK Ltd (LP).

In addition the JPUT acquired £35,435,000 of interest free loan notes issued by the LP and bought at par of which the scheme owns 30% and NAPS owns 70%.

BAPTL also acquired 50% of the share capital of the General Partner of the LP (GP) of which APS owns 30%.

The value of these investments attributable to APS is as follows;

	2007 £'m	2006 £'m
JPUT Holding	21.10	Nil
General Partner	.01	Nil
Total	<u>21.11</u>	<u>Nil</u>

The Tesco Red Limited Partnership Accounts show the following asset and liabilities:

	2007 £'m	2006 £'m
Gross Assets	536	Nil
Gross Liabilities	(466)	Nil
Net Investment	<u>70</u>	<u>Nil</u>

# Notes to the Accounts

## 12. Derivative Contracts

The scheme uses derivative instruments for both investment purposes and to manage exposures to financial risks, such as interest rate, foreign exchange and liquidity risks arising in the normal course of business.

### Foreign Currency Risk

The Scheme holds investments in a number of currencies. The Scheme's policy is to hedge a minimum of 50% of the combined international equities benchmark exposure and the overseas bond portfolio.

The scheme enters into foreign exchange forward contracts to offset the impact of currency fluctuations on foreign currency investments measured as 50% of the exposure in USD, EUR and JPY.

Period	Maturity Date	Broker	Nominal Value m	Fair Value £'m
3 Month forward to sell USD	14 May 07	UBS	\$40.0	0.1
3 Months forward to sell USD	17 May 07	RBS	\$70.8	0.2
6 Months forward to sell USD	15 May 07 6 Sep 07	RBS	\$111.0	0.2
6 Months forward to sell USD	15 May 07 13 Sep 07	RBS	\$164.3	2.0
6 Months forward to sell EUR	15 May 07 13 Sep 07	UBS	€143.6	0.0
7 & 6 Months forward to sell EUR	12 Jun 07 6 Sep 07	UBS RBS	€118.0	(0.1)
5 & 6 Months forward to sell JPY	15 May 07 13 Sep 07	DEUT	¥12,200.0m	1.4
				3.8

These are included in the Investments within cash.

### Commodity Swap contracts

The scheme entered into the following Total Return Swap contracts in December 2006. The contracts were rolled forward at the 30th March.

Nature	Duration	Collateral Value	Counterparty	Notional Value m	Fair Value
GSEI Index 3 Enhanced Total Return Index	Dec 2007	Nil	Goldman	\$58.0	Nil

A US Treasury Bill is held to cover this exposure of \$73.65m.

Goldman Sachs held £0.9m collateral and Morgan Stanley held £0.4m collateral in respect of these positions.

# Notes to the Accounts

## Options

Exchange traded options were purchased as part of the APS protection strategy to protect 6% of the equity portfolio.

Description	Maturity Date	Broker	Fair Value £'m
Index Options (EUR)	June 07	UBS	£1.8
Index Options (USD)	June 07	UBS	£1.1
Index Options (GBP)	May 07/June 07	UBS	£1.8
			<u>£4.7</u>

These are in Investments within equities.

## Derivatives

The Scheme had four index-linked Swap contracts with a combined value of £41.2m at the year end relating to its index-linked portfolio. The details of the contracts are as follows:

Nature	Nominal Amount £'m	Duration
Index-Linked Swap	60.2	Expires Aug 2016
Index-Linked Swap	20.0	Expires May 2020
Index-Linked Swap	20.0	Expires Sep 2013
Index-Linked Swap	4.3	Expires May 2020

As at 31 March 2007 collateral of £40.1m had been received from Barclays to cover the Swap exposure.

## Futures

The Scheme had overseas stock index futures outstanding at the year end relating to its equity portfolio as follows:

Nature	Notional Amount	Duration	Economic exposure at year end £'m
Dow Jones Stock Futures sold	1,570	June 2007	(4.4)
Topix Stock Futures sold	78,000	June 2007	(5.8)
Total Overseas Futures			<u>(10.2)</u>

# Notes to the Accounts

## 13. Unitised Funds

APS and NAPS hold units in the following funds. As at 31 March 2007 APS held 21.2% of the units in the AVC Mixed Portfolio Fund, 49.9% of the units in the Property Unitised Fund and 50.6% of units in the Private Equity Unitised Fund. The value of investments attributable to APS for each of these funds is as follows:

	2007 £'m	2006 £'m
<b>Private Equity Unitised Fund</b>		
UK Unlisted	17.9	23.9
Overseas Unlisted	40.5	38.8
Other	0.1	2.3
<b>Total</b>	<b>58.5</b>	<b>65.0</b>
<b>Property Unitised Fund</b>		
UK Property	378.8	336.0
Property Unit Trust	95.4	81.5
Other Managed Funds	12.1	10.8
Loan *	(20.0)	(20.3)
Other	(0.4)	0.6
<b>Total</b>	<b>465.9</b>	<b>408.6</b>

All of the Other Managed Funds and £85.5m of the Property Unit Trusts are established in Jersey.

\* The Trustees granted approval to gear the Property Unitised Fund to a maximum of £80m. As at 31 March 2007 £40m of this facility had been utilised of which the Scheme's proportion was £20m. During the year the loan has been renegotiated to a 364 day facility. Interest rate risk is managed by using an interest rate Swap.

	2007 £'m	2006 £'m
<b>AVC Mixed Portfolio Fund</b>		
Fixed Interest Securities	2.2	2.8
Index-Linked Securities	0.9	0.8
Equities	19.1	24.8
Cash	0.5	0.8
<b>Total</b>	<b>22.7</b>	<b>29.2</b>

# Notes to the Accounts

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## 14. Additional Voluntary Contributions

### Internal AVC Schemes

In addition to the separately managed AVC Mixed Portfolio Fund there are two Additional Voluntary Contribution Schemes within the Investments; The Short-dated Gilts Fund and the Equity Biased Fund. The value of these funds is as follows:

	2007	2006
	£'m	£'m
Short-Dated Gilts Fund	4.6	9.1
Equity Biased Fund	25.8	23.7
<b>Total</b>	<b>30.4</b>	<b>32.8</b>

## 15. Contingent Liabilities and Contractual Commitments

The following contractual commitments for the investment fund existed at the year end.

	2007	2006
	£'m	£'m
Private Equity	29.8	-
Private Equity Unitised Fund	28.4	43.1
Property Unitised Fund	15.2	19.8
	<b>73.4</b>	<b>62.9</b>

## 16. Self Investment

The Scheme holds no direct investment in BA or any shares or other securities as defined by section 40 of the Pensions Act 1995.

## 17. Related Party Transactions

The employees of the Pension Scheme are employed by British Airways Plc, British Airways Pension Investment Management Ltd or British Airways Pension Services Ltd. All employee costs are borne by the Schemes.

British Airways Pension Services Ltd provides secretariat support to the British Airways Retirement Pension Plan. British Airways Plc is recharged for these services. British Airways Plc provide occasional services to the Scheme (e.g. recruitment, advice on contracts for the purchase of equipment) for which the Scheme is not recharged.

The Trustees appointed by British Airways Plc can be members or pensioners of either the Airways or New Airways Pension Schemes. If they are members or pensioners then they do not have different terms from other members and pensioners by virtue of their office as Trustees.

Pensioner elected Trustees were eligible for payment by the Company during the year.

British Airways Pension Trustees Ltd holds the assets on behalf of the Scheme as Custodian Trustee, including the assets of the unitised funds.

British Airways Pension Services Ltd provides administration services and British Airways Pension Investment Management Ltd provides investment management services.

British Airways Pension Property Holdings Ltd and British Airways Pension Property Holdings (Number 2) Ltd, hold the legal title of the properties given as security on the loan facility set up to gear the Property Unitised Fund.

British Airways Pension APS Nominees Ltd hold the legal title to the units held in the JPUT for investment in the Tesco Red Limited Partnership.

# Independent Auditors' Statement About Contributions

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**Independent Auditors' Statement about Contributions, under Regulation 4 of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, to the Trustees of the Airways Pension Scheme.**

We have examined the summary of contributions payable under the schedule of contributions to the Airways Pension Scheme in respect of the Scheme year ended 31 March 2007 which is set out on page 31.

This statement is made solely to the Scheme's Trustees, as a body, in accordance with the Pensions Act 1995 and Regulations made thereunder. Our work has been undertaken so that we might state to the Scheme's Trustees those matters we are required to state to them in an auditors' statement about contributions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme's Trustees, as a body, for our work, for this statement, or for the opinions we have formed.

## **Respective Responsibilities of Trustees and Auditor**

As described on page 31, the Scheme's Trustees are responsible, under the Pensions Act 2004, for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions which sets out the rates and due dates of certain contributions payable towards the scheme by or on behalf of the employer and the active members of the scheme. The Trustees have a general responsibility for procuring that contributions are made to the scheme in accordance with the schedule of contributions.

It is our responsibility to provide a statement about contributions paid to the scheme and to report our opinion to you.

We read the Trustees' report and other information in the annual report and consider whether it is consistent with the summary of contributions. We consider the implications for our statement if we become aware of any apparent misstatements or material inconsistencies with the summary of contributions.

## **Basis of Statement About Contributions**

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to give reasonable assurance that contributions reported in the summary of contributions have been paid in accordance with the relevant requirements. For this purpose, the work that we carried out included examination, on a test basis, of evidence relevant to the amounts of contributions payable to the scheme and the timing of those payments. Our statement about contributions is required to refer to those exceptions which come to our attention in the course of our work.

## **Statement About Contributions Payable Under the Schedule**

In our opinion contributions for the Scheme year ended 31 March 2007 as reported in the summary of contributions and payable under the schedule have been paid in all material respects at least in accordance with the schedule of contributions certified by the actuary on 26 January 2004.

**KPMG LLP  
Chartered Accountants**

**27 June 2007  
8 Salisbury Square  
London  
EC4Y 8BB**

# Summary of Contributions

## Statement of Trustees' Responsibilities in Respect of Contributions

The Scheme's Trustees are responsible under pensions legislation for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions showing the rates of contributions payable towards the Scheme by or on behalf of the employer and the active members of the scheme and the dates on or before which such contributions are to be paid. The Scheme's Trustees are also responsible for keeping records of contributions received in respect of any active member of the Scheme and for procuring that contributions are made to the scheme in accordance with the schedule.

## Trustees' Summary of Contributions Payable Under the Schedule in Respect of the Scheme Year Ended 31 March 2007

This Summary of Contributions has been prepared on behalf of and is the responsibility of the Trustees. It sets out the employer and member contributions payable to the scheme under the schedule of contributions certified by the actuary on 26 January 2004 in respect of the scheme year ended 31 March 2007. The Scheme Auditor reports on contributions payable under the schedule in the Auditors' Statement about Contributions.

## Contributions Payable Under the Schedule in Respect of the Scheme Year

	£'m
Employer: Normal Contributions	18.2
Member: Normal Contributions	5.5
	<hr/>
<b>Contributions Payable Under the Schedule (as reported on by the scheme auditors)</b>	<b>23.7</b>

## Reconciliation of Contributions

Reconciliation of contributions payable under the schedule to contributions reported in the accounts in respect of the scheme year:

	£'m
Contributions Payable Under the Schedule (as above)	23.7
Contributions Payable in Addition to Those Due Under the Schedule:	
Member Additional Voluntary Contributions	2.2
Employer Augmentations	9.5
Other – Section 75 debts	0.2
	<hr/>
<b>Total Contributions Reported in the Accounts</b>	<b>35.6</b>

This Report was approved by the Board of Trustees on 27 June 2007 and was signed on their behalf by:

**John Birch**  
Secretary

# Scheme Actuary's Report

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The Scheme Actuary signed and issued his formal report on the 2006 valuation on 29 March 2007. His report is available to Scheme members on request, but the following extract is a summary of the results and conclusions set out in the report.

The current valuation takes account of the information set out in the Statement of Funding Principles dated 7 and 9 February 2007. In particular, as part of the valuation process, the Trustees and British Airways plc (BA) agreed assumptions which took account of the existence of additional security provided by BA under a separate guarantee to the Scheme amounting to some £230 million.

The principal conclusions of the current valuation are as follows:

- The accumulated assets of the Scheme as at the valuation date represented 100.3% of the Scheme's Technical Provisions in respect of past service benefits. This corresponds to a raw funding surplus of £22 million, none of which is disposable.
- The Trustees and BA have agreed that contributions from the Employers with effect from 1 April 2007 will be:

	Percentage of pay for contribution purposes
General Staff	32.5%
Air Cabin Crew	39.4%
Pilots and Officers	39.5%

- The above contributions exclude those required to fund any augmentations made but include allowance for the administrative costs of the Scheme. Levies required by the PPF Board are payable by BA.
- The results determined on the basis set down under Section 179 of the Pensions Act 2004 show that assets exceeded the amount required to provide the benefits payable by the Pension Protection Fund.
- However, 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 effective valuation date, on the assumptions specified in Section 3, is 86%, before taking any account of the benefit of the £230 million guarantee available to the Trustees.

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.

**Michael J Pardoe**  
Fellow of the Institute of Actuaries  
Watson Wyatt Limited

29 March 2007

Watson House  
London Road  
Reigate  
Surrey  
RH2 9PQ

# Schedule of Contributions

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## The Airways Pension Scheme Schedule of Contributions

**Period covered by this schedule:** Five years from the date of certification of this Schedule by the Actuary

**Level of contributions payable:**

By members: As specified in the rules of the Scheme

By the Employers:

Contributions at the following multiples of members' standard contributions until 31 March 2007:

General Staff	3.85
Air Cabin Crew	3.75
Pilots and Officers	3.55

Subject to review at future actuarial valuations, contributions from 1 April 2007 at the following percentages of Pay for Contribution Purposes:

General Staff	32.5%
Air Cabin Crew	39.4%
Pilots and Officers	39.5%

**Due date for payment of contributions:** All contributions (from both members and the Employers) are payable monthly and are due to be paid to the Scheme by the 19th day of the month following that to which the contributions relate.

Note: This schedule of contributions relates to the payment of normal contributions to the Scheme payable under Rule 5 of Part VI and Rule 6 of Parts I - V; it does not relate to payments by any Participating Employer on the cessation of participation in the Scheme, nor to the payment of additional voluntary contributions (AVCs) under Rule 32 of Part VI and Rule 29 of Parts I - V, nor to contributions payable under Clause 24. Pension Protection Fund levies are to be paid directly by BA plc in addition to the amounts specified in this Schedule.

Agreed on behalf of the Management Trustees

Agreed on behalf of the Employers

**J Birch**

Secretary to the Management Trustees

**K Williams**

Chief Financial Officer

# Actuarial Certificate

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## Actuarial Certificate Schedule of Contributions

Name of Scheme: The Airways Pension Scheme

### Adequacy of Rates of Contributions

- 1 I certify that, in my opinion, the rates of contributions shown in this schedule of contributions are such that the statutory funding objective could have been expected on 31 March 2006 to continue to be met for the period for which the schedule is to be in force.
- 2 I also certify that the rates of contributions shown in this schedule are not lower than I would have provided for had I had responsibility for preparing or revising the schedule, the statement of funding principles and any recovery plan.

### Adherence to Statement of Funding Principles

I hereby certify that, in my opinion, this schedule of contributions is consistent with the Statement of Funding Principles dated 7 and 9 February 2007.

Michael J Pardoe  
Fellow of the Institute of Actuaries  
Watson Wyatt Limited

29 March 2007

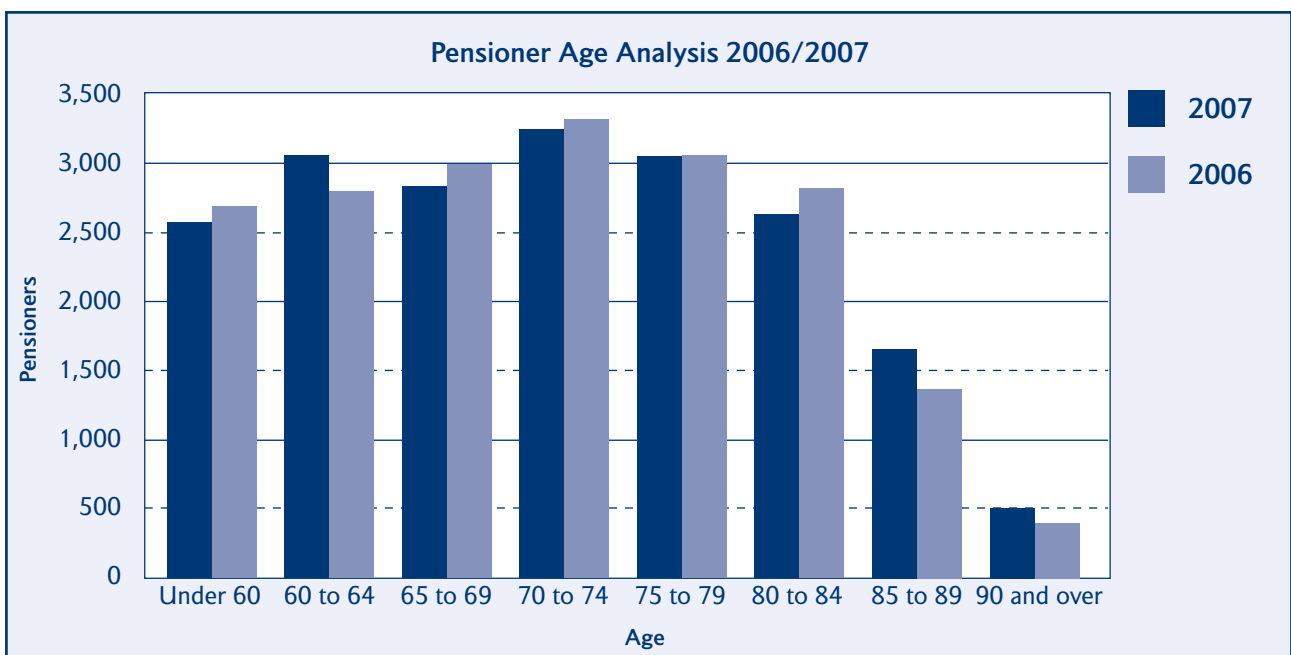
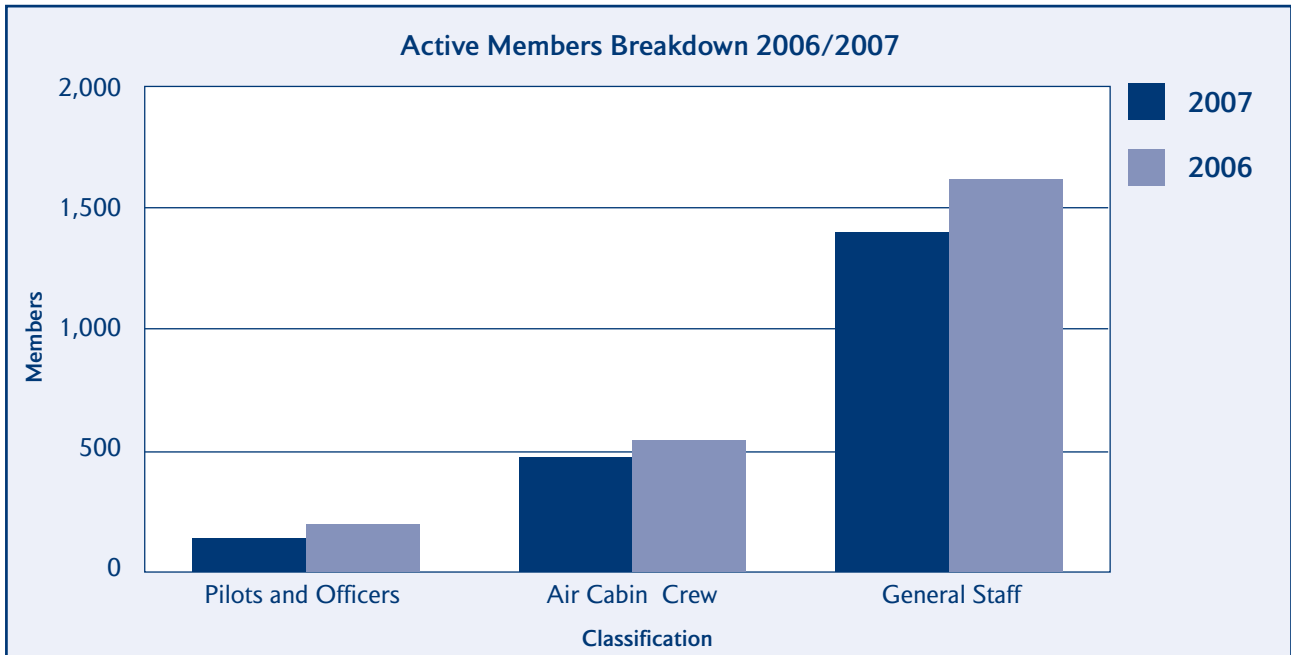
Watson House  
London Road  
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### Note:

The certification of the adequacy of the rates of contributions for the purpose of securing that the statutory funding objective can be expected to be met is not a certification of their adequacy for the purpose of securing the scheme's liabilities by the purchase of annuities, if the scheme were to be wound up.

# Membership Information

	2007	2006
Active Members	1,940	2,364
Pensioners in Payment	19,521	20,031
Dependant Pensioners	7,367	7,282
Deferred Pensioners	3,850	4,194
	<u>32,678</u>	<u>33,871</u>



There are approximately 30,000 (2006: 31,000) deferred pensions under £46 a year payable in accordance with the National Insurance Acts. These benefits are known as Equivalent Pension Benefits (EBPs).

# Compliance Statement

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## The Scheme

APS provides retirement benefits for employees of BA 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 at 31 March 1984.

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 contracted-in to the State Second Pension.

From 1 April 2007 APS members may pay up to 30% of salary in pension contributions.

## Membership

Membership of the Scheme is voluntary and members can opt out on giving one month's notice in writing to the Trustees. Members of APS who opt out cannot normally join NAPS or any other pension arrangement sponsored by BA.

## Internal Dispute Resolution Procedure (IDRP)

The Trustees are required by law to operate an IDRP. This is a mechanism by which a member may request a designated person to adjudicate on a disagreement with their scheme. The Trustees have appointed John Birch, Managing Director of BAPSL, as the designated person to deal with the first stage adjudication. Complaints made under this procedure must be in writing and a leaflet giving full details is available from Whitelocke House.

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