

APS Discretionary Increases – settlement proposed

Subject to obtaining the approval of the High Court, the Trustee Directors of the Airways Pension Scheme have unanimously agreed with British Airways Plc (BA) terms for an out-of-Court settlement. This would bring to an end the litigation that commenced in 2013 and which is otherwise due to proceed to appeal at the Supreme Court later this year. Under the terms of the proposed settlement, the Trustee of the Airways Pension Scheme (the APS Trustee) will be permitted, subject to some affordability tests, to award Discretionary Increases so that APS pensions are increased up to the annual change in the Retail Prices Index (RPI) from 2021 with interim catch-up increases, BA will cease paying further deficit recovery contributions, including cash sweep payments, and the Trustee will withdraw its appeal to the Supreme Court.

The APS Trustee will seek the High Court's approval of this proposed settlement before it can be implemented. This will include a review of the APS Trustee's decision that the terms better serve the interests of the APS members than continuing with the appeal to the Supreme Court.

The Court process to seek approval for this settlement will be started now but, given the timeline for securing a hearing date, the settlement may not receive approval until Summer 2019 at the earliest. If approved, the proposed payments for 2019 will be made as soon as practicable, backdated to 8 April 2019.

We will continue to keep members updated on developments as soon as we can.

Summary of the proposed settlement

The proposed settlement includes:-

- A one-off lump sum for pensioners in relation to the period from 2013 to April 2019, for which no Discretionary Increases were paid due to the litigation, and certain increases to the rate of pensions for pensioners and deferred pensions also to cover the period 2013 to 2019, to take effect from this year.
- A further Discretionary Increase in 2020 to the rate of pensions for pensioners and deferred pensions of 75% of the relevant gap between RPI and the Government's Pensions Increase Review Orders (PIRO). Increases under PIRO are currently calculated by reference to the Consumer Prices Index.
- Discretionary Increases are intended to be made from April 2021 onwards so that the overall pension increase is in line with the annual increase in RPI.
- The increases for 2019 have been agreed by the APS Trustee and are assured, subject to the settlement being approved by the High Court. Discretionary Increases from 2020 onwards will be subject to an assessment of their affordability and at the discretion of the APS Trustee. Based on advice, the judgement of the APS Trustee is that under the terms of this settlement payment of full RPI should be affordable from 2021.
- BA will not be required to make deficit reduction and cash sweep contributions to APS after 31 December 2018. Deficit contributions would restart only if funding falls below 100%

with an assumption for future pension increases in line with the index used in PIRO, which is the entitlement that most members have under the rules of APS.

Further details on the proposed settlement can be found in the attached [Detailed Q&A](#).

This communication has been agreed with BA and is issued by the APS Trustee on 8 April 2019.

Detailed Q&A

Why has the APS Trustee decided to settle with BA rather than pursue the case through the appeal to the Supreme Court?

The Trustee Directors have agreed unanimously that the terms of the settlement agreed with BA better serve the interests of the members as a whole than proceeding with the appeal. The Trustee Directors will now ask the High Court if it agrees with this and ask it to approve the settlement.

Why now and not earlier?

Recent events have had a significant and positive effect on the funding level of APS.

Over the past two years the APS Trustee accelerated its de-risking drive to make APS members' benefits substantially more secure by considerably reducing the Scheme's exposure to longevity and investment risk.

In 2017 the APS Trustee identified an opportunity to improve the security of APS members' benefits by removing the requirement for investments in stocks and shares (equities) and moved the proceeds into safer investments.

The APS Trustee was then able to improve significantly the security of APS members' pensions by insuring £4.4 billion of APS liabilities through a pensioner bulk annuity buy-in with Legal & General on an RPI basis. As a result of this transaction APS is more than 90% protected against all risks: longevity, interest rate and inflation (on an RPI basis).

BA has made contributions to APS through the deficit recovery payments and the cash sweep arrangements. We have also had substantial returns from our investments including those linked to RPI.

Together, these factors have effectively reversed the funding deficit and APS is expected to show a substantial surplus at the next valuation relative to PIRO increases. This surplus would be used to deliver the proposed package of Discretionary Increases.

How soon will APS be able to return to RPI for pension increases?

The settlement includes a range of increases for deferred pensions and pensions already in payment over the next two years with the intention that full RPI increases will be granted from 2021 and beyond. This would mean a return to payment of full RPI earlier than 2023, the date which had been anticipated by the APS Trustee at the time of the 2012 Valuation.

What increases will APS members receive in 2019?

For pensioner members:

Discretionary Increases will be paid on pensions, or part of pensions, that are entitled to Scheme pension increases in line with the Government's Pensions Increase (Review) Orders (PIRO) as follows:-

- A one-off lump sum payment to be paid this year of up to 4.6% of APS pensions that were already in payment on 31 March 2019. This is in relation to the period 2013 to April 2019, for which no discretionary increases were paid due to the litigation. The lump sum payment will be adjusted for members whose pension, or whose Guaranteed Minimum Pension (GMP), has come into payment since 1 April 2013.
- A "catch-up" Discretionary Increase with effect from 8 April 2019 of up to 1.7% of pensions already in payment on 31 March 2019 (adjusted according to the date of leaving active service and/or if a GMP has come into payment). This is to uprate pensions to cover the period from 2013 to 2018 during which no discretionary increases were paid due to the litigation.
- A further Discretionary Increase of 0.7% (the 2019 Discretionary Increase) to be awarded with effect from 8 April 2019 on top of the 2.4% PIRO increase for 2019 that has already been announced (adjusted according to the date of leaving active service and/or if a GMP has come into payment).

For deferred members:

Discretionary Increases for deferred pensions that are entitled to Scheme pension increases in line with PIRO as follows:-

- A catch-up Discretionary Increase with effect from 8 April 2019 of up to 1.7% of pensions at 31 March 2019 (adjusted according to the date of leaving active service).
- A Discretionary Increase of 0.7% to be awarded with effect from 8 April 2019 on top of the 2.4% PIRO increase already announced (adjusted according to the date of leaving active service).

What about Discretionary Increases from 2020?

BA and the APS Trustee have agreed their intention that 75% of the difference between PIRO and RPI should be granted in April 2020 and full RPI increases from April 2021 onwards. These increases will be made at the discretion of the APS Trustee and will be subject to an assessment of their affordability. The increases would be paid on pensions or part of pensions that are entitled to Scheme pension increases in line with PIRO.

How will the Trustee Directors reach their decision each year on whether to award a Discretionary Increase?

Under the settlement, the APS Trustee will have the power to consider the award of Discretionary Increases each year up to RPI under a framework agreed with BA, a Discretionary Increase Protocol ("DI Protocol"), which is a legally binding set of principles on which the decision to award Discretionary Increases will be made. Discretionary Increases can be paid on pensions or part of pensions that are entitled to Scheme pension increases in line with PIRO. The DI Protocol includes tests of whether the award will be affordable. The relevant test will change in 2028. Up to this date the test will guard against extreme events unexpectedly removing a large portion of the surplus; from 2028 the test will become tighter, recognising

that the APS Trustee expects APS by then to be fully insured and all members eligible to draw their full APS pension.

Will the APS Trustee need to obtain BA's agreement each year before a discretionary increase can be made?

No. As part of the settlement, BA is giving its agreement to, and will not challenge, the changes to the APS Rules that will allow the APS Trustee to adopt the legally binding DI Protocol that will be applied each year to determine whether the proposed Discretionary Increase can be paid. Provided the Trustee Directors properly apply the agreed DI Protocol, BA also undertakes not to challenge their decisions in doing so.

The annual decision to award Discretionary Increases from 2020 will be a unilateral decision of the APS Trustee made by simple majority, not the 2/3rds majority required under the 2011 Rule 15 amendment that was challenged by BA through the litigation.

How confident can we be that the increases for 2020 onwards will be affordable and will be paid?

Based on the professional advice the Trustee Directors have received and in the Trustee Directors' judgement, there is good reason to believe payment of full RPI will be achieved from 2021 and for all years thereafter.

The Trustee has been advised that until April 2027 the annual affordability test is highly likely to be passed and the proposed increases are very likely to be paid. BA is, however, providing support during this period in the form of a potential cash payment of up to £40m, in the event that adverse experience results in future RPI increases not being affordable from the Scheme assets. Beyond 2027, passing the revised annual test will depend in part on whether the Trustee has successfully insured the remaining liabilities and sold the remaining invested assets on acceptable terms. As part of the transition between the two tests, the Scheme's financial position as at 31 March 2027 will be assessed to determine whether future RPI increases are expected to be affordable. If there is a shortfall on this assessment then BA will pay the potential cash payment of up to £40m (to the extent not already paid by BA) to the Scheme, providing further reassurance for Discretionary Increases after 2027.

Will all pensions receive the Discretionary Increases?

Not all APS pensions are entitled to receive PIRO increases under Rule 15 and Discretionary Increases would only be granted to pensions or parts of pensions which are entitled to receive PIRO increases. For example, excluded are those pensions paid under Parts I-V of APS which are not entitled to receive PIRO increases as are Guaranteed Minimum Pensions (GMP) that form part of a pension in payment once a member reaches his or her GMP age. If under the Rules any pensions are already increased by PIRO subject to a fixed overall percentage cap (which is the case for certain pensions under Parts I-V of the Rules) then that fixed overall percentage cap will continue to apply.

Will future Discretionary Increases still be paid if the APS funding level falls below 100%?

Discretionary Increases would not be paid for any period that the APS funding level is below 100% with an assumption for future pension increases in line with the index used in PIRO. However, the projections provided by the APS Actuary indicate that this situation is very unlikely to occur.

What if I have tax protections and cannot receive some or all of these Discretionary Increases without losing those protections?

The increases are being structured in such a way that it will not be compulsory for members to receive them if they would otherwise lose valuable tax protections (known as "[enhanced protection](#)" and "[fixed protection](#)"). Please let BA Pensions know if you have these protections. If you believe you might be affected, you are strongly recommended to obtain appropriate advice.

If you are a deferred member who does not have these protections the value of the Discretionary Increases will count towards your pensions "[annual allowance](#)" and will be taxable in any year you exceed your annual allowance.

What are the benefits to BA under the settlement agreement?

With the funding level of APS expected to show a surplus, rather than a deficit, BA's existing contribution and funding arrangements are not expected to be needed.

After 31 December 2018, BA will not be required to make deficit and cash sweep contributions to APS. Deficit contributions would restart only if funding falls below 100% with an assumption for future pension increases in line with the index used in the Government's Pensions Increase Review Orders (PIRO), which is the entitlement that most members have under the rules of APS.

However, BA will make available a contingent payment of up to £40m should it be required by APS in future to fund the proposed package of discretionary increases.

What about the remaining active members?

BA will continue to pay pension contributions for future accrual of benefits for the remaining active members of APS. The rate of BA's contributions will ensure the cost of future accrual is met in full without assuming any contribution from the existing APS surplus.

What's next?

The Representative Beneficiary (a member appointed to represent the interests of the Scheme members who will be affected by the Court's decision) and his legal team will be briefed in detail about the proposed terms of settlement and the APS Trustee will ask the High Court to give its approval to the proposed settlement agreement. If approved, the proposed payments for 2019 will be paid to members as soon as practicable.

As soon as the legal process is complete the APS Trustee and BA will work to agree and finalise the 2015 and 2018 valuations on a basis consistent with the proposed settlement (the settlement sets out an agreed valuation basis).

What about the 2019 Contingent Payment agreed as part of the 2010 Funding Agreement?

In the 2010 Valuation, BA agreed that if APS was not fully funded by 2019 it would make a cash payment to APS of up to £250m. To the extent this payment was not required by APS, it was agreed it would be paid to the New Airways Pension Scheme (NAPS). If the Court approves the proposed settlement, the full £250m will be paid to NAPS.

**Issued by the APS Trustee
8 April 2019**