Letter from the Chairman of the NAPS Trustees, sent to NAPS members & pensioners 8 November 2011

Dear NAPS member

Pension Increases and the NAPS Funding position

The last time the Trustees wrote to you was in April 2011 and we want to provide you with an update on events and developments since then, particularly with regard to:

- The NAPS Members' and Pensioners' meeting which was held on 13 September at Ascot,
- Notice of the Members' and Pensioners' ballot requisitioned following that meeting, and
- The Trustees' ongoing work in relation to pension increases.

KEY MESSAGES

1. Both the APS and NAPS Trustees have set an objective to return to paying RPI type annual increases when it is prudent to do so.
2. It is likely that APS will achieve this objective in a much shorter time horizon than NAPS, primarily because of the relative funding positions of the Schemes.
3. APS has a unilateral power of amendment and has already introduced a power to award discretionary increases over and above the increase specified in the Order, although the APS Trustees concluded that an additional increase would not be awarded in April 2011.
4. Unlike APS, NAPS requires BA's agreement to change the Rules. However even if BA agreed to amend the Rules, the deficit and the uncertainties around the long-term covenant mean that it is likely to be many years before it would be a proper use of any discretionary increase power to award an increase.
5. The NAPS deficit as at 31 March 2011 is over £2 billion.

13 September meeting

The Members' and Pensioners' (active Members and Pensioners in receipt of a pension) meeting took place at Ascot Racecourse on 13 September and 228 people attended with 747 appointing an attendee as their proxy for the meeting.

The meeting was an opportunity for NAPS members to ask questions of the Chairman of Trustees, Paul Spencer, the Scheme's Actuary, James Wintle, and the Scheme's Solicitor, Anthony Arter, in connection with the NAPS pension increase provisions.

You will recall that the NAPS Rules state that annual pension increases are as specified in the Pensions Increase (Review) Orders ("the Order") which are issued each year by the Government. In June 2010, the Government announced that these Orders would no longer be based on the retail prices index (RPI) and would instead be based on the consumer prices index (CPI). The Trustees took advice from the Scheme's legal team and also consulted a leading Queen's Counsel (QC) who specialises in pensions law. The conclusion was that as NAPS increases are linked to the Order, increases have automatically become linked to CPI. The change to CPI was the result of action taken by the Government – not by the Trustees.

In general terms, CPI is often a lower figure than RPI because it is calculated in a different way. However, in 6 out of the past 22 years September CPI has been higher than September RPI. This is because as well as the different way the two indices are calculated, the basket of goods used to calculate them is different. For example, the basket assumed for CPI does not presently include housing costs whereas the basket for RPI does.

The Trustees used the BA Intranet and the NAPS website to publicise the meeting to NAPS active members. Whilst this is in line with the Rules, from comments made at the meeting it is clear that some members had missed these announcements. The Trustees will try to learn from this for any similar future communication exercises.

Background to the key messages

Funding Position of NAPS

A full update on the evolution of the funding position of NAPS will be provided in the next In Focus publication which will be sent later this year. The table below sets out how the funding position has developed since the last formal valuation in 2009:

Comparison between the NAPS funding position at 31 March 2009, 31 March 2010 and 31 March 2011			
	31 March 2009 (£m)	31 March 2010 (£m)	31 March 2011 (£m)
Technical Provisions (Liabilities)	(8,778)	(10,684)	(11,214)
Assets	6,096	8,033	8,809
Deficit	(2,682)	(2,651)	(2,405)
Funding Level	69%	75%	79%

There are three primary reasons for the relative improvement: higher than expected investment returns achieved over the two years to 31 March 2011, the deficit contributions paid by BA and the pension increase granted in April 2011 which, in accordance with the 2011 Order, was based on CPI (3.1%) rather than RPI (4.6%).

Since March 2011 there has been considerable volatility in investment markets. Following a fairly stable few months, there were significant falls in most major equity markets during August 2011, with many markets losing around 10% in a week, and in bond markets there was a reduction in gilt yields. The next full formal valuation will be as at 31 March 2012 and preparatory work for that is underway. Over time, as NAPS matures, the intention is to move to lower risk assets designed to match the liabilities more closely to help insulate the Scheme from adverse market movements. However, moving to a more cautious investment strategy will reduce the level of future investment returns that can be assumed which will mean a higher liability value. The increase in the value of the liabilities between 2009-2011 (shown as the 'Technical Provisions' in the table above) illustrates how liability values can increase as the level of expected future return is lowered.

The position will evolve over time but even when we reach 100% funding on the current valuation basis we will still not be in a position where the Trustees can feel that we have fully secured the ability to pay your pensions in all possible future circumstances. Those circumstances include factors such as changes to interest or inflation rates and how long people will live which are very difficult to estimate. We are a very long way off our long-term objective of having a funding position which provides full security for your pensions.

The Trustees' primary duty is to secure the existing benefits for all members and pensioners. For this reason the Trustees also look at what the funding position of NAPS would be in the event that BA were to become insolvent and responsibility for providing benefits was transferred to an insurance scheme. This provides a very broad indication of how far benefits might be cut if BA became insolvent and the estimated funding position as at 31 March 2011 is 55%. In such an environment NAPS could enter the Pension Protection Fund (PPF) with benefits becoming payable by the PPF. The PPF benefit structure is not straightforward[1] but one of the key differences is that future pension increases are likely to be less than the NAPS benefits and are likely to be less than CPI or RPI increases.

In relation to BA's contributions, under the terms of the Recovery Plan (agreed in June 2010), BA is required to pay substantial contributions each year until 2026. These started at £144m for the year ended 31 March 2011 and will gradually increase over the period to 2026. This year BA will pay £164m and next year £177m. This year BA also made an extra payment of £105m to NAPS under the terms of the recovery arrangements. The Scheme is and will remain dependent on BA for many years. For this reason the Trustees must be concerned about, and carefully monitor, BA's covenant.

Covenant

As well as looking at the Scheme's assets and liabilities, the Trustees have to take account of the financial strength of BA and its ongoing ability to pay the contributions needed by the Scheme. Since 2006, PricewaterhouseCoopers have been engaged by the Trustees to provide them with an objective and independent assessment of the overall financial strength of BA. However, given the likely long-term reliance on BA's contributions and the cyclical nature of the aviation industry, there remains a high level of covenant uncertainty.

Amending the Scheme Rules

The deficit funding position and the uncertainties surrounding the covenant mean that even if BA agreed to amend the Rules, as the APS Trustees have done by using their unilateral power of amendment, it is likely to be many years before it would be a proper exercise of the Trustees' powers to grant an additional increase. Unlike APS, NAPS does not have a unilateral power of amendment and any changes to the Scheme's Rules must be agreed with BA.

Steps the Trustees are taking to achieve the objective of paying RPI annual increases

When the Trustees negotiated the Recovery Plan with BA in 2010 the Trustees of APS and NAPS worked together to maximise the package of contributions, security and protections. In the same way we hope to work with APS and BA to agree some principles by which RPI type annual increases might be restored. Both Schemes have an objective to get to a position where RPI type annual increases can be paid in circumstances where the Scheme has a strong funding position which is supported by low risk and well matched investments. A sub group of APS and NAPS Trustees has begun work on how these principles would operate in practice and in due course we will work with BA to try and reach agreement on implementing additional increases when circumstances permit. Given the relative funding positions it is almost inevitable that any increases above the Order will be paid in the nearer term for APS, whilst for NAPS this is a longer-term proposition. However, the intention is that, having created a precedent in relation to APS, the underlying principles can also apply to NAPS.

The April 2012 increase to pensions in payment and deferred pensions will be based on the percentage increase specified in the Pensions Increase (Review) Order 2012 (capped at 5% for NAPS increases) which is expected to be published in March 2012. Assuming that there is no change to past practice it would be expected that the Order will reference the relevant inflation measure for the prior September. Figures released in the last few weeks, show that CPI for September 2011 was 5.2% so the capped NAPS increase is anticipated to be 5%.

[1] More information on PPF benefits can be found at **www.pensionprotectionfund.org.uk**

Notice of a Postal Ballot

At the 13 September Ascot meeting there was a request, subsequently confirmed in writing by over 100 Members and Pensioners, for a postal ballot to be held. As with the meeting, the ballot will involve only active Members and Pensioners in receipt of a pension. When such a request is received the Trustees are required to arrange the postal ballot. This letter provides formal notification that this ballot will be sent out to eligible Members and Pensioners approximately one month after receipt of this letter. The general nature of the questions, which are set by the Members and Pensioners who requested the ballot, is the NAPS pension increase provisions.

Ongoing Trustee work in relation to the Pension Increases

As well as the work that the sub group is doing to deliver on the objective to restore RPI type annual increases once it is prudent to do so, the Trustees are also monitoring relevant industry events. For example, a Judicial Review has been lodged by various public sector and trade union representatives (e.g. the Police Federation, the GMB and the Civil Service Pensioners' Alliance). The claim contends that the adoption of CPI by the Government was unlawful. Various arguments are put forward as to the inappropriateness of CPI. For example, the measure does not include an allowance for housing costs, members have legitimate expectations as to the pension increases they should receive and that the use of CPI does not satisfy the duties of the Secretary of State under the relevant legislation. The review hearing is currently taking place and the Trustees are closely monitoring the progress of this review with their advisers.

We want to be clear that in reality NAPS is some distance from being in a position to award increases additional to those prescribed in the Order and we cannot undertake to provide such increases without BA agreeing to a Rule change. We recognise that in the interim, pensioners will receive only CPI increases. We need to balance all of the relevant factors including: BA's views, the funding position, the level of investment risk and benefit security, and the risk of external factors having an impact on BA's business. The decisions we take must not jeopardise our ability to fulfil the promises made under the Scheme Rules to you, our members and pensioners.

The Trustees recognise that the benefit structure of NAPS has been subject to two rounds of benefit changes; first in 2007 and then again last year. From a funding perspective these changes have reduced the cost of new pension benefits which means that more of the money available from BA can be put towards reducing the deficit in respect of past service benefits.

We need to balance these issues across the whole membership. I would like to reassure you that it is a very important aim of all the Trustees to provide RPI type annual pension increases as soon as it is prudent to do so.

We are working on this and will keep you informed.

Yours sincerely

Paul Spencer
Chairman of Trustees