

ANNEX 1

National pension regulations and accounting regulations

a. Background and legal obligations

By law, UK companies are required by the State to provide a minimum level of pension benefits to employees. NERL, through its parent company NATS Limited, meets these legal obligations by providing pension benefits to its staff either through a defined benefit pension scheme or through a defined contribution scheme. Staff who are not members of the defined benefit pension scheme are able to participate in the defined contribution scheme. The company bears the cost risk associated with the cost of the defined contribution scheme and for this reason the scheme is not discussed further in this report.

CAAPS

The defined benefit pension scheme is a fully funded scheme and provides benefits based on final pensionable salaries. The scheme is called the Civil Aviation Authority Pension Scheme (CAAPS). NERL staff participate in this scheme.

At 31 March 2001, the business of NATS was separated from the CAA in advance of a public-private partnership (PPP) transaction. As a consequence, NATS became a 'non associated employer' requiring the assets relating to the liabilities of NATS employees at 31 March 2001 to be separately identified within the pension scheme. The pension scheme was divided into two sections (the NATS section and the CAA section) under Statutory Instrument 2001 Number 853, Transport act 2000 (Civil Aviation Authority Pension Scheme) Order 2001 to accommodate this and a series of common investment funds was established in which both sections participate for investment purposes. The two sections are managed under the same Trustee Board structure.

Only the NATS Section is relevant to the company.

Governance of CAAPS

CAAPS is governed by a Board of 13 Trustees who are responsible for ensuring that the scheme is managed in accordance with the Trust Deed and Rules and for implementing the funding and investment strategy. The Trustee Board comprises 6 Trustees nominated by the CAA and 6 nominated by NATS, as well as an independent Chairman. Of these, 6 Trustees are appointed by the employers and 6 are Member Nominated Trustees. The Chairman of the Trustees is appointed by the CAA. Through its employer nominated Trustees, NATS has some influence over the Trustees decision-making process but does not have the ability to control those decisions.

UK legal framework and the Trust Deed and Rules

The Trustees must act within the framework of the law. There are several types of law affecting occupational pension schemes like CAAPS, in particular: the general law of trusts and specific UK law applying to pension schemes, including Acts of Parliament and regulations (supported by the codes of practice issued by The Pensions Regulator). These laws determine how occupational pension schemes are administered, the roles and duties of trustees and the roles and objectives of The Pensions Regulator. Two important pieces of pensions legislation in relation to the role and duties of a trustee are the Pensions Act 1995 and the Pensions Act 2004, and the regulations made under them. For example, the Pensions Act 1995 reinforces trust law affecting how schemes should be run and increases the security of members' benefits and the Pensions Act 2004 builds on this with the aims of further improving the security of members' benefits

and standards of scheme administration, and strengthening the scheme funding requirements. Both Acts give trustees additional rights and duties. Trustees are also obliged to follow guidance from the Pensions Regulator.

The Trust Deed and Rules set out the Trustees powers and the procedures Trustees must follow. The Trust Deed is a legal document that sets up and governs the scheme. The scheme Rules set out more detailed conditions, for example, the benefits that will be provided.

UK legislation also determines how defined benefit schemes should be funded. A statutory funding framework, which replaced the minimum funding requirement, came into force in December 2005. Under these requirements each scheme must meet a 'statutory funding objective' to have sufficient and appropriate assets to cover its technical provisions. Technical provisions are an estimate, based on actuarial principles, of the assets needed to cover the schemes liabilities. Liabilities include pensions in payment, benefits payable to the survivors of former members and those benefits accrued by other members which will be payable in the future.

Technical provisions are calculated using an accrued benefits funding method and assumptions chosen by the Trustees, after taking the Scheme Actuary's advice and usually obtaining the employer's agreement. The scheme funding provisions require the Trustees to:

- prepare a statement of funding principles. The Trustees are responsible for deciding the investment strategy to be adopted by the scheme and the principles governing how decisions about investments must be made;
- obtain regular actuarial valuations and reports. Valuations must be performed at least every three years;
- put in place a recovery plan addressing any funding shortfall; and
- keep scheme members informed about their scheme's funding position by issuing regular summary funding statements.

The Trust Deed and Rules provides members of CAAPS with significant protections provided by a "no decrement" clause. This clause prevents any amendment which reduces previously accrued or prospective benefits of existing members, including any increase in member contribution rates. These protections were further reinforced at PPP through the Trust of a Promise.

The Trust of a Promise is a legal document designed to implement an undertaking given by the UK State to employees employed by NATS Limited at the time of the PPP. The Trust of a Promise provides a guarantee that an employee who was a member of CAAPS on or before the PPP date will have their pension maintained for as long as they remain an employee of NATS and an active member of CAAPS. However, it also provides protection on the sale of any part of the NATS business or an equivalent transfer of undertaking.

In conjunction with the Trust of a Promise, the Strategic Partnership Agreement specifies at Clause 11.6 that a member of CAAPS continues to accrue benefits under the scheme, on a basis which is overall at least as good as the basis which applied at 25th July 2001, immediately prior to the PPP. The "Trust of a Promise" is also detailed in the Employee Handbook at Part 1A, Chapter 11.

The provisions of the Trust Deed and Rules and Trust of a Promise significantly limit the scope of possible pension reforms and means that NATS is unable to propose many of the changes available to other companies with less restrictive rules.

Other relevant agreements arising from pension reforms

In order to mitigate the impact of defined benefit pension costs to users the company entered into a legally binding Memorandum of Understanding with employees in 2009 and a Supplemental Memorandum of Understanding in 2013. These agreements reflected the pension reforms agreed between the company and staff. The reforms are explained elsewhere in this report in the explanation of mitigating actions.

b. Requirement to prepare regulatory accounts

NERL is economically regulated by the UK Civil Aviation Authority (CAA) within the regulatory framework of the European Commission's Single European Sky. It operates under an air traffic services licence granted by the UK Secretary of State for Transport. Condition 6 of this licence requires the company to prepare Regulatory Accounts to help the CAA and the public to assess performance against the assumptions underlying the regulatory charge control. This requires the company to establish Determined Costs relating to pensions calculated using prudent assumptions based on the governance of the scheme and to report differences from Determined Costs annually to CAA through Regulatory Accounts.