Letter from the chairman of the APS Trustees, sent to APS members and pensioners - July 2010 (the full 2009 valuation report is available on the 'Scheme Documents' page)

Dear APS member

2009 Valuation Update – Airways Pension Scheme

I am pleased to confirm that the 31 March 2009 Scheme Valuation has now been completed.

Over the last fifteen months we have received extensive financial, actuarial and legal advice from the external professional advisors that help us manage the Scheme, enabling us to conclude our discussions and to agree the basis of the Valuation and the necessary Recovery Plan with British Airways. We are in the final stages of completing the documentation that is required to finalise the process and the full Valuation Report will be available on our website during July.

As was provisionally reported in December 2009, the valuation of the Scheme's assets and liabilities as at 31 March 2009 showed that the value of the benefits expected to be paid by the Scheme exceeded the value of the APS assets at that time resulting in a funding deficit. The funding deficit as at 31 March 2009 was £1,030 million. This compares to a small funding surplus at the last valuation in 2006 of £22 million.

Why has the funding position moved from a surplus to a deficit?

The main reason for the change in the funding position is that the investment returns achieved by the Scheme over the three years between 2006 and 2009 were lower than projected in 2006, mainly as a result of the economic crisis during 2008/09. Even though a large proportion of the Scheme's assets are held in government bonds, the market values of other assets, such as shares, property and corporate bonds, were particularly low at 31 March 2009.

In addition, the Trustees strengthened the allowance made for continuing improvements to future life expectancy. This means we anticipate that pensions will be paid for longer than previously assumed. This has the effect of increasing the value of the Scheme's liabilities and therefore the deficit.

Recovery Plan

Having identified a deficit, the Pensions Act 2004 requires that a Recovery Plan is put into place to bring the Scheme back into balance as quickly as possible. The Recovery Plan is an agreement with British Airways regarding the future contributions and payments that will be made to the Scheme over the coming years to repair the deficit.

When setting the Recovery Plan it is possible for changes in investment conditions and asset values since the valuation date to be considered. The changes in investment conditions and market performance generally have been significant since March 2009. The Trustees have taken into account the improvements in the asset values and financial conditions over the year, and based the Recovery Plan on a reduced deficit amount at 31 March 2010 of £552 million.

The Trustees of APS and NAPS worked together to maximise the package of contributions, security and other protections negotiated with BA. Those benefits were then apportioned, recognising the particular needs and profile of each Scheme, to ensure the maximum benefit to each.

Headline items of the Valuation process and Recovery Plan

The key features of the valuation and recovery plan are summarised below.

- The level of contributions paid by British Airways in respect of continuing accrual of benefits for active members will vary as active members leave the Scheme but initially are expected to be approximately £12 million a year.

- Deficit payments, at the level of £55 million (£57 million in 2010/11) will be payable by British Airways each year throughout the period of the Recovery Plan, which is anticipated to be a period of 13 years, ending in 2023.

- A "cash sweep" has been agreed with British Airways, such that should their cash holdings as at 31 March each year exceed £1.8 billion, any amount over this figure up to an aggregate of £150 million will become due for payment to APS and NAPS. Furthermore, 50% of any available cash in excess of £150 million will also be payable to the Schemes. Whilst APS remains in a deficit position 25% of any amount payable would be expected to be paid to APS and the remainder to NAPS (if APS becomes fully funded then the full amount of this cash sweep would be payable to NAPS, unless NAPS was also fully funded).

- A detailed package of additional security and other measures aimed at further improving the funding position and members' benefit security over time has also been agreed with British Airways. This includes the following items:

- Security in the form of a charge over Company assets to the value of £250 million would become available to the Scheme in the event of the insolvency of British Airways. If this charge is still in place in 2019 and the Scheme remains underfunded the charge would be replaced by a cash payment of £250 million to the Scheme.

- The Guarantee of £230 million available in the event of British Airways insolvency, provided as part of the 2006 Valuation remains in place. We reported in July 2009 that we had agreed to release this existing Guarantee should appropriate alternative security be provided by British Airways. We have not however received any request from the Company to replace this Guarantee.

- In setting the Recovery Plan, no allowance has been made for any additional payments under the cash sweep or the package of additional security and other measures. If such payments are made then the deficit could be met in full sooner than has been anticipated in the Recovery Plan (in other words before 2023). Similarly, the allowance for future investment returns in the Recovery Plan has been set cautiously and if actual investment returns are higher than assumed this could result in the deficit being repaired before 2023.

- The expected investment return (also referred to as the discount rate) used in the Valuation remained consistent with that used in 2006. At both valuations, annual returns were assumed to be 0.5% higher than could be achieved by investing purely in gilts (bonds issued by the UK Government).

Changes to the APS Investment Strategy

In addition to the Recovery Plan discussions detailed above we have also made some changes to the general APS investment strategy recognising the maturity of the scheme and the need to build in as much security as possible in relation to the Scheme's assets.

The allocation to equities and other return seeking assets was reduced by 4% with effect from 30 April 2010, and the proceeds were invested in gilts.

The Trustees have also invested £1.3 billion in an insurance policy issued by Rothesay Life Limited. This type of transaction is often referred to as a 'buy-in'. The Scheme will receive payments from Rothesay Life which match a proportion of the benefits due to pensioners. If these benefits cost more than we currently expect – for example, because members live longer than currently anticipated – the payments we receive from Rothesay Life will also be worth more. There is no change to the way APS benefits are calculated or paid. Pensioners will continue to be paid at the same rate, at the same time and from the same place.

One of the primary objectives of the Trustees, particularly in relation to investment policy, is to manage risk to achieve a high level of security for pension benefits. One way we have sought to achieve this has been to align the Scheme's investment strategy with the benefits that are expected to be paid. However, this does not fully protect the Scheme from longevity risk which is the extra cost of providing pensions caused by improvements in life expectancy. The insurance policy with Rothesay Life Limited will provide protection for longevity risk as well as providing a better match for pension cashflows.

Rothesay Life Limited is authorised by the UK Financial Services Authority and has experience in this area having entered into these types of arrangements with a number of other pension schemes. The Trustees are satisfied that the policy meets the objective of covering longevity risk and that within the policy there are robust security provisions to protect the Scheme.

The recovery plan and the continued de-risking of the investment strategy of the Scheme are intended to improve the security of your pension. I joined as Chairman in March 2010 by which time the valuation process was well underway. I have been impressed by the manner in which the APS Trustees have conducted themselves, on your behalf, during the process. They were steadfast in seeking to ensure that the various elements of the recovery arrangements represented the best terms that could be achieved to improve the security of the pensions which members have built up in the Scheme and to ensure that benefits are paid in full as they fall due. Taken together we believe that the package of benefits available to APS provides a strong basis for the recovery of the funding position.

Yours sincerely

Paul Spencer
Chairman of Trustees