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Dear Richard

**Strategic outcomes for the economic regulation of NERL 2020-2024: Discussion document  
(CAP 1511)**

I am writing in my capacity as independent chair of the Trustee of the Civil Aviation Authority Pension Scheme (CAAPS). As you are aware, the NATS Section of CAAPS (the Section) is a defined benefit pension scheme with assets of around £5.5bn, providing benefits to some 7,000 current and former NATS employees and their dependants.

The substantial majority of NATS' business relates to NERL so the economic regulation of NERL, in particular the treatment of NERL's pension costs (as referenced in paragraphs 2.24 to 2.31 of the discussion document), is directly relevant to the Trustee.

The Trustee's primary duty is to operate the Section in accordance with the trust deed and rules, UK pensions law and the Pensions Regulator's guidance, acting in the best interests of the Section's members and beneficiaries. This includes managing the security and funding of the promised benefits, having appropriate regard to the covenant strength of the sponsor. Subject to that primary duty, the Trustee also has a responsibility to work with NATS to deliver the promised benefits cost effectively.

To date, the Trustee has been able to regard the sponsor covenant supporting the Section as strong, both now and over the longer term. The economic benefits which this brings to NERL and, in turn, to airspace users are that:

- The Trustee can invest in assets which carry a greater level of risk but are expected to deliver real growth over the long term, resulting in lower expected ultimate pension costs.
- The Trustee can finance the Section having regard to the expected returns on these growth assets, resulting in lower cash funding requirements in the shorter term.
- The Trustee can allow funding deficits to be repaired over a longer time period (11 years at the latest valuation), again resulting in lower cash funding requirements in the shorter term.

As noted in paragraph 2.25 of the Discussion Document, the size of the Section is many times the size of NERL's RAB, which we understand is a highly unusual position amongst regulated industries. The strength of the sponsor covenant supporting the Section is therefore derived predominantly from NERL's regulatory pricing framework rather than from the assets of NERL itself. If the Trustee were no longer confident in the long-term stability of that framework then it would be required to take a much more cautious approach to investment and funding, leading to very substantial increases in

both expected ultimate pension costs and short-term cash demands. As you will be aware, at the most recent (31 December 2015) valuation of the Section, the technical provisions deficit of £459m corresponded to a solvency deficit of some £4.7bn, so the economic benefit derived from the assumption of a continued strong covenant over the long term is very large indeed.

In its annual funding statement published earlier this month, the Pensions Regulator emphasises the long-term nature of pension scheme liabilities and states "*trustees should focus on the ability of the employer to contribute cash to the scheme while there remains good visibility of covenant*".

For these reasons, there is a clear economic benefit to airspace users in the continuation of a stable and predictable regulatory pricing framework with respect to pensions over the long term. The Trustee fully appreciates why it is appropriate for the CAA to test the Trustee's (as well as NERL's) good stewardship of the Section and to require NERL to behave in a manner consistent with a commercially-minded company in order to support this framework, as referenced in paragraph 2.31 of the discussion document. Although the Trustee itself has no direct line of responsibility to the CAA as NERL's economic regulator or to airspace users, and must always act in accordance with its fiduciary duty to members rather than as a commercial entity, it remains committed to participating fully in such reviews in order to support the regulatory framework from which the bulk of the covenant strength supporting the Section is derived.

Please contact either myself or the Pensions Director, Jeff Butler, if you have any questions about this letter.

Yours sincerely

Joanna Matthews

For and on behalf of CAAPS Trustee Limited, as Trustee of CAAPS

cc: Lynette Hilton, Scheme Secretary  
Jeff Butler, Pensions Director