

Letter from the APS Trustees, sent to APS members & pensioners – 3 August 2012

Dear APS member/APS pensioner

Pension Increases Update – Airways Pension Scheme (APS)

When we wrote to you in March this year we were waiting to learn the outcome of the Appeal Court judgment relating to the claim lodged by various public sector unions against the Government's decision to move from the Retail Price Index (RPI) to the Consumer Price Index (CPI) as the basis of the Pensions Increase (Review) Orders, (the Orders). We promised that we would keep you updated on developments. The Appeal Court's judgment was issued shortly after we sent our letter and upheld the High Court's judgment that the Government's action was lawful. We have now had an opportunity to consider in detail the implications of the judgment for APS and are able to confirm the conclusions of our deliberations in relation to: 1) the appropriateness of CPI as an index for the purposes of Rule 15 (the rule that governs pension increases) and 2) our current position regarding a Court application.

We understand that the annual increases your pension receives are a vital part of your retirement income. The strength of feeling that this issue has caused is fully understood and evidenced by the receipt of over 900 second stage Internal Dispute Resolution Procedure (IDRP) complaints, a similar number having been through the first stage of the IDRP process. To enable us to respond to these complaints we asked the pensions law specialists at Allen & Overy, a well-known international firm of lawyers who are independent of our normal advisers, Eversheds, to review our decision making process in responding to the Government's change to the Orders. Allen & Overy's conclusion was that the approach was correct. We recognise, however, that until we are able to pay pensioners RPI increases this will be cold comfort and we would like to take this opportunity to repeat that it remains our intention to return to paying RPI increases just as soon as we believe this to be in your best interests bearing in mind the long term security of the fund.

The appropriateness of CPI for Rule 15

Rule 15 provides that the Orders are used to increase APS pensions and says that if the Orders are replaced by the Government or if it becomes necessary to review the basis of the increases the Trustees should take steps to ensure that increases continue to be based on an appropriate national index reflecting fluctuations in the cost of living.

As the Orders have not been replaced the only question facing the Trustees is whether CPI falls within the definition of an 'appropriate national index reflecting fluctuations in the cost of living'. If it is 'appropriate' then there is no scope for us to take any further steps under Rule 15 and the Order is applied as normal. The question, in the context of Rule 15, is therefore a narrow one and does not allow us to consider what is the *most* appropriate index, only if CPI is in the range of what is 'appropriate'.

We have taken considerable professional advice over the last two years regarding the structure of both RPI and CPI and received detailed legal, actuarial and economic analysis relating to the construction and composition of cost of living indices and price indices. Commentary on these same points was also provided in the High Court and Appeal Court judgments. We have heard arguments that neither RPI or CPI are true cost of living indices but, for the purpose of Rule 15, the requirement is only that the index used reflects fluctuations in the cost of living. The outcome is that we have no option other than to conclude that, for the purposes of Rule 15, CPI is within the range of appropriate indices.

We know that there is a view that what is an appropriate index for the Orders is not necessarily appropriate for APS pensioners (i.e. what is right for public sector pensioners is not right for APS pensioners). The advice that we have received on this point is that Rule 15 does not provide for an assessment of the appropriateness of the increase measure specifically for APS (e.g. to take

account of the cost of living of the APS population) but refers instead to an appropriate 'national' index reflecting fluctuations in the cost of living more generally.

Having had to reluctantly conclude that there is no basis to reject CPI as an 'appropriate national index reflecting fluctuations in the cost of living' then Rule 15 does not provide for us to take any further action. This means that any action to change the index for pension increases would need to be done under the general power of amendment which is Clause 18.

Using Clause 18 to fix RPI or some other index in the Rules

We have been asked why we have not changed the Rules to automatically provide increases over and above the level stated in the Orders or to fix RPI as the index for APS pension increases. This is not a straightforward matter. The Scheme is in deficit and it would therefore be difficult to reconcile taking action which could be detrimental to the funding position of the Scheme with our primary duty which is to protect the security of existing benefits.

Our current position regarding Court action

Before we obtained the advice of Leading Counsel in April 2011, we had agreed that we would refer our decisions regarding pension increases to a Court. However, this decision has been superseded by Counsel's advice and the greater clarity about the legal issues that has come from recent decisions of the High Court. We have taken the steps which Leading Counsel said were required under Rule 15. He also confirmed that the introduction of the discretionary increases power was a good way of addressing the pension increase issue.

Following further consideration of all relevant issues we are agreed that at present there is no legal issue on which we need to seek the Court's direction. If, in the future, we identify a legal matter on which we feel it is necessary to obtain guidance from a Court, such action remains available to us.

Future pension increases

In March 2011, using Clause 18, we introduced the discretionary power to pay pension increases over and above those specified by the Order. We remain committed to our stated objective of returning to RPI annual increases when to do so would not put at risk our ability to pay your pensions in full.

Alongside the ongoing work associated with the 2012 funding valuation, we intend to finalise the terms of a framework which will enable us to determine circumstances when we can exercise our discretionary power to pay annual pension increases additional to those due in accordance with the Orders.

Keeping you informed

We would also like to take this opportunity to let you know that we have recently introduced a new online quarterly newsletter which will be published on our member website throughout the year following the regular quarterly Trustee meetings. The newsletter is intended to provide you with more timely information about the work we are doing. The first newsletter was issued in June and can be viewed on www.mybapension.com in the 'News' section.

Issued by the Trustees of the Airways Pension Scheme