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By email

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Dear Sirs

Economic regulation of NATS (En Route) plc: consultation on approach to the next price controls review (CAP 1994)

I am writing to share the views of the Trustee of the Civil Aviation Authority Pension Scheme (“CAAPS”) in respect of the NATS Section on the above consultation, and in particular the proposed Regulatory Policy Statement (“RPS”) in relation to Pension Costs.

The Trustee agrees that an RPS which provides clear guidance to NERL and the Trustee on the principles the CAA will apply in determining Pension Costs for a price control period, and the arrangements for the recovery of any significant and unforeseen changes to Pension Costs, would be of benefit to all those associated with the NATS Section of CAAPS. As such the Trustee welcomes the publication of a draft RPS for consultation which includes examples of circumstances when determinations of future costs would and would not be subject to pass-through.

However, the RPS needs to be drafted in such a way that it consistently recognises that the Trustee’s primary responsibility is to its members. The Trustee is fully aware of the huge pressures the airline industry is under at present but its main duty is to make sure benefits are paid to members in full as and when they fall due. It also needs to be acknowledged that the NATS Section of CAAPS is unusual in that benefits accruing to members cannot be reduced and the pensionable service of existing members cannot be terminated unless they cease to be employed by NATS. Many of the cost mitigation tools normally available to employers are not therefore available here.

With this in mind we have the following observations on the draft RPS at Appendix C of the consultation document particularly in the context set out in Paragraph 2 of the draft RPS which acknowledges that the Trustee is not subject to economic regulation by the CAA and is governed by separate pensions legislation and regulated by the Pensions Regulator (tPR).

Section 1: Principles to be applied by NERL and/or the Trustee of the NATS Section (the Trustee)

Principle 1: efficient Pension Costs

Paragraph 3 – although we will work with NERL to take appropriate actions to mitigate and to manage properly the Pension Cost burden on airspace users in terms of this RPS the obligation can only properly be placed on NERL therefore the reference to both parties should be deleted.

Paragraph 4 – the Trustee is not regulated by the CAA and therefore should not be required to provide any evidence to the CAA under this paragraph. This obligation should be for NERL alone as is the case

at the moment. In addition it is for NERL to take the steps that are available to it to ensure Pension Costs remain affordable. Although the Trustee will always consider proposals made by NATS at the end of the day it is legally required to act in the best interests of its members.

Principle 2: appropriate actuarial valuations

Paragraph 5 – the Trustee does take into account the strength of the employer’s covenant which includes the interests of airspace users. However it is inappropriate for the interests of airspace users to be specifically referenced here as the Trustee owes no direct duty to airspace users. It would be more appropriate to specifically recognise the interests of CAAPS’ members in terms of Trustee decision making.

Paragraph 7 – the observation here is the same as for paragraph 5.

Principle 5: de-risking and treatment of surpluses

Paragraph 17 – we question the need for this paragraph given paragraph 18. If it is to remain then the interests of CAAPS members needs to be referenced as well in (ii).

Paragraph 18 – the reference here should be to Rule 10 rather than Section 10. We would also prefer it to say that it “allows the Sponsoring Section Employer (NATS Ltd) to make arrangements for the reduction or elimination of the surplus” rather than “vests dealing with any such surplus in NERL and not in the Trustee” as this mirrors the wording in the Rule.

Paragraph 19 – again, it is not for the Trustee to provide any evidence to the CAA. This obligation should be for NERL alone.

Section 2: Principles we propose to apply

Principle 6: Remuneration of future service costs and deficit repair contributions

Paragraph 22 - subject to addressing the concerns raised in this letter the Trustee would be able to comply with the principles in this proposed RPS.

Paragraph 23 – this should be extended to make clear that the principles set out in the RPS do not cover other entities within NATS Group.

Principle 7: Pass-through mechanism in relation to unforeseen and significant changes in the Pension Costs

Paragraph 24 – we acknowledge the non-alignment of the price control periods with actuarial valuations and therefore recognise that the level of cash contributions that NERL is required to make may vary from the allowances in the performance plan/price control. In the context of the current framework, this is partly addressed through the pass-through mechanism; any variances not addressed are reflected in our assessment of the covenant and affordability.

Paragraph 26 – we recognise this paragraph is adopted from the Eurocontrol principles but consider it would be helpful if it could specifically be extended to cover unforeseeable changes in “demographic assumptions” in (iii) given that this is something the CAA could now agree to.

Paragraph 27 – this should be amended consistently if the amendment suggested in paragraph 26 is made

Paragraph 28 – although changes are to be considered on a case by case basis we would need there to be consistency in terms of the CAA’s approach to allow us to place long term reliance on the operation of the RPS.

Principle 8: stability of regulatory regime

Paragraph 30 – given the importance of the RPS in terms of long term planning we would ask that any changes are subject to consultation, not just material ones (to avoid disagreements as to what is and is not material), and that the introduction of any changes should be aligned with the notice period of NERL's licence.

In paragraph 1.12 of the consultation document you refer to a statement from NERL that the benefit of an RPS in terms of reducing the valuation placed on the pension liabilities in the NATS Section could be around £400m. This is stated to be as a result of the Trustee adopting less prudent discount rates.

The Trustee is unable to confirm that a reduction of this amount in the liabilities would follow from the publication of an RPS in a form acceptable to the Trustee. However, we can confirm that we would expect the pension costs to NERL to be lower in future with an acceptable RPS than they would otherwise be for any given set of market conditions without an RPS.

If you would like to discuss any of the points in this letter in more detail please let me know.

Yours faithfully

A handwritten signature in black ink, consisting of several vertical strokes followed by a horizontal line and a loop.

Joanna Matthews
Chair of the Civil Aviation Authority Pension Scheme Trustee