



**The BAA Pension Scheme
Report & Accounts
for the year ended 30 September 2016**

Report and Accounts for the year ended 30 September 2016

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Any enquiries regarding the Scheme generally or in relation to an individual's entitlement to benefits should be addressed to:

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Sutherland House
Russell Way
Crawley,
West Sussex
RH10 1UH
Telephone: 01293 604 248
Email: baa.pensions@equiniti.com**

THE BAA PENSION SCHEME

The BAA Pension Scheme ("the Scheme") was established in April 1966. It is a contributory, final salary, defined benefit arrangement. The Scheme includes the transferred assets and liabilities of the BAA Group Pension Scheme established 1 January 1991 and wound up 30 June 1996.

The Scheme was closed to new entrants with effect from 14 June 2008.

The Scheme is established under irrevocable trusts and administered by the Trustee in accordance with the provisions of the Trust Deed and the Rules which are amended from time to time. The Principal Employer is LHR Airports Limited ("the Employer") and the primary purpose of the Scheme is to provide pensions on retirement and other benefits for all eligible participants.

1. TRUSTEE AND ADVISERS

The Trustee is BAA Pension Trust Company Limited, and it is responsible for the management of the Scheme. Law Debenture Pension Trust Corporation (LDPTC), although not formally a trustee is referred to in the Rules as the Independent Trustee and has special reserve powers designed to safeguard the accrued rights of beneficiaries. LDPTC satisfies requirements of independence from the Employer set out in the Trust Deed and Rules. LDPTC's nominated representatives, who attend Trustee meetings, are Messrs M Chatterton or M Jaffe.

The Trustee is responsible for all aspects of the Scheme. However, in order to facilitate the efficient discharge of business certain matters are, from time to time, delegated to and managed by an investment committee or other specialist committees. Any decisions of the committees are subject to endorsement by the full Trustee Board, except where this is not appropriate, e.g. where doing so would create a "conflict of interest".

Details of the Directors of the Trustee Company ("the Trustee Directors") and its advisers, who served during the year, are set out below:

BAA Pension Trust Company Limited

Unless otherwise stated, the Trustee Directors are Management Representatives

Trustee Directors

P Wilbraham *β	Chairman
S Chambers *+β	(Member Nominated Trustee Representative)
M Gorman #+	resigned 1 April 2016
A Hurn *β	
M Macgregor #+	(Pensioner Nominated Trustee Representative)
A Macmillan*	appointed 1 June 2016
D Provan#	(Member Nominated Trustee Representative) appointed 1 June 2016 and resigned 31 January 2017
P Stannett #	
P Williams #	(Member Nominated Trustee Representative)

Independent Trustee

*+β Mr M Chatterton (LDPTC)
*+β Mr M Jaffe (LDPTC)

Secretary to the Trustee

#*+β Mr A Knowles

+member of the Audit Committee
* member of the Investment Committee
member of the Administration Committee
β member of the Valuation Committee

The Law Debenture Trust Corporation plc owns the whole of the share capital of LDPTC and has the right to appoint and remove the Directors of LDPTC and is currently the sole Director.

**BAA Pension Scheme
Trustee's Report**

ADVISERS

Actuary	C Sheppard FIA, Mercer Limited
Auditor	Crowe Clark Whitehill LLP
Administrators	Equiniti Paymaster
Bankers	Lloyds Bank plc
Custodian	JP Morgan Chase. Assets are held in the name of 'Chase Nominees'.
Investment Managers	BlackRock Investment Management (UK) Limited BlueBay Asset Management LLP Brevan Howard Fund Ltd Invesco Asset Management Ltd M&G Asset Management Rogge Investment Management State Street Global Advisors Ltd Wellington Asset Management Westwood Holdings Group (until August 2016) Winton Capital Management Ltd
Investment Consultants	Cardano (until 31 March 2017) Redington (from 13 February 2017)
Legal Adviser	CMS Cameron McKenna LLP

1. TRUSTEE AND ADVISERS (continued)

Procedure for Appointment and Removal of Trustee Directors of BAA Pension Trust Company Limited

The approved arrangements for this Scheme, which comply with the requirements specified in the Pension Act 2004, are summarised as follows:

Trustee Directors are appointed by the Board of the Employer and will normally serve a three year term. There shall be eight Trustee Directors: four Management Representatives, three Members' Representatives and one Pensioner Representative. At 30 September 2016 there was one Trustee Director vacancy on the Board. The appointment of the Chairman and Management Representatives is based on nominations made by the Employer. The Members' and Pensioner Representatives are chosen by ballot controlled by the Electoral Reform Society.

A Trustee Director may also be removed at his/her own or at the Employer's request and any Trustee Director who fails to attend any Trustee meeting in a six month period may be removed from office by the Employer at the request of the other Trustee Directors. Where the Trustee Director being removed was a Member or Pensioner representative, all the other Trustee Directors must agree to the removal and elections would then be held to appoint a replacement.

Procedure for Appointment and Removal of the Independent Trustee

There must at all times be a single Independent Trustee of the Scheme. It is appointed by and can be removed by the Employer in certain circumstances or may, at its own request, retire. A replacement Independent Trustee would have to be appointed simultaneously with any removal or resignation and the outgoing Independent Trustee would be entitled to write to all beneficiaries explaining the circumstances of its replacement, removal or resignation.

Investment Committee

The membership of the Committee is noted on page 1. The Trustee decided that this group will be a standing committee which would make operational decisions relating to the implementation of the Scheme's investment strategy including selection and appointment of investment managers.

Valuation Committee

The membership of the Committee is noted on page 1. The Trustee decided that this group will be an ad hoc committee which would only deal with the issues relating to the triennial actuarial valuation, including dialogue with the Company and preparation of valuation related correspondence for the Main Board.

Audit Committee

The membership of the Committee is noted on page 1. The Trustee decided that this group will be a standing committee which would be responsible for dealing with any issues relating to the preparation and audit of the statutory accounts, monitoring the Scheme's internal controls and record keeping, and maintenance of the Risk Register of the Scheme.

Administration Committee

The membership of the Committee is noted on page 1. The Trustee decided that this group will be a standing committee which would be responsible for monitoring the third party administration services provided by Equiniti Paymaster and make delegated day to day decisions concerning settlement of death benefits and other discretionary benefits.

Trustee Training

All newly appointed Trustee Directors are required to attend suitable training. During their term of office or on reappointment, Trustee Directors are encouraged to identify their own training needs and attend appropriate courses. In addition a formal half day's training is organised every November.

The Pensions Regulator has issued scope guidance specifying the expected knowledge and understanding requirements of a competent trustee. Each Trustee Director attends appropriate training so they become conversant with Scheme documents and develop knowledge and understanding (appropriate to their role as Trustee Director) of trusts and pensions law and the principles of funding and investment.

2. CHANGES DURING THE YEAR

(a) Changes to benefit structure

With effect from 1 October 2015 following an Employer led consultation process with the active membership, it was agreed to amend the Scheme Rules for future service from 1 October 2015 to reflect a reduction in the accrual rate from 1/54th to 1/60th, to cap pension increases at the maximum of RPI or 2.5% (whichever is lower) and to recognise the agreed contractual change between the Employer and members to cap pensionable pay increases at 2% per annum for both past and future service accrual.

(b) Investment Manager Changes

Following movements in interest rates, the Trustee rebalanced the Liability Hedging portfolio managed by Rogge. This involved redeeming £50m in March 2016: £40m was moved to the J.P. Morgan Liquidity Fund and £10m was moved to the Trustee bank account to fund benefit payments.

In August 2016, the Trustee instructed full redemption from Brevan Howard following disappointing performance, though proceeds will only be available in the next financial year.

In August 2016, the Trustee closed its equity protection strategy, receiving £93m of which £19m was realised profit. This strategy had been managed by State Street (the incumbent equity manager) through the use of an equity option put spread collar. At the same time, the Trustee also agreed to redeem £91m from State Street Passive Equity and £128m from Westwood Emerging Market Equity, to reduce its equity exposure.

The combined proceeds of the above were invested in the Winton Futures Fund (c. £87m) and the Invesco Global Targeted Returns Fund (c. £225m).

3. CHANGES AFTER YEAR-END

The Trustee reviewed the investment strategy, agreeing to transfer their Liability Hedging portfolio from Rogge to BlackRock in order to improve the efficiency of the liability hedging solution. The transition was completed by December 2016.

4. MEMBERSHIP OF THE SCHEME AND PENSIONERS

	30 September 2016	30 September 2015
(a) Active Members	3,366	3,655
(b) Pensioners		
Former Members	7,148	7,108
Dependents	1,753	1,727
(c) Deferred Pensioners	5,127	5,108
Total	<u>17,394</u>	<u>17,598</u>

5. ACTUARIAL VALUATION AND CONTRIBUTIONS

The Trustee undertakes a full valuation at least every three years in line with the requirements of the Pensions Act 2004. A full valuation of the BAA Pension Scheme was carried out as at 30 September 2015 and determined a shortfall of £228m (equal to a funding level of 94%).

The 2015 valuation was the fourth valuation for the Scheme under the Pensions Act 2004 and the Scheme Funding Regulations issued in 2005 which require schemes to adopt the Statutory Funding Objective. The Trustee decided on a funding objective, including a set of actuarial assumptions, and agreed it with the Employer. This is set out in the current Statement of Funding Principles.

The Trustee and Employer agreed a Recovery Plan that sets out how the shortfall of £228m as at 30 September 2015 is to be addressed. The Trustee and Employer agreed that £27m p.a. (payable monthly) would be paid into the Scheme until 30 June 2016 followed by £23m p.a. paid monthly from 1 July 2016 to 30 September 2022. At the end of this Recovery Plan period, the shortfall is expected to be eliminated. The Recovery Plan will be reviewed, and may be revised, as part of the Scheme's next valuation due as at 30 September 2018.

As a result of the 2015 valuation, the Trustee and Employer agreed that regular Employer contributions of 23.0% of Basic Pay plus Shift Pay will be paid from 1 July 2016, a reduction from 33.3% payable up to 30 June 2016, in addition to the deficit reduction contributions of £23m p.a., to meet the cost of the future accrual of benefits. Employee contributions continued to be payable at between 5% and 7.5% of pensionable salary, however, from 1 June 2016, pensionable salary increases were capped at 2% p.a.

The Employer also continues to pay the augmentation costs (if any) arising following redundancies.

The level of contributions paid by members of the Scheme is set out in the Schedule of Contributions and Trust Deed and Rules of the Scheme. A revised Schedule of Contributions was agreed by the Employer and the Trustee during the year, effective from 1 July 2016, which set out the changes to contributions due to the Scheme as detailed above.

Employees' and Employers' contributions are due monthly by the 19th day of the following month to which contributions relate. Contributions relating to benefit augmentations are due within one month of the later of the date of granting of the augmentation or such later date as is agreed between the Trustee and the Employer.

Report on Actuarial liabilities

Under section 222 of the Pensions Act 2004, every scheme is subject to the Statutory Funding Objective, which is to have sufficient and appropriate assets to cover its technical provisions, which represent the present value of benefits to which members are entitled based on pensionable service to the valuation date. This is assessed using the assumptions agreed between the Trustee and the employer and set out in the Statement of Funding Principles, a copy of which is available to Scheme members on request.

**BAA Pension Scheme
Trustee's Report**

The most recent actuarial valuation of the Scheme was carried out as at 30 September 2015. A summary of the funding position at the valuation date is set out below:

	Funding Assessment as at 30 September 2015	Funding Assessment as at 30 September 2013
	£m	£m
Market value of assets	3,316.2	£2,836.5
Technical provision liabilities	3,544.3	£3,136.4
Deficit	(228.1)	(299.9)
Funding Level	94%	90%

Method: The actuarial method used in the calculation of the technical provisions is the Attain Age method.

The key assumptions underlying the calculation of technical provisions were:

Retail Price Inflation	3.29% p.a.
Consumer Price Inflation	2.54% p.a.
Pensionable salary increases	
• Scale/ negotiated grade employees	1.90% p.a.
• Non-scale/ management grade employees	1.90% p.a.
Basic Salary plus Shift Pay increases	
• Scale/ negotiated grade employees	4.79% p.a.
• Non-scale/ management grade employees	4.79% p.a.
Discount rate:	
Pre-retirement	4.11% p.a.
Post-retirement	2.91% p.a.
Pension increases in payment:	
Open section	3.19% p.a.
Closed section	3.29% p.a.
Post 2015 pension	2.29% p.a.
Mortality – base table	103% of S2PA year of birth tables for males and 95% of S2PA year of birth tables for females to reflect the membership profile of the Scheme.

6. FINANCIAL DEVELOPMENT OF THE SCHEME

The financial statements have been prepared and audited in accordance with regulations made under Section 41(1) and (6) of The Pensions Act 1995. The Fund Account shows in detail the financial development of the assets of the Scheme over the year to 30 September 2016.

A summary of the changes in the Scheme during the year and in the preceding year were as follows:

	Year to 30 September 2016 £'000	Year to 30 September 2015 £'000
Income	70,113	155,259
Expenditure	(106,781)	(245,312)
Net withdrawals	(36,668)	(90,053)
Net return from investments	762,705	273,392
Net increase	726,037	183,339
Net assets at beginning of year	3,337,519	3,154,180
Net assets at end of year	4,063,556	3,337,519

7. PENSION INCREASES

Although the two original schemes have been merged, pension increases are still determined relative to the category of membership basis.

Both the "Plc Section" basis and the "Group Section" basis are determined in accordance with the relevant version of the Trust Deed and Rules (as amended) that applies to particular members. Under the version of the Rules in place as at 30 September 2015, pensions are increased with effect from 1 October in line with the proportionate increase in the Government's Index of Retail Prices during the year ending in the preceding August. For the Group Section basis only, increases are capped at 5% per year. Deferred pensions have increased in accordance with the Scheme's Trust Deed and Rules.

Pensions in payment as at 30 September 2016 were increased on 1 October 2016 by 1.8% for the Plc section and 1.8% for the Group section (in line with RPI for the year to August 2016). There were no discretionary increases.

8. ADMINISTRATION AND INVESTMENT MANAGEMENT COSTS

The fees for professional services provided by the actuary, auditor, custodian, independent trustee, legal advisers, investment adviser and investment managers are all paid by the Scheme as well as the salary for the Scheme Secretary.

9. TRUSTEE GOVERNANCE MATTERS – RISK MANAGEMENT

The Trustee has adopted and maintains a formal risk management process to assess risks and implement risk management strategies. This has involved identifying the type of risks the Scheme faces, presenting them in terms of potential impact and likelihood of occurrence and identifying means of mitigating the risks. As part of this process the Trustee has reviewed the adequacy of the Scheme's internal controls as documented in the Scheme's risk register.

10. SUMMARY FUNDING STATEMENT

The Scheme provides members with an annual statement summarising the funding position under the Scheme. The next statement for the year ended 30 September 2016 will be sent to members in Spring 2017.

11. STATEMENT OF TRUSTEE'S RESPONSIBILITIES

The financial statements, which are prepared in accordance with UK Generally Accepted Accounting Practice, are the responsibility of the Trustees. Pension scheme regulations require the Trustee to make available to scheme members, beneficiaries and certain other parties, audited financial statements for each Scheme year which:

- Show a true and fair view of the financial transactions of the Scheme during the Scheme year and of the amount and disposition at the end of that year of the assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year, and
- Contain the information specified in the Schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including a statement whether the financial statements have been prepared in accordance with the Statement of Recommended Practice "Financial Reports of Pension Schemes".

The Trustee has supervised the preparation of the financial statements and has agreed suitable accounting policies, to be applied consistently, making any estimates and judgments on a prudent and reasonable basis.

The Trustee is also responsible for making available certain other information about the Scheme in the form of an Annual Report.

The Trustee is responsible under pensions legislation for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions showing the rates of contributions payable towards the scheme by or on behalf of the employer and the active members of the scheme and the dates on or before which such contributions are to be paid. The Trustee is also responsible for keeping records in respect of contributions received in respect of any active member of the scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the schedule of contributions. Where breaches of the schedule occur, the Trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to The Pensions Regulator and the members.

The Trustee also has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to them to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities, including the maintenance of an appropriate system of internal control.

12. INVESTMENT STRATEGY

The Trustees set the investment strategy for the Scheme, taking into account considerations such as the strength of the Employer covenant, the long term liabilities of the Scheme and the funding agreed with the Employer. The investment strategy is set out in the Scheme's Statement of Investment Principles ("SIP") and Investment Policy Implementation Document ("IPID").

The current strategy is broadly split between:

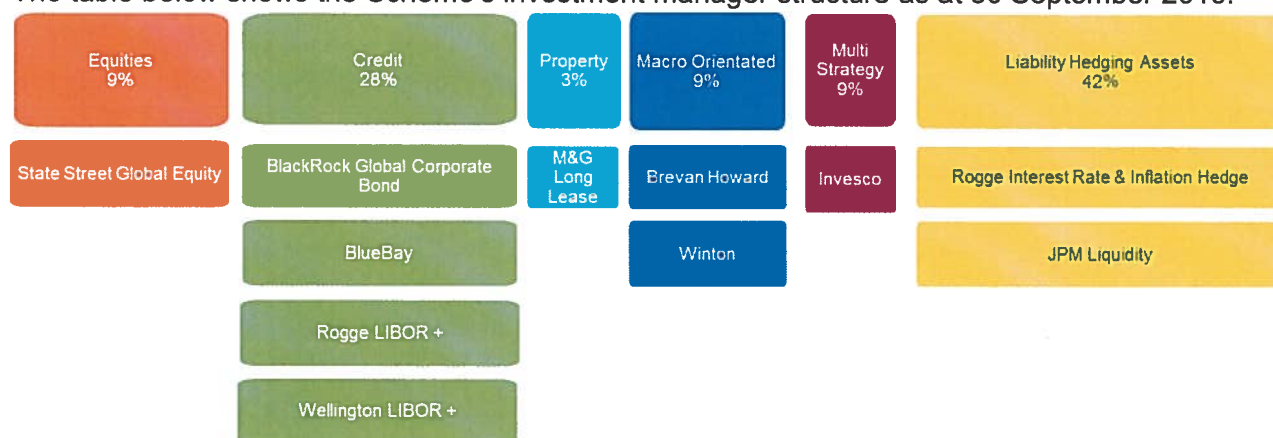
1. Investments that move in line with the long term liabilities of the Scheme. This is referred to as Liability Driven Investing ("LDI") and comprises UK government bonds, cash, interest rate swaps and inflation swaps. The purpose of these investments is to hedge against the impact of interest rate and inflation movements on the value of the long term liabilities.
2. Return seeking investments comprising UK and overseas equities, UK and overseas non-gilt bonds, property, diversified growth funds and hedge funds. The purpose of these investments is to deliver positive absolute returns in a risk-controlled manner.

Over the course of the year, a number of changes were made to the investment strategy. The Scheme's allocation to the Winton Futures Fund and Invesco Global Targeted Returns Fund were increased to improve the diversification of return-seeking assets. These increases were partially funded from a redemption from the State Street Passive Equity mandate and closure of the downside equity protection strategy, implemented by State Street.

The Trustee agreed to increase the interest rate hedge ratio to 100% of Scheme assets in the year ending 30 September 2017. As a first step, the Trustee has agreed to transfer their Liability Hedging portfolio from Rogge to BlackRock in order to improve the efficiency of the hedging solution. The transition was completed by December 2016.

In August 2016, the Trustee instructed a full redemption from Brevan Howard following disappointing performance.

The table below shows the Scheme's investment manager structure as at 30 September 2016:



Source: JPM, Investment Managers and Cardano
The LIBOR + mandates have been classified as credit
Residual cash balances and legacy portfolios included under JPM Liquidity

Investment in stock, shares, debentures or other securities issued by Grupo Ferrovial SA, any holding company of Grupo Ferrovial SA or any subsidiary of Grupo Ferrovial SA or any such holding company is restricted under the terms of the investment manager agreements in place. The Trustee accepts that where they invest in pooled investment vehicles the Trustee cannot impose this restriction on the investment manager.

13. ASSET ALLOCATION

The table below shows the Scheme's investment allocation as at 30 September 2016 versus last year's asset allocation and target strategic allocation:

	30 September 2016	30 September 2015	Target asset allocation
Equity	8.6%	16.7%	18.5%
Credit	12.9%	14.8%	17.5%
Property	2.9%	3.4%	4.0%
Macro Orientated/ Multi Strategy	17.9%	12.6%	14.0%
LIBOR+	15.4%	18.5%	22.0%
Liability hedging assets & Cash*	42.3%	34.0%	24.0%

*Includes liability hedging interest rate and inflation swaps, cash and residual balance in legacy portfolios
Figures subject to rounding

The deviation over the year from the target allocation set previously was attributable to: 1) a reduction in equities in favour of other return-seeking assets, and 2) large gains in the value of liability hedging assets. The first was a deliberate decision by the Trustee to diversify the sources of returns late in an equity bull market cycle. The second was the result of a significant fall in interest rates over the year resulting in a large increase in the value of the liability hedging assets, which helped to protect the Scheme's funding position. The Trustee is aware of this change and it has been agreed to increase the interest rate hedging ratio from 80% to 100% of Scheme assets. The first 10% of this increase was implemented in the two months after the year-end. A detailed review of the Scheme's strategy is currently underway, and is targeted for completion in the second half of 2017 after which the target asset allocation will be revised.

A Statement of Investment Principles (SIP), which reflects the Trustee's investment approach, has been produced and is periodically reviewed and updated. The SIP was amended in January 2016 to reflect the Scheme's latest investment objectives and strategy.

14. INVESTMENT PERFORMANCE

The table below shows the Scheme's return over various periods to 30 September 2016.

	1 Year	3 Years (p.a.)	5 Years (p.a.)
Scheme	23.2%	14.3%	11.7%
Change in value of liabilities*	24.5%	16.7%	12.0%

*Change in liabilities has been calculated on a Gilts basis by the Actuary and the asset return uses performance data estimated by Cardano.

As the most appropriate overall benchmark for the investment strategy, the Scheme uses an approximation for the movement in the value of its liabilities through time. Adopting this benchmark means that over certain periods there may be significant discrepancies between this benchmark and the underlying targets for each of the investment managers used. This is because strategic decisions (such as not to fully liability hedge at low interest rates) have been taken with a long term view, and individual investment managers are therefore not intended to exactly match a liability based benchmark.

15. INVESTMENT MANAGER FEES

All of the investment managers are remunerated on an ad valorem basis, i.e. fees are calculated based on the market value of the assets under their management. There are however additional performance related fees in place for Brevan Howard and Winton.

16. INVESTMENT POLICY

The Trustee makes all major decisions on the management of assets and liabilities based on investment advice. There is also an Investment Committee that has limited powers to make certain decisions as agreed and delegated by the Trustee. The Investment Committee also receives investment advice before taking decisions.

The Trustee has clear investment objectives, which relate to improving the value of the assets compared to the liabilities. They also monitor the risk versus the liabilities, based on information supplied by their investment advisor. Performance is measured against the Trustee's liability related benchmark each quarter, as well as underlying manager performance being reviewed on a quarterly basis against their respective benchmarks.

The Trustee's Statement of Investment Principles (SIP) sets out their policy on Responsible Ownership. The Trustee's policy is that its Investment Managers should take account of social, environmental and ethical considerations in the selection, retention and realisation of investments to the extent material to the value of the investments, and where to do so would not prejudice the best long-term financial interests of the Scheme, more generally. With regard to corporate governance, the Trustee wishes to encourage best practice in terms of activism. It therefore encourages its managers investing in equities to discharge their responsibilities in respect of investee companies in accordance with the Statement drawn up by the Institutional Shareholders' Committee.

The global custodian, JP Morgan, is responsible for the safekeeping of the Scheme's directly held assets and performs the associated administrative duties.

The Trustee communicates periodically with members on investment issues as part of their regular member updates. In particular, the SIP is reviewed periodically and is available to all members on request.

Signed on behalf of BAA Pension Trust Company Limited:

.....
Director

Director

Date:6/4/17.....

The Compliance Statement on pages 38 to 39 forms part of this Trustee's Report.

**BAA Pension Scheme
Independent Auditor's Report**

Independent Auditor's Report to the Trustee of the BAA Pension Scheme

We have audited the financial statements of the BAA Pension Scheme for the year ended 30 September 2016 which comprise the Fund Account, the Net Assets Statement and the related Notes set out on pages therein.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Trustee, as a body, in accordance with The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. Our audit work has been undertaken so that we might state to the Trustee those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme and the Trustee as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Trustees and auditors

As explained more fully in the Trustee's Responsibilities Statement, the Trustee is responsible for the preparation of financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Scheme's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Trustee; and the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the annual report, (which comprises the Trustee's Report, the Investment Report, the Actuarial Certificate and the Compliance Statement) to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion

In our opinion the financial statements:

- show a true and fair view of the financial transactions of the Scheme for the year ended 30 September 2016, and of the amount and disposition at that date of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- contain the information specified in Regulations 3 and 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995.

Crowe Clark Whitehill LLP
Statutory Auditor
London

6 April 2017

BAA Pension Scheme
Fund Account for the year ended 30 September 2016

	Note	2016	2015
		£'000	£'000
Contributions and benefits			
Contributions receivable	3		
Employer		64,456	148,811
Employee		5,501	6,337
Transfers in	4	156	111
		<u>70,113</u>	<u>155,259</u>
Benefits payable	5	(96,136)	(99,800)
Payments to and on account of leavers	6	(8,035)	(142,529)
Administrative expenses	7	(2,610)	(2,983)
		<u>(106,781)</u>	<u>(245,312)</u>
Net (withdrawals) from dealings with members		<u>(36,668)</u>	<u>(90,053)</u>
Return on investments			
Investment income	8	43,286	41,879
Investment management expenses	9	(5,507)	(5,395)
Change in market value of investments	10	724,926	236,908
Net returns on investments		<u>762,705</u>	<u>273,392</u>
Net increase in the fund during the year		<u>726,037</u>	<u>183,339</u>
Net assets of the scheme at 1 October		<u>3,337,519</u>	<u>3,154,180</u>
Net assets of the scheme at 30 September		<u>4,063,556</u>	<u>3,337,519</u>

The notes on pages 15 to 34 form part of these financial statements

BAA Pension Scheme
Statement of Net Assets (available for benefits) as at 30 September 2016

	Note	2016 £'000	2015 £'000
Investment assets			
Bonds	12	2,027,785	1,734,084
Pooled Investment vehicles	13	1,487,894	1,296,126
Derivatives	14	1,127,155	609,890
AVC Investments	15	1,321	1,294
Other investment balances	16	124,996	125,926
		4,769,151	3,767,320
Investment liabilities			
Derivatives	14	(510,097)	(312,475)
Other investment balances	16	(203,982)	(129,570)
		4,055,072	3,325,275
Total net investments			
Current assets	20	12,494	15,092
Current liabilities	21	(4,010)	(2,848)
Total net assets as at 30 September		4,063,556	3,337,519

The financial statements summarise the transactions of the Scheme and deal with the net assets at the disposal of the Trustee. They do not take account of obligations to pay pensions and benefits which fall due after the end of the Scheme year. The actuarial position of the Scheme, which does take account of such obligations, is dealt with in the Report on Scheme Liabilities on page 5 to 6 of the Annual Report and these financial statements should be read in conjunction with this report.

The financial statements were approved by the Directors of BAA Pension Trust Company Ltd on

...6 April 2017...

Director

Director

The notes on pages 15 to 34 form part of these financial statements

1. BASIS OF PREPARATION

The financial statements have been prepared in accordance with the Occupational Pension Plans (Requirements to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, Financial Reporting Standard 102 ("FRS 102") – The Financial Reporting Standard applicable in the UK and Republic of Ireland issued by the Financial Reporting Council and the guidance set out in the Statement of Recommended Practice (Revised November 2014) ("the Revised SORP").

This is the first year FRS 102 and the Revised SORP have been applied to the Scheme's financial statements. Under "Amendments to FRS 102 – Fair value hierarchy disclosures" issued by the Financial Reporting Council in March 2016 and effective for accounting periods beginning on or after 1 January 2017, financial instruments must be categorised in line with IFRS 13 Fair Value Measurement. This has been adopted early and the Scheme's financial statements have been prepared on this basis.

2. ACCOUNTING POLICIES

The principal accounting policies adopted by the Trustee are shown below:

a) Contributions

- (i) Employee contributions, including AVCs and added years, are accounted for by the Trustee when they are deducted from pay by the Employer.
- (ii) Employer normal contributions that are expressed as a rate of salary are accounted for on the same basis as the employees' contributions, in accordance with the Schedule of Contributions in force during the year.
- (iii) Augmentation contributions are paid from time to time by the employer to fund benefit improvements on the terms agreed with the Trustee. These are accounted for on an accruals basis.
- (iv) Deficit contributions are accounted for on the due dates on which they are payable in accordance with the Schedule of Contributions under which they are paid.

b) Transfers in

Transfers in from other registered pension arrangements include all transfers which have been formally accepted by the Trustee of the Scheme as at 30 September in respect of individual members.

2. ACCOUNTING POLICIES (continued)

c) Benefits Payable and Payments to Leavers

- (i) Pensions in payment are accounted for in the period to which they relate.
- (ii) Benefits are accounted for in the period in which the member notifies the Trustee of their decision on the type or amount of benefit to be taken, or if there is no member choice, on the date of retiring or leaving.
- (iii) Individual transfers out are accounted for on a cash basis and represent the capital sums paid to personal pensions or pension plans of new employers for members who have left service. Group transfers are recognised in accordance with the transfer agreement.

d) Expenses

Administration and investment management expenses are accounted for on an accruals basis.

e) Investment Income

- (i) Investment income from bonds is recognised on an accruals basis.
- (ii) Dividend income from equity shares is recognised when the Scheme becomes entitled to the dividend. In the case of UK quoted shares this will be from the ex-dividend date.
- (iii) Income from accumulating pooled investment vehicles is reinvested by the fund managers and is included within change in market value.
- (iv) Deposit and other income receivable is accounted for on an accruals basis.

f) Change in market value of investments

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on the sale of investments during the year.

2. ACCOUNTING POLICIES (continued)

g) Investments

(i) Investments other than derivatives

- Listed securities are valued at bid price as at the year end date.
- Pooled investment vehicles are valued at the bid market values at the year end date for funds with bid/offer spreads, or a single price where there are no bid/offer spreads, as provided by the relevant fund managers on the last dealing day prior to the year-end date.
- The Macro Orientated Funds disclosed within pooled investment vehicles are valued at fair value either using a swinging single price or the net asset value at the year-end.
- Investments held in foreign currencies are valued as above and translated into sterling at the relevant spot rates ruling at the year-end date.
- Investments are included in the financial statements at fair value. In the absence of a liquid market for certain securities, these fair values may differ from their realisable value.

(ii) Derivatives

Futures

- Open futures contracts that are exchange traded are included in the net asset statement at market value. For futures contracts that are assets, market value will be unrealised profit at the quoted bid price of the contract at the year end. For futures contracts that are liabilities, market value will be the unrealised loss at the quoted offer price of the contract at the year end.
- Amounts due to or from brokers are included within cash deposits and other investment balances and represent the amounts outstanding in respect of the initial margin (representing collateral on the contracts) and any variation margin which is due to or from the broker.
- The amounts included in change in market value are the realised and unrealised gains or losses on open and closed futures contracts.

(iii) Swaps

- Swaps are 'Over the Counter' (OTC) derivatives and are included in the net asset statement at market value using pricing models and relevant market data at the year-end date.
- Interest is accrued monthly on a basis consistent with the terms of each contract. The amounts included in change in market value are the realised gains or losses on closed contracts and the unrealised gains or losses on open contracts.
- Interest receipts or payments on swap contracts are reported within investment income.
- All gains and losses arising on these contracts are included within change in market value.

2. ACCOUNTING POLICIES (continued)

(iv) Options

- All option derivatives utilised by the Scheme are exchange traded and are included in the net asset statement at their mark to market value.
- Options contracts are entered to hedge risk exposures and all gains or losses arising on open and closed contracts are included within change in market value.

(v) Bond Forwards

- Bond forward contracts are included in the net asset statement at their mark to market value. All gains or losses arising on open and closed contracts are included within change in market value.

(vi) Forward Foreign Exchange

- Forward foreign exchange contracts outstanding at the year-end are stated at fair value which is determined as the gain or loss that would arise if the outstanding contract was closed out at the year-end date with an equal and opposite contract.
- All gains or losses arising on these contracts are included within change in market value.

(vii) Repurchase Agreements

- Securities sold subject to repurchase agreements are included in the financial statements as assets of the Scheme at their year-end market value. Amounts payable under repurchase agreements are included under other investment liabilities.

h) Currency

The Scheme's functional and presentational currency is pounds Sterling (GBP).

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

3. CONTRIBUTIONS RECEIVABLE

	2016 £'000	2015 £'000
Employer		
Normal - future service	37,440	48,491
Augmentations	1,016	3,608
Deficit funding	26,000	26,250
Commutation payment*	-	50,462
Additional**	-	20,000
	<u>64,456</u>	<u>148,811</u>
Employee		
Normal	5,345	6,070
Additional voluntary contributions	26	84
Additional contributions to purchase added years	130	183
	<u>5,501</u>	<u>6,337</u>
	<u>69,957</u>	<u>155,148</u>

Augmentations include £1.016m (2015: £1.005m) in respect of the reimbursement by the employer of discretionary UURBS pensions paid by the Scheme and included in pensions payable in note 5.

Deficit funding contributions are payable by the Employer until 30 September 2022 in accordance with the Recovery Plan agreed with the Trustee. Until 30 June 2016 £27m p.a. was payable in monthly installments and from 1 July 2016 £23m p.a. was payable also in monthly instalments.

* The Commutation Payment received in the prior year was due on the disposal of Aberdeen, Southampton and Glasgow Airports in respect of former employees.

** The Employer agreed to pay a one-off additional contribution of £20m which was received by the Scheme in December 2014.

4. TRANSFERS IN

	2016 £'000	2015 £'000
Individual transfers in from other schemes	<u>156</u>	<u>111</u>

5. BENEFITS PAYABLE

	2016 £'000	2015 £'000
Pensions	87,469	85,669
Lump sum death benefits	513	323
Commutations and lump sum retirement benefits	8,145	12,575
Taxation on lifetime or annual allowance exceeded	9	1,233
	<u>96,136</u>	<u>99,800</u>

6. PAYMENTS TO AND ON ACCOUNT OF LEAVERS

	2016 £'000	2015 £'000
Refund on leaving	11	1
Refund on death	13	10
State scheme premium	(6)	2
Individual transfers out to other schemes	8,017	6,284
Group transfer out	-	136,232
	<u>8,035</u>	<u>142,529</u>

The group transfer out was due on the disposal of Aberdeen, Southampton and Glasgow Airports in respect of former employees.

Included within the 2016 State scheme premium expense is the release of a prior year over accrual of £6k.

7. ADMINISTRATIVE EXPENSES

	2016 £'000	2015 £'000
Actuarial fees	528	548
Legal and professional fees	328	456
Investment adviser fees	573	536
Independent Trustee fees	50	111
PPF levy and other regulatory levies	388	479
Audit fee	68	68
Scheme administrative costs	675	785
	<u>2,610</u>	<u>2,983</u>

8. INVESTMENT INCOME

	2016 £'000	2015 £'000
Dividends from equities	90	153
Income from bonds	34,450	33,436
Income from pooled investment vehicles	4,609	4,891
Interest receivable on swap contracts	13,898	15,002
Interest payable on swap contracts	(9,585)	(11,517)
Interest on cash deposits	27	62
Net interest on cash instruments	(244)	(202)
Income from stock lending	41	54
	<u>43,286</u>	<u>41,879</u>

Income from pooled investment vehicles principally consists of distributions from the M&G property fund £4,557k (2015: £4,723k) and Bluebay £nil (2015: £162k).

9. INVESTMENT MANAGEMENT EXPENSES

	2016 £'000	2015 £'000
Administration, management and custody	5,562	5,471
Investment managers fee rebate	(55)	(76)
	<u>5,507</u>	<u>5,395</u>

Included within investment management expenses is irrecoverable VAT amounting to £403k (2015: £507k).

10. RECONCILIATION OF INVESTMENTS

	Value at 30 September 2015 £'000	Purchases at cost and derivative payments £'000	Sales proceeds and derivative receipts £'000	Change in Market Value £'000	Value at 30 September 2016 £'000
Bonds	1,734,084	795,696	(869,943)	367,948	2,027,785
Pooled investment vehicles	1,296,126	484,268	(392,980)	100,480	1,487,894
Derivative contracts	297,415	368,264	(278,455)	229,834	617,058
AVC investments	1,294	26	(116)	117	1,321
	<u>3,328,919</u>	<u>1,648,254</u>	<u>(1,541,494)</u>	698,379	4,134,058
Cash deposits & other investment balances	(3,644)			26,547	(78,986)
	<u>3,325,275</u>			<u>724,926</u>	<u>4,055,072</u>

Indirect costs are incurred through the bid offer spread on investments within pooled investment vehicles and charges made within those vehicles.

In August 2016, the Trustee redeemed £184m from State Street Equity and £128m from Westwood Emerging Market Equity, to reduce its equity exposure. The proceeds were invested in the Winton Futures Fund (c. £87m) and the Invesco Global Targeted Returns Fund (c. £225m).

Transaction costs are included in the cost of purchases and deducted from the sale proceeds. Direct transaction costs include costs charged to the scheme such as fees, commissions and stamp duty.

Transaction costs analysed by main asset class and type of cost are as follows.

	Fees £'000	Commissions £'000	Taxes and other £'000	2016 Total £'000	2015 Total £'000
Other	-	-	457	457	-

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

11. Concentration of investments

Except as noted below, no investments represented more than 5% of the Scheme's assets.

Holding	2016 £'000	2015 £'000
Invesco Global Targeted Returns Fund	374,450	145,866
BlueBay Global Multi Asset Credit Fund	277,318	271,058
Winton Futures Fund	234,516	150,188
State Street MPF North America Equity 75Pct Hedged	210,639	226,978

12. Bonds

	2016 £'000	2015 £'000
Bonds		
Fixed interest securities	1,054,280	972,252
Index linked securities	973,505	761,832
Total Bonds	2,027,785	1,734,084

13. Pooled investment vehicles

Equity funds	347,754	471,704
Credit funds	298,672	287,203
Property fund	117,590	111,840
Macro orientated funds	349,428	271,443
Multi strategy fund	374,450	145,866
Liquidity funds	-	8,070
Total pooled investment vehicles	1,487,894	1,296,126

The underlying assets in the Credit funds consist primarily of higher yielding fixed income securities.

Macro (Global) orientated funds primarily contain global equity, bond, commodity and currency derivatives.

Multi strategy funds contain a range of asset classes with different characteristics, predominantly UK and overseas equities, currencies, and derivatives.

		2016 £'000		2015 £'000	
14. Derivative contracts		Assets	Liabilities	Assets	Liabilities
Futures	14(a)	11	(36)	51	(253)
Forward foreign exchange contracts	14(b)	980	(17,632)	306	(14,144)
Swaps	14(c)	1,116,851	(491,842)	555,170	(268,328)
Options	14(d)	2	(16)	51,137	(27,466)
Bond forwards	14(e)	1	6		
		1,127,155	(510,097)	609,890	(312,475)

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

14(a) Futures

The Scheme manages risk in the portfolio by entering into a futures position to adjust the portfolio weighting without disturbing the underlying assets.

Futures contracts are exchange traded derivatives, which reduces the risk that the counterparty does not fulfill their side of the contract.

Open futures contracts at the year-end, all of which expire within one year are as follows:

Investment Future	Underlying	Economic Exposure Value (asset)	Economic Exposure Value (liability)	Market Value (asset)	Market Value (liability)
		£'000	£'000	£'000	£'000
UK Bonds		-	(22,012)	36	(74)
Overseas Bonds		42,086	(208,108)	75	(277)
UK Equity		-	(8,850)	-	(1)
Overseas Equity		-	(43,008)	-	(24)
Total		42,086	(281,978)	111	(376)

Expiration

30 September 2016	42,086	(281,978)	111	(376)
30 September 2015	178,053	(383,362)	501	(2,532)

The economic exposure values futures on a 'gross basis' showing the total exposure to the underlying asset class that the future effects as if the change in asset allocation in the underlying asset has taken place.

14(b) Forward Foreign Exchange Contracts

During the period forward foreign exchange contracts were entered into by the Scheme to hedge foreign exchange risk on overseas securities.

Forward contracts are individually traded over-the-counter contracts. The contracts are generally three months duration.

Open forward foreign exchange contracts at the year-end are as follows:

Country of currency underlying forward foreign exchange contracts	Gross amount at inception (asset) £'000	Gross amount at inception (liability) £'000	Market Value (asset) £'000	Market Value (liability) £'000
USA	741,367	(1,230,324)	5,526	(10,622)
Europe	118,209	(226,985)	914	(2,704)
Japan	33,032	(88,115)	1,104	(1,743)
Others	84,081	(105,853)	2,416	(2,563)
30 September 2016	976,689	(1,651,277)	9,960	(17,632)
30 September 2015	1,314,443	(1,314,442)	3,076	(14,144)

The gross amount is the gross sterling equivalent of the currency on which the contract is based.

14(c) Swaps

The Scheme has entered into a series of interest rate, inflation, total return and credit default swaps primarily to hedge against long term interest rate and inflation rate movements.

Swap contracts in place as at 30 September 2016 are as follows:

Expiration	Nominal Principal £'000	Market Value (asset) £'000	Market Value (liability) £'000
Up to 2020	714,739	9,230	(715)
2021 to 2030	1,001,725	112,830	(118,953)
After 2030	1,590,036	911,891	(355,704)
30 September 2016	3,306,500	1,116,851	(475,372)
30 September 2015	4,095,637	55,170	(28,328)

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

14(c) Swaps (continued)

Types of swaps	Nominal Principal £'000	Market Value (asset) £'000	Market Value (liability) £'000
Interest rate	2,093,191	1,018,955	(325,723)
Inflation	775,339	908	(165,358)
Total return	437,970	8848	7
30 September 2016	3,306,500	1,116,851	(491,842)
30 September 2015	4,095,637	555,170	(268,328)

The notional principal of the swap is the amount used to determine the value of swapped receipts and payments.

To reduce counterparty risk during the life of the swap collateral in the form of cash or government bonds is passed between the parties depending on whether there is an asset or a liability and the value of the swap. See note 14(f).

14(d) Options

The Scheme enters into option contracts to meet the requirements of its risk management activities. These option contracts are exchange traded and the exchange acts as the counterparty, bearing the risk of failure to deliver the position. All contracts expire within one year.

Investment underlying option Contract	Nominal amount of contract £'000	Market value (asset) £'000	Market value (liability) £'000
Overseas bonds purchased - Puts	14501	2	
Overseas bonds purchased - Calls	3606		
Overseas bonds written - Puts	1750		1
Overseas bonds written - Calls	3988		10
30 September 2016	9910	2	11
30 September 2015	2809	5137	(2745)

The notional amount represents the value of underlying stocks subject to the option contracts. Included in options are swaptions with a value of £29,300 (2015: £21,595).

14(e) Bond Forward Contracts

Bond forwards are over the counter contracts entered into by two counterparties to buy or sell a bond on a specified future date at an agreed price. The contracts generally expire in up to three months.

	Gross amount at inception (asset)	Gross amount at inception (liability)	Market value (asset)	Market value (liability)
	£'000	£'000	£'000	£'000
UK	-	(14,125)	-	(9)
Overseas	17,287	(14,342)	11	(73)
Total 30 September 2016	17,287	(28,467)	11	(82)
30 September 2015	2,848	(6,805)	6	(6)

14(f) Collateral

During the year collateral was received and pledged in respect of swaps, bond forward contracts and repurchase agreements. As at 30 September 2016 the collateral received/pledged was as follows:

	2016 £'000	2015 £'000
Collateral Received		
Stock equivalents	283,977	31,802
Cash equivalents	454,891	358,293
	<u>738,868</u>	<u>390,095</u>
Collateral Pledged	£'000	£'000
Stock equivalents	(83,418)	(111,193)
Cash equivalents	(7839)	(7839)
	<u>(83,418)</u>	<u>(119,032)</u>

14(g) Stock Lending

During the year the Fund lent some of its investments under a stock lending agreement. The titles to the investments that have been lent remain with the Fund and dividends paid during the year in respect of stock lent by the Fund are paid to the Fund. Collateral is received by the Fund in excess of the market value of the stock lent. At 30 September 2016 the position was as follows:

	2016 £'000	2015 £'000
Stock Lending		
Bonds	<u>10,941</u>	<u>2,765</u>
Collateral	£'000	£'000
Bonds	6,018	1,082
Cash equivalents	<u>5,282</u>	<u>2,900</u>
	<u>11,300</u>	<u>3,982</u>
	<u>£000</u>	<u>£000</u>
Income for the year (note 8)	<u>4</u>	

15. AVC investments

	2016 £'000	2015 £'000
Santander	269	319
Equitable Life Insurance	125	135
Friends Provident	927	840
	<u>1,321</u>	<u>1,294</u>

AVC investments held on a money purchase basis are invested separately from main Scheme assets. Members participating in such AVC arrangements each receive an annual statement confirming the value of their investments and the movement in the year.

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

	2016 £'000		2015 £'000	
16. Cash deposits and other investment balances	Investment Assets	Investment Liabilities	Investment Assets	Investment Liabilities
Amounts payable under repurchase agreements		(2015)		(120,307)
Investment income receivable	10,181		9,766	
Cash deposits and liquidity funds	64,474		48,102	
Short term investments	4,604		8,789	
Amounts due under rehypothecation		(175,000)		
Cash due to/from Broker	1,497		47,683	
Outstanding trades	4,000	(987)	12,106	(963)
	124,956	(203,982)	125,926	(129,570)

The Scheme instigated a collateral rehypothecation programme over the course of the year. This programme allowed the Scheme to reduce its ongoing funding costs within its LDI portfolio managed by Rogge, by using some of the cash collateral posted to it for "in-the-money" derivative positions to reduce the amount of borrowing required on Repurchase Agreements and Total Return Swaps that was needed to achieve the target rate of exposure within the LDI portfolio. The programme was subsequently unwound after year-end, in preparation for the transition of assets to the Scheme's newly appointed LDI manager, BlackRock. At 30 September 2016 this amounted to a negative value of £175m (2015: £nil).

17. Repurchase Agreements

The Scheme holds an interest rate and inflation hedging mandate under which bonds have been sold subject to repurchase agreements.

The Scheme retains the entitlement to receive income accruing on these securities and has a contractual agreement to repurchase the securities at a specified future date.

The securities are included in the financial statements as assets of the Scheme at their market value. At 30 September 2016 the market value of securities sold under repurchase agreements was £20.52m (2015: £120.92m).

Cash received from counterparties in respect of the securities that have been sold is used by the investment manager to purchase additional securities to meet desired exposure levels. Amounts payable to counterparties under repurchase agreements are disclosed as liabilities in the Scheme's financial statements under other investment liabilities. At 30 September 2016 this amounted to £20.18m including accrued interest (2015: £120.30m).

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

18. Fair value determination

The fair value of financial instruments has been determined using the following fair value hierarchy:

Level 1: The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

Level 2: Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

The Plan's investment assets and liabilities have been fair valued using the above hierarchy categories as follows:

	Level 1	Level 2	Level 3	Total
	£	£	£	£
At 30 September 2016				
Bonds	1,254,181	773,604	-	2,027,785
Pooled investment vehicles	-	1,372,982	114,912	1,487,894
Derivatives	(265)	617,323	-	617,058
AVC investments	-	46	1,275	1,321
Cash deposits & other investment balances	(78,986)	-	-	(78,986)
	1,174,930	2,763,955	116,187	4,055,072
At 30 September 2015				
Bonds	961,999	772,085	-	1,734,084
Pooled investment vehicles	-	1,174,871	121,255	1,296,126
Derivatives	(2,031)	299,446	-	297,415
AVC investments	-	55	1,239	1,294
Cash deposits & other investment balances	(3,644)	-	-	(3,644)
	956,324	2,246,457	122,494	3,325,275

19. Investment Risks

Financial Reporting Standards (FRS) 102 requires the disclosure of information in relation to certain investment risks. These risks are set out by FRS 102 as follows:

Credit risk: this is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation.

Market risk: this comprises currency risk, interest rate risk and other price risk as follows:

Currency risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates;

Interest rate risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates; and

Other price risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Scheme has exposure to the above risks because of the investments it makes in following the investment strategy set out below. The Trustees manage investment risks within agreed risk limits, taking into account the Scheme's strategic investment objectives. These investment objectives and risk limits are implemented through the investment agreements in place with the Scheme's investment managers and they are monitored by the Trustees in regular reviews of the investment portfolio.

The following table summarises the extent to which the various classes of investments are affected by investment risks:

	Credit risk	Market risk			2016	2015
		Currency	Interest rate	Other price	£m	£m
Liability Driven Investments						
Bonds	●	○	●	○	1,240.2	955.9
Derivatives	●	●	●	●	625.4	287.1
Cash and Other investment assets and liabilities	●	●	○	○	(181.6)	(116.8)
Return Seeking Investments						
Bonds	●	●	●	○	787.6	778.2
Pooled investment vehicles	●	●	●	●	1,487.9	1,296.1
<i>Bond funds (direct and indirect risk)</i>					298.7	287.5
<i>Other funds (direct risk only)</i>					1,189.2	1,008.6
Derivatives	●	●	●	●	(8.4)	10.3
Cash and Other investment assets and liabilities	●	●	○	○	102.6	113.2
Total (excluding AVCs)					4,053.7	3,324.0

In the above table, the risk noted affects the asset class [●] significantly, [●] partially or [○] hardly/not at all.

Further information on the Trustees' approach to risk management is set out below. This does not include AVC investments as these are not considered significant in relation to the overall investments of the Scheme.

Investment Strategy

The Trustees determine their investment strategy after taking advice from a professional investment adviser. The investment objective is to maintain a portfolio of suitable assets of appropriate liquidity which, together with future contributions, will generate investment returns to meet the benefits of the Scheme payable under the Trust Deed and Rules, as they fall due. Further details of the Trustee's investment strategy are set out in the Trustee's report on page 9.

Credit Risk

The Scheme is subject to credit risk because it invests directly in bonds and over-the-counter ("OTC") derivatives and because it holds cash balances. The Scheme also invests in pooled investment vehicles and is therefore directly exposed to credit risk in relation to the instruments it holds in the pooled investment vehicles. In addition, the Scheme is indirectly exposed to credit risks arising from some of the financial instruments held by the pooled investment vehicles.

Credit risk arising from bonds held directly is mitigated by the appointment of investment managers with the appropriate skill and processes to manage these assets. These managers are also set limits and guidelines including restriction on the credit quality of the investment they purchase for the Scheme. These portfolios are very well diversified and the risk from any individual security or issuer is kept at an appropriate level given the credit worthiness of that security or issuer. For example, the Scheme may hold significant positions in UK Government Bonds as the credit risk associated with the UK Government is small.

Credit risk arising from OTC derivatives is mitigated by collateral arrangements (see note 14).

Credit risk arising from cash balances is mitigated by transacting with governments and financial institutions which are investment grade credit rated.

Direct credit risk arising from pooled investment vehicles is mitigated by: the underlying assets of the pooled arrangements being ring-fenced from the pooled fund manager; the regulatory environments in which the pooled managers operate; diversification of the investments amongst a number of pooled arrangements; and due diligence checks carried out by the investment advisors appointed by the Trustees on the appointment of new pooled investment managers and on an ongoing basis thereafter.

Indirect credit risk arising from pooled investment vehicles is mitigated by the investment restrictions in place for each of the pooled investment vehicles, and varies depending on the nature of the underlying assets (see note 13).

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

A summary of exposures to credit risk at both the current and previous year end is given in the following tables:

2016				
£m	Investment Grade	Non-Investment Grade	Unrated	Total
Bonds	2,021.9	5.8	0.1	2,027.8
Pooled investment vehicles	-	-	1,487.9	1,487.9
Derivatives	617.0	-	-	617.0
Cash and Other investment assets and liabilities	(79.0)	-	-	(79.0)
Total (excluding AVCs)	2,559.9	5.8	1,488.0	4,053.7
2015				
£m	Investment Grade	Non-Investment Grade	Unrated	Total
Bonds	1,719.7	14.1	0.3	1,734.1
Pooled investment vehicles	-	-	1,296.1	1,296.1
Derivatives	297.4	-	-	297.4
Cash and Other investment assets and liabilities	(3.6)	-	-	(3.6)
Total (excluding AVCs)	2,013.5	14.1	1,296.4	3,324.0

Currency Risk

The Scheme is subject to currency risk because some investment are denominated in overseas currencies.

A number of the managers hold bonds for the Scheme which are denominated in overseas currencies. The currency risk from the bonds is mitigated by the managers who use currency forwards to offset the majority of currency exposure. Any remaining exposure is held to achieve improved returns and the risk from these positions is carefully managed.

All pooled funds are reported in GBP so there is no direct currency risk from the pooled investment vehicles. Indirect currency risk from pooled investment vehicles is mitigated by investing in currency hedged share classes where available.

A summary of exposures to currency risk at both the current and previous year end is given in the following table:

2016	Investments	Currency Contracts	Total
	£m	£m	£m
US Dollar	502.5	(494.1)	8.5
Euro	108.6	(110.6)	(2.0)
Japanese Yen	41.5	(55.7)	(14.3)
Other overseas currency	26.6	(21.9)	4.7
Total overseas exposure	679.2	(682.3)	(3.1)
Unhedged exposure (Total as % of Investments)			(0.5%)

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

2015	Investments	Currency Contracts	Total
	£m	£m	£m
US Dollar	594.6	(536.7)	57.9
Euro	136.3	(146.2)	(9.9)
Japanese Yen	26.4	(16.5)	9.9
Other overseas currency	17.9	0.4	18.3
Total overseas exposure	775.2	(699.0)	76.2

Unhedged exposure (Total as % of Investments) 9.8%

Interest Rate Risk

The Scheme is subject to interest rate risk on the LDI investments, comprising government bonds, interest rate and inflation swaps and cash.

Interest rate risk is mitigated by aligning the sensitivity of the LDI investments with that of the Scheme's long term liabilities. Under this strategy, if interest rates fall the value of LDI investments will rise to match the increase in actuarial liabilities arising from a fall in the discount rate. Similarly, if interest rates rise, the LDI investments will fall in value as will the actuarial liabilities because of an increase in the discount rate.

At the year-end the LDI portfolio represented 41.5% of the total assets (2015: 33.9%). The Trustee's target allocation to LDI investment is 42.0% (2015: 34.0%).

Other Price Risk

The Scheme is subject to other price risk in relation to the return seeking investments which include equities, non-gilt bonds, property funds, diversified growth funds and hedge funds.

Other price risk is mitigated by constructing a diverse portfolio of investments across various markets and managers.

At the year-end these represented 58.5% of the total assets (2015: 66.1%).

BAA Pension Scheme
Notes to the Financial Statements for the year ended 30 September 2016

20. CURRENT ASSETS

	2016 £'000	2015 £'000
Debtors		
Contributions due from the Principal Employer in respect of augmentations and UURBS pensions		402
Prepayments		381
Due from HMRC – VAT		149
	<u>1</u>	932
Cash balances:		
Current Account	122	14,160
	<u>120</u>	15,092

The contributions due from the Principal Employer in respect of augmentations at the prior year-end were received 180 days after the due date set out in the Schedule of Contributions. The contributions due from the Principal Employer as at 30 September 2016 were in respect of discretionary UURBS pensions paid by the Scheme.

21. CURRENT LIABILITIES

	2016 £'000	2015 £'000
Creditors		
Administration and investment management expenses	2,345	1,419
Due to HMRC	1,162	1,125
State Scheme premiums payable	1	9
Benefits payable	502	295
	<u>4,010</u>	2,848

22. RELATED PARTY TRANSACTIONS

LHR Airports Ltd provides certain administration and other services to the Scheme. The costs of these services are recharged to the Scheme and are included within administrative expenses disclosed in Note 7. During the year these costs amounted to £120,000 (2015: £120,000). Independent Trustee fees are also disclosed in Note 7.

LHR Airports Ltd is responsible for certain discretionary payments of pension benefits. The actual payment of these amounts is made by the Scheme and reimbursed by LHR Airports Ltd. During the year such payments amounted to £1,016,326 (2015: £1,005,180). Apart from the above, and transactions and balances with the Principal Employer shown in the Financial Statements and notes thereto, there were no other related party transactions.

23. CAPITAL COMMITMENTS

At the year-end the Scheme had no capital commitments (2015: nil)

Independent auditor's statement about contributions, under regulation 4 of The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, to the Trustee of the BAA Pension Scheme

We have examined the summary of contributions payable to the BAA Pension Scheme for the year ended 30 September 2016 which is set out on page 36.

This report is made solely to the Scheme's Trustee, as a body, in accordance with The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. Our work has been undertaken so that we might state to the Scheme's Trustee those matters we are required to state to them in an auditors' statement about contributions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme's Trustee as a body, for our work, for this report, or for the opinion we have formed.

Respective responsibilities of Trustees and auditors

As explained more fully in the Statement of Trustee's Responsibilities, the Scheme's Trustee is responsible for ensuring that there is prepared, maintained and from time to time revised a Schedule of Contributions which sets out the rates and due dates of certain contributions payable towards the Scheme by or on behalf of the employer and the active members of the Scheme. The Trustee is also responsible for keeping records in respect of contributions received in respect of any active member of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the Schedule of Contributions.

It is our responsibility to provide a Statement about Contributions paid under the Schedule of Contributions and to report our opinion to you.

Scope of work on Statement of Contributions

Our examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported in the attached summary of contributions have in all material respects been paid at least in accordance with the Schedule of Contributions. This includes an examination, on a test basis, of evidence relevant to the amounts of contributions payable to the Scheme and the timing of those payments under the Schedule of Contributions.

Statement about contributions payable under the Schedule of contributions

In our opinion contributions for the Scheme year ended 30 September 2016 as reported in the summary of contributions have in all material respects been paid at least in accordance with the Schedules of Contributions certified by the Actuary on 7 January 2015 (for the period 1 October 2015 to 31 May 2016) and 30 June 2016 (for the period 1 June 2016 to September 2016).

Crowe Clark Whitehill LLP
Statutory Auditor
London

Date: 6 April 2017.

**BAA Pension Scheme
Summary of Contributions**

Trustee's summary of contributions payable during the Scheme year ended 30 September 2016

Contributions payable to the Scheme in accordance with the Schedules of Contributions in respect of the year ended 30 September 2016 were as follows:

	2016 £'000
Employer normal contributions	37,440
Employer deficit funding contributions	26,000
Employer augmentations	1,016
Member normal contributions	5,345
Total contributions paid under the Schedule of Contributions	<u>69,801</u>
 Member additional voluntary contributions	 26
Member additional contributions to purchase added years	130
Contributions disclosed in the financial statements	<u>69,957</u>

For and on behalf of the BAA Pension Trust Company Limited

Director

Director

Date:6/9/17.....

BAA Pension Scheme Actuarial Certificates



CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS

Name of Scheme

BAA Pension Scheme

Adequacy of rates of contributions

1. I certify that, in my opinion, the rates of contributions shown in this schedule of contributions are such that the statutory funding objective could have been expected on 30 September 2015 to be met by the end of the period specified in the recovery plan.

Adherence to statement of funding principles

2. I hereby certify that, in my opinion, this schedule of contributions is consistent with the Statement of Funding Principles dated 29 June 2016.

The certification of the adequacy of the rates of contributions for the purpose of securing that the statutory funding objective can be expected to be met is not a certification of their adequacy for the purpose of securing the Scheme's liabilities by the purchase of annuities, if the Scheme were to be wound up.

Signature

Scheme Actuary

Chris Sheppard

Qualification

Fellow of the Institute and Faculty of Actuaries

Date of signing

30/06/2016

Name of employer
Address

Mercer Limited
One Christchurch Way
Woking
Surrey
GU21 6JG



Mercer Limited is authorised and regulated by the Financial Conduct Authority
Registered in England No. 664275 Registered Office: 1 Tower Place West,
Tower Place, London EC3A 5BU



COMPLIANCE STATEMENT

1. Tax Status

The Scheme was approved by the Inland Revenue Pension Schemes Office under Chapter 1 Part XIV of the Income and Corporation Taxes Act 1988 until 5 April 2007. Subsequently it became a Registered Scheme with Her Majesty's Revenue and Customs from 6 April 2007, in accordance with the provisions of the Finance Act 2006. The Trustees' opinion is that there is no reason to believe this approval/registration may be prejudiced or withdrawn.

2. Employer Related Investments

Shares in Grupo Ferrovial

Following the acquisition of BAA plc (now LHR Airports Limited) the Trustees decided that there should be no direct investment in the shares of Grupo Ferrovial and there was no such investment during the year.

3. Transfer of Pension Rights

The Scheme can transfer pension rights to, or receive them from such schemes as are suitably approved by the Commissioners of Inland Revenue. Transfers out to other pension schemes include transfers to arrangements approvable under Section 32 of the Finance Act 1981. The sums transferred were cash equivalents calculated, and paid in the manner prescribed by the Actuary in accordance with legislation. The calculation of transfer values does not make any allowance for discretionary benefits as these are not a feature of the Scheme. Transfer values paid during the year are the full cash equivalent and have not been adjusted as a result of Scheme funding levels.

4. Complaints

If Scheme members have any queries concerning their benefits they should contact the Scheme's administrator at the address shown for enquiries on the contents page. If the enquiry is not resolved to their satisfaction, members should use the Scheme's dispute resolution procedure, which is aimed at resolving complaints and disputes.

The Pensions Advisory Service (TPAS), an independent voluntary organisation, offers free advice and assistance to members at any stage during the complaints process. The TPAS can be contacted at:

11 Belgrave Road
London
SW1V 1RB
Tel: 0845 601 2923
www.pensionsadvisoryservice.org.uk

COMPLIANCE STATEMENT (continued)

If the matter remains unresolved after TPAS has assisted, members have the right to refer their complaint to the Pensions Ombudsman, who investigates complaints of injustice caused by bad administration or disputes of fact or law. The Pensions Ombudsman can be contacted at:

11 Belgrave Road
London
SW1V 1RB
Tel: 0207 834 9144
www.pensions-ombudsman.org.uk

5. The Pensions Regulator

The Pensions Regulator is the UK regulator of work-based pension schemes. The Regulator's aim is to encourage high standards in the way pension schemes are run, to prevent problems from developing. The Regulator works with pension scheme trustees and scheme managers to help protect work-based pensions and if problems do develop, the Regulator has powers to put matters right. The Regulator cannot help with individual complaints or disputes, but if members believe that the Scheme is not complying with pensions rules and regulations, they can report this to the Regulator, at the following address:

Napier House
Trafalgar Place
Brighton
BN1 4DW
Tel: 0870 6063636
www.thepensionsregulator.gov.uk