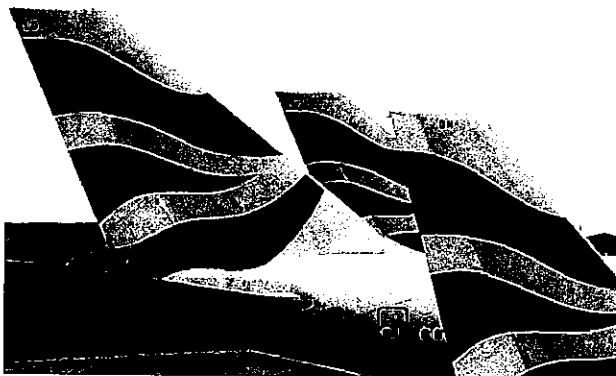


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Q&A: BA's pension deficit

BA's £3.7bn pension shortfall piles pressure on the airline, which made a record loss last year, and threatens its merger with Iberia

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British Airways is believed to have one of the top 10 biggest pension deficits for a private company. Photograph: Bruno Vincent/Getty

British Airways revealed today that its pension deficit has grown by 76% during the past three years to £3.7bn.

Q: What does this mean?

A: The deficit means that the assets in BA's pension schemes are insufficient to meet the pensions that will need to be paid out to members during the coming 80 years. Based on current calculations, the shortfall is £3.7bn.

Q: Does that mean BA needs to find an additional £3.7bn?

A: It's not quite that simple. The calculation is based on a range of factors, including gilt yields and estimates for life expectancy, so the amount needed to meet benefits as they fall due will change over time.

The value of the scheme's assets will also change over time as the stock market recovers, reducing the deficit.

However, BA said the Pension Regulator's provisional view was that the technical provisions it has used may be "materially below" a level that it feels is appropriate. If this remains its view when it has completed its review, the deficit could be even greater than £3.7bn.

Q: What type of pension scheme does BA have?

A: BA has two final salary pension schemes, the Airways Pension Scheme, which has a deficit of £1bn, and the New Airways Pension Scheme, which has a £2.7bn shortfall.

Both schemes are closed to new members, but existing members can continue to build up benefits in them. Members earn a pension equivalent to one 60th of their final salary for every year they belong to the scheme.

Q: Is this the first time BA has taken action to tackle the deficit?

A: No, a number of changes were made to the schemes in 2007 in exchange for extra contributions from BA. Under these changes, members could choose a retirement age ranging from 55 to 65, with contributions ranging from 5.25% of their pay to 17.5%, depending on what age they wanted to start drawing their pension from. A cap was imposed on future pay increases that would be used in pension calculations.

In exchange, BA agreed to make a one-off cash injection of £800m into the scheme, annual contributions of £131m every year up to 2016 and additional contributions of £50m a year for the next three years if the company had a cash balance of more than £1.8bn.

Q: What happens now?

A: BA now needs to agree a plan with the scheme trustees to plug the deficit and present this to the pensions regulator by 30 June next year. BA is at the beginning of discussions with scheme trustees about how it could do this, but it has said it cannot afford to increase its contributions further.

Q: So how will it close the deficit?

A: It is likely to look to make changes to the structure of the scheme to reduce costs.

At the most extreme end of the scale, this could involve closing the pension scheme to future accruals by existing members. Alternatively, BA could increase contribution levels by members, raise the retirement age, decrease the rate at which people build up benefits, impose further limits on pay increases that will be used in pension calculations or get members to share some of the risk of the scheme, for example by switching to a career average scheme rather than a final salary one.

Q: Is the pension scheme deficit a significant threat to BA?

A: BA has made no secret of the fact that its pension scheme deficit is a big challenge to the company that needs to be resolved.

BA made a record loss of £401m last year. During the past three years it has paid £1.8bn into its pension scheme, but made profits of just £1bn.

Q: Are other companies suffering from similar deficits?

A: Final salary pension schemes have become increasingly expensive to offer in recent years due to rising life expectancy and falling investment returns. Aon Consulting recently estimated that the UK's 200 biggest schemes collectively faced a deficit of £88bn.

Analysts claim BA has one of the top 10 biggest pension deficits for a private company, however, there are other companies with far bigger shortfalls, including Royal Mail, which recently said it was on course to record a £10bn deficit, while BT has a £9.4bn one.

Q: Will the deficit affect BA's planned merger with Spain's Iberia?

A: It could. The agreement signed by the two airlines last month allows Iberia to terminate the merger deal if it is not satisfied with the outcome of discussions between BA and its pension trustees on how to fund the deficit.