Consultation on the Decision of the 2012 Aviation Appeals Panel

Submitted By

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1. Introduction

The IAA has appealed the decision of the Commission for Aviation Regulation ("the Commission") determination of 24 October 2011, entitled *"maximum level of aviation terminal services charges that may be imposed by the Irish Aviation Authority* ("the Determination") not to allow the full cost of pensions to be included in the price cap. The decision of the Commission can be found in paragraph 5.22 of the determination.

This decision was referred to the Aviation Appeals Panel. The Panel concluded that the Commission had not adequately considered the matter. In its judgement of 16th November 2012, the Appeals Panel was not satisfied that the Commission for Aviation Regulation 'had due regard' to the pension costs incurred by the Irish Aviation Authority ("IAA") in providing aviation terminal services.

The pensions issue has been referred back to the Commission by the Appeals Panel for consideration. The Commission has asked for observations to the Appeals Panel decision and the IAA has set out its views in this paper.

2. Legal Requirements

The IAA operates a defined benefit scheme which was established under statute. The deficit in the pension fund at 1 January 2012 was €145 million. Unlike private company pension schemes, there is limited scope for changes to be made to the provisions of the IAA's scheme. The Irish Aviation Authority Act, 1993, section 40 paragraph 5 provides that

'Superannuation benefits granted under schemes under this section to persons who, immediately before the vesting day, were members of the staff of the Minister for Transport, Energy and Communications and the terms and conditions relating to those benefits shall not be less favourable to those persons than those to which they were entitled immediately before that day.'

The Trust Deed and Rules of the scheme states that any benefits provided under the trust deed or the rules which are not funded by the scheme shall be financed out of the revenue of the employer. The IAA has legal advice from the Attorney General's Office which confirms that the IAA is severely limited in its ability to vary conditions to the main scheme because of the provisions in the IAA Act. In this regard, the only way that pension costs of employees can be financed is through the price cap. By not allowing the full cost of pensions into the price cap, the Commission is undermining the provisions of the IAA's defined benefit scheme.

3. Charging regulations

The en route and terminal cost bases comprise mainly shared costs. Commission Regulation (EU) No 1191/2010 of 16 December 2010 amending Regulation (EC) No 1794/2006 laying down a common charging scheme for air navigation services, the basis on which all European air navigation service providers charge for their en route services and their terminal services (1 January 2015) makes particular mention of pension costs: 'Pension costs may be calculated using prudent assumptions according to the governance of the scheme or to national law, as appropriate' *(Article 6 Paragraph 2)*. The IAA makes pension payments in accordance with the actuarial valuation of the scheme and to meet the requirements of pension legislation.

In its judgement of 16th November, the Aviation Appeals Panel was not satisfied that the Commission for Aviation Regulation in its determination dated 24 October 2011, entitled *"maximum level of aviation terminal services charges that may be imposed by the Irish Aviation Authority* ("the Determination") had due regard to the pension costs incurred by the Irish Aviation Authority ("IAA") in providing aviation terminal services.

In reply to the Appeals Panel, the Commission advised that the Department of Transport had notified them in April 2011 of the Government's decision *"not to apply the provision of Regulation 1191/2010 to terminal charges until 31 December 2014"*. In light of this the Appeals Panel concluded that Article 6.2 of Regulation 1794/2006 applied and that this Article allows the IAA to recoup its pension costs through aviation terminal services charges for staff involved in the provision of terminal services at Dublin, Cork and Shannon Airports. Article 6 of Regulation 1794/2006 provides:

"Calculation of costs:

1. *The costs of eligible services ..... shall be established in such a manner as to be consistent .....*
2. *The costs referred to in paragraph 1 shall be broken down into staff costs, other operating costs, depreciation costs, cost of capital and exceptional items including non-recoverable taxes and custom duties paid, and all other related costs.*
   Staff costs shall include gross remuneration, payments for overtime, employers' contributions to social security schemes as well as pension costs and other benefits..."

Pension costs have been fully allowed in the calculation of the IAA's en route cost base in the National Performance plan which has been approved by the National Supervisory Authority. In the UK, the CAA has agreed with NATS, the provider of air traffic services in the UK, that the full cost of the cash contribution to its pension fund should be allowed in its cost base and overspends on pension costs in regulatory periods can be clawed back in the following regulatory period. NATS, like the IAA, are funding a defined benefit pension

scheme in deficit. Pension costs have also been fully allowed in other jurisdictions with similar funding issues such as LFV Sweden, and NAVIAIR Denmark.

4. Reform of existing pension scheme

Contrary to the suggestion that cost pass-through diminishes incentives to reduce costs, the IAA has acted in a very responsible manner in its efforts to reduce its liability to the pension fund and its future risk exposure. The IAA has been very proactive with its employees and, has successfully put in place measures which will hopefully eliminate the pension fund deficit by 2018. **Most importantly, the main defined benefit pension scheme has been closed to new entrants from 31 December 2011**. Other measures, agreed in November 2010 following lengthy meetings with union representatives, and which have been accepted by the Pensions Board, include:

a) An employee pension contribution and a freeze/cap on pensionable pay up to 31 December 2018 for all employees who either transferred from the Department of Transport, Energy and Communications on 1 January 1994 or joined the IAA after that date;

b) Pension increases limited to CPI or 3%, whichever is lower;

c) A new pension scheme for all new entrants from 1 April 2008 which has a member contribution, a retirement age of 65 and links future benefits to a maximum of 3% or CPI, whichever is lower;

d) The IAA's annual contribution rate continues to be 30.5% of pensionable salary for the foreseeable future;

e) An additional cash contribution to the fund by the IAA for an eight year period commencing 1 January 2011;

f) Retrospective pay arrears due to employees under the 'Towards 2016' national wage agreement paid into the pension fund;

g) The IAA to match the value of the retrospection of the 'Towards 2016' national wage agreement arrears as a once-off payment into the pension fund.

More recently, guidelines from the Pensions Board have set significant challenges for defined benefit pension schemes. The guidelines expand on the provisions of the Social Welfare and Pensions Act 2012. The most salient provision in the revised legislative

requirement centres on the introduction of a risk reserve in situations where a defined benefit scheme is unable to achieve solvency within timelines set down by the Pensions Board. In this regard the majority of schemes will probably have a risk reserve requirement ranging from 5% - 15% of Minimum Funding standard liabilities. The guidelines will be applicable to the IAA should the defined benefit pension solvency level not meet the requirement of the Pensions Board.

The recent actuarial valuation carried out on the IAA's defined benefit pension scheme in January 2012, under section 42 of the Pensions Act 1990, reported that the IAA's funding proposal is on track to achieve a return to full solvency in accordance with the requirements/timelines set down by the Pensions Board.

While the solutions outlined above represent significant costs, shared by both the employees and the employer, and driven by the poor performance of financial markets and by higher mortality levels, the IAA has not looked to repair the pension fund deficit in one go but has allowed for eight years for a return to a surplus.

New employees to the IAA from 1 January 2012 are members of the 2012 Hybrid Pension Plan. This plan has a capped defined benefit element, and a defined contribution element with a maximum contribution by the employer. This plan significantly reduces the pension cost to the IAA for new entrants and, as existing employees retire, the overall cost of pensions to the IAA will fall significantly.

5. Conclusion

The IAA has an obligation to fund its legacy pension fund and its obligations are clearly set out in the IAA Act (1993) and the pensions board requirements. EU regulations on charging clearly indicate that "pension costs may be calculated using prudent assumptions according to the governance of the scheme or to national law as appropriate". IAA has significantly reformed its pension scheme by closing the existing scheme to new members and putting a new hybrid scheme in its place. This scheme has been approved by the Pensions Board and the assumptions have been accepted by the National Supervisory Authority as part of the national performance plan and adopted by the Government.

The IAA does not have recourse to the State for any funding and therefore, pension costs must be met from within its operational activities. The only mechanism by which the IAA can recover its costs and fund its pension obligations is through the price cap. The IAA respectfully submits that pension costs are different to OPEX costs and, therefore, should be treated differently within the price cap with the full costs of pensions being allowed.

Furthermore, pension costs incurred in the period 2007 to 2011 in the previous determination made by the Commission, where these pension costs exceeded the level of pension costs allowed by the Commission, should be allowed to be carried forward into the current determination 2012 to 2015 and be fully recovered in the price cap.