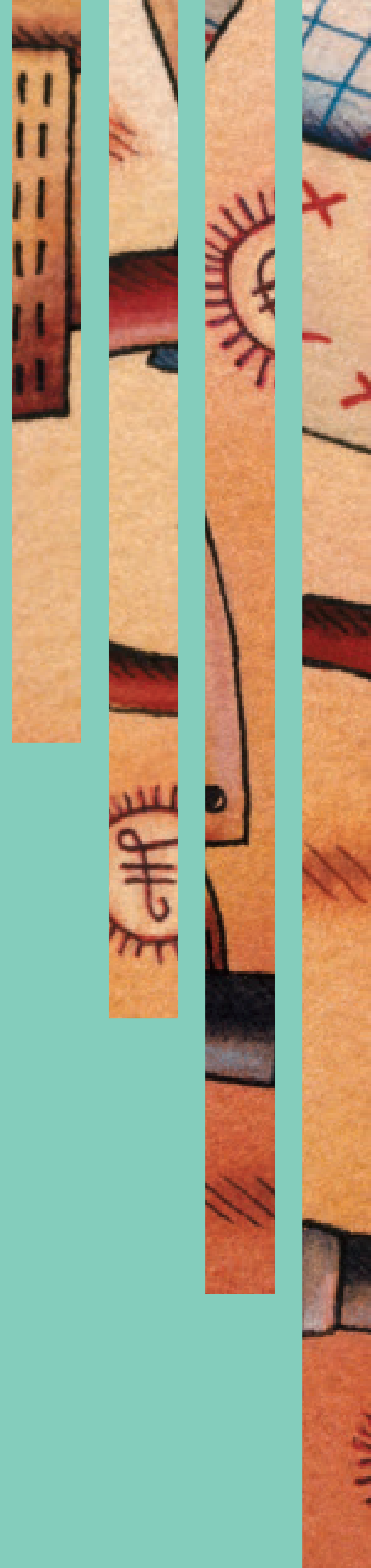
Lane Clark & Peacock

Actuaries & Consultants



Accounting For Pensions UK and Europe

Annual Survey 2006

This is the 13th edition of Lane Clark & Peacock's "Accounting for Pensions" Survey. It is widely recognised as the authoritative survey of the accounting standards that regulate accounting and disclosure of pensions information in UK company accounts and includes companies in the Europe Dow Jones STOXX 50^{SM}.

ACTUARIAL CONSULTANCY OF THE YEAR

For further information, please contact **Bob Scott or Charlie Finch** at our London office, **Shaun Southern or Adam Poulson** at our Winchester office or the partner who normally advises you.

For further copies of the report, please download a copy from our website **www.lcp.uk.com** or contact **Claire Rothwell on 020 7439 2266** or email **enquiries@lcp.uk.com.**

This survey may be reproduced in whole or in part, without permission, provided prominent acknowledgement of the source is given. The survey is not intended to be an exhaustive analysis of FRS17 or IAS19. Although every effort is made to ensure that the information in this report is accurate, Lane Clark & Peacock LLP accepts no responsibility whatsoever for any errors, or the actions of third parties. Information and conclusions are based on what an informed reader may draw from each company's annual report and accounts. None of the companies was contacted to provide additional explanation or further details.

© Lane Clark & Peacock LLP August 2006

Accounting for Pensions

1. Main findings — Page 1

2. Introduction and summary — Page 4

2.1 Introduction – content overview

2.2 Pension scheme deficits

2.3 Other measures of deficits

2.4 Eliminating deficits

2.5 Managing pension scheme risk to the business

2.6 Are the deficits measured correctly?

3. Developments in UK pension provision — Page 14

4. Accounting standards for pensions — Page 18

5. LCP's analysis of FRS17/IAS19 disclosures — Page 20

5.1 Analysis of results

5.2 Key assumptions

5.3 Investment strategy

6. Accounting for pensions in Europe — Page 31

Glossary — Page 35

Appendix 1 – FTSE 100 accounting disclosure listing — Page 36

Appendix 2 – FTSE 100 accounting measures — Page 39

Appendix 3 – European disclosures — Page 43

Lane Clark & Peacock
Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

1. Main findings

Accounting deficits volatile – markets offer no solutions

- Under the international accounting standard IAS19 Lane Clark & Peacock LLP (LCP) estimates that the aggregate FTSE 100 deficit for UK defined benefit schemes is £36 billion in July 2006, compared to £37 billion in July 2005 – broadly unchanged.
- However, deficit instability remains a serious concern. Owing to volatile equity and bond markets, the aggregate deficit hit a high of £54 billion in January 2006; while just three months later in April it plummeted to £29 billion before climbing to its current level.
- This volatility is having a direct impact on companies' balance sheets. Under IAS19, most companies are opting to recognise defined benefit pension deficits in their balance sheets in the same way that they recognise debt and other liabilities.
- In general, schemes cannot rely on investment returns alone to bridge the gap. In their 2005 accounts, companies reported that investment outperformance knocked £24 billion off deficits but this was outweighed by falling bond yields and updated mortality assumptions, which together represented "losses" of £30 billion. Contributions plugged the rest of the gap.
- On a positive note, only three companies now have a reported deficit that exceeds 30% of market capitalisation – down from six last year. This is largely due to increases in their share price rather than falls in deficits.

Significant movements in equity and bond markets mean that the aggregate FTSE 100 pensions deficit has fluctuated considerably in recent months.

Deficits hit capital structures

- Deficits dilute the value of shareholders' equity[1]. Under IAS19, there can be a significant reallocation on the balance sheet from shareholders to pension schemes.
- For seven companies the presence of the pension accounting deficit on the balance sheet reduces shareholders' equity[1] by over 30%. The aggregate reduction in shareholders' equity[1] is 6%.
- If the pension accounting deficit is considered as company borrowing, the aggregate net debt[2] of FTSE 100 companies (excluding financial companies, for whom debt is an integral part of their operating activities) increases by about 15%.

Recognising the deficit on the balance sheet reduces shareholders' equity by 6% overall.

"Buy-outs" new focus for insurers

- Under UK legislation, the cost for a company to eliminate its obligation to its defined benefit scheme is the "buy-out" measure – the price an insurance company would charge to take over the pension liabilities. We estimate that the total buy-out cost across the FTSE 100 companies is around £500 billion and amounts to a net shortfall of more than £175 billion.
- This represents an attractive market to the insurance companies and investment vehicles that have started taking steps to enter the buy-out arena in the last 12 months.

[1,2] *Please see the glossary for how these terms are defined.*

View a full list of our services on our website – www.lcp.uk.com

- If buy-out costs rather than IAS19 deficits were recognised on company balance sheets then capital structures would be hit even harder – we estimate that this would lead to a 20% reduction in shareholders' equity and, if treated as borrowing, an increase in the net debt of the FTSE 100 companies (excluding financial companies) of about 80%.

Pensioners vs shareholders: the FTSE 100 picture

- Directors face a difficult choice: how much cash to divert to pension schemes and where should it come from? Recent legislation encourages companies to accelerate the funding of their pension deficits.
- Eight companies paid off in excess of 25% of their accounting deficits whereas 16 companies paid contributions which we estimate did not reduce their accounting deficits in 2004 or 2005 at all.
- For some companies the burden is heavy. Eight companies reported that they paid more cash to their pension schemes than to their shareholders. For 10% of companies there was no surplus cash flow[3] to fund deficits.
- For other companies the burden is not so great. For example, some companies could have eliminated their obligation to their pension scheme completely – we estimate that 30% of FTSE 100 companies could have paid their buy-out deficit from their surplus cash flow[3]. A full two thirds of companies could have eliminated their pension accounting deficit from their surplus cash flow[3].
- Overall, cash contributions were up by 12% to £12.1 billion. This knocked £5 billion off the aggregate accounting deficit, after allowing for the additional benefits earned by members over the year.
- The new scheme funding standard will require even greater cash contributions from some companies to avoid risking intervention by the Pensions Regulator. We estimate that 30 FTSE 100 companies need to boost aggregate cash contributions by £1.3 billion pa over the next ten years – an increase of more than 50% for these companies.
- Although the Pensions Act 2004 and associated legislation have made it more likely that pension scheme members will receive their promised benefits, the price of this greater security could be more pension scheme closures, as companies who are forced to commit cash to funding their deficits reduce benefits for future service to help mitigate the effect.

Mortality assumptions disclosed

- For the first time a significant number (37) of companies have disclosed the allowance made for longevity. The average assumption for a male employee who retires at age 60 is that he will live to age 85.
- It is not surprising that the allowance varies between pension schemes but the importance of the mortality assumption is highlighted by the range of assumptions adopted. We estimate that the difference between the lowest and highest mortality assumptions disclosed is equivalent to more than 10% of the accounting liabilities or an aggregate deficit of about £40 billion across the FTSE 100 companies.

More cash to the pension scheme means less cash for shareholders and for investment.

Companies again paid record contributions into their pension schemes in 2005 but the influence of the Pensions Regulator could mean that some companies have to increase their contributions still further.

An aggregate deficit of £36 billion is a manageable sum for the FTSE 100 companies as a whole but for some companies the burden is heavy.

[3] Please see the glossary for how this term is defined.

Lane Clark & Peacock

Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

The Pension Protection Fund

- We estimate that the Pension Protection Fund (PPF) – which compensates members whose employer becomes insolvent leaving an underfunded scheme – will raise a total levy of £50 to £100 million this year from the pension schemes of the FTSE 100 companies. This compares to the total levy of £575 million which the PPF originally estimated that it would collect.

Europe

- It is still not possible to compare pension deficits easily between companies without analysis. This is a result of the different accounting standards still being used, and the options within IAS19 as to how deficits are spread.
- Companies from Germany, Spain and the Netherlands have the largest average pension deficits, followed by the UK.

Companies adopted a wide range of mortality assumptions and the difference between the lowest and highest is material.

View a full list of our services on our website – www.lcp.uk.com

2. Introduction and summary

2.1 Introduction – content overview

This survey provides an insight into the disclosure of pension scheme costs in companies' accounts, comparing the different practices adopted by the UK's and Europe's largest companies and highlighting the financial implications.

By analysing their pension disclosures we aim to measure the exposure that companies have to their pension liabilities and deficits, particularly in relation to capitalisation and liquidity, and we identify the steps that companies are taking to address their pension issues.

FTSE 100 companies scrutinised

In this survey we analyse the pension cost disclosures for companies comprising the FTSE 100 index on 1st January 2006. Eight companies have been excluded from our survey, generally because they do not sponsor a defined benefit pension scheme. This leaves 92 companies that are covered by this year's survey.

The information and conclusions of this survey are based on detailed analysis of the information companies have disclosed in their annual report and accounts for accounting periods ending in 2005. We do not approach companies or advisers for additional information or explanation.

Accounting standards have gone international

For accounting periods beginning on or after 1st January 2005 UK listed companies are required, by EU regulations to adopt international financial reporting standards (IFRS). For pension cost disclosures UK companies have adopted international accounting standard IAS19, which is broadly similar to the UK accounting standard FRS17 which it replaces. There are some differences and these are discussed further in section 4.

Of the 92 FTSE 100 companies covered by this year's survey, 51 companies have financial years ending as at 31st December 2005 and have therefore adopted IAS19, as required. Of the remaining companies, 12 have adopted FRS17 in their primary statements and the other 29 companies have disclosed FRS17 information in the notes to their accounts under the transitional requirements.

The requirement to adopt international standards has allowed us to include some companies in the survey for the first time – including *Royal Dutch Shell*, which has significant pension liabilities but formerly disclosed under US accounting standards preventing its inclusion.

Royal Dutch Shell

Throughout this survey we refer to the IAS19 accounting standard rather than FRS17, as going forwards all FTSE 100 companies will be required to use IAS19.

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

European companies analysed

Once again we have also examined the pension cost disclosures of the European companies comprising the Dow Jones STOXX 50℠ blue chip index on 1st January 2006. This includes some of the largest companies in Europe, providing interesting comparative information.

2.2 Pension scheme deficits

Update on deficits

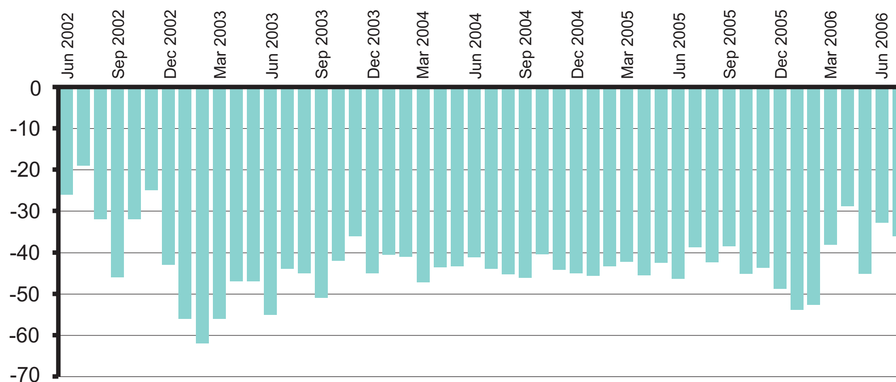
Under IAS19, unless the company chooses to adopt a "spreading" approach (see section 4), a measure of the surplus or deficit in the pension scheme appears directly on the company's balance sheet.

In mid-July 2006 we estimate the aggregate deficit under IAS19 of UK pension schemes sponsored by companies in the FTSE 100 to be £36 billion. This compares to £37 billion at the same time last year.

This figure excludes, where possible, the overseas pension schemes sponsored by companies in the FTSE 100 or any employee benefits other than pensions. If we included companies' other retirement benefits (such as overseas schemes and healthcare plans), then the aggregate deficit would be higher.

In the chart below we show how the aggregate UK pension deficit has developed over the past four years.

Estimated FRS17/IAS19 deficit for FTSE 100 companies (£ bn)



Our figures have been calculated by projecting forward the financial positions of the pension schemes from their year-end positions as disclosed in the companies' latest annual reports, allowing for changes in the financial markets.

The deficits have been calculated as the sum of the companies' FRS17 or IAS19 liabilities less the sum of the assets for the UK pension schemes they sponsor and, like all deficits or surpluses quoted in this report, are prior to any adjustment for tax. The chart takes account of changes in FTSE 100 constituents.

View a full list of our services on our website – www.lcp.uk.com

Deficits volatile

After a period of relative stability, the aggregate deficit has fluctuated markedly in recent months. At the end of January 2006, it was in excess of £50 billion – the highest level since June 2003 – yet by the end of April 2006 we estimate the aggregate FTSE 100 deficit had fallen to £29 billion.

This volatility reflects the significant movements that we have seen in equity and bond markets. The FTSE 100 index reached a five-year high at over 6,100 in late April 2006 before falling back significantly. On 10th July it closed at around 5,900. Long-dated bond yields reached an all time low in mid-January with long-dated AA-rated corporate bond yields falling to 4.5% pa before climbing back to their current rate of about 5.2% pa.

Deficits in context

Across the FTSE 100 companies, the deficit of £36 billion as of mid-July 2006 can be viewed as:

- nearly three months of companies' 2005 pre-tax profits;
- nine months of companies' 2005 declared dividends;
- over five months of companies' 2005 surplus cash flow;
- 3% of the market capitalisation of FTSE 100 companies; or
- assets of £90 being held for every £100 of IAS19 liability – this compares to £88 at the same time last year.

Last year we noted that there were six companies that reported deficits in excess of 30% of their market capitalisation. This year three of these companies have reported deficits below this level, primarily as a result of increased market capitalisations. Further details are set out in section 5.1.

Deficits hitting capital structures

Recognising the deficit on the balance sheet reduces shareholders' equity. After allowing for those companies who opted under IAS19 to adopt a "spreading" approach, the aggregate reduction in total shareholders' equity would have been 6% at 2005 year-ends.

For seven companies the impact of the pension accounting deficit on the balance sheet is to reduce total shareholders' equity by over 30%. This is a significant reallocation on the balance sheet from shareholders to the pension scheme.

If the pensions accounting deficits were viewed as company borrowing, then the aggregate net debt of FTSE 100 companies (excluding financial companies) would increase by about 15%. This represents a significant level of additional leverage of which investors may not previously have been aware.

Lane Clark & Peacock

Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

2.3 Other measures of deficits

Buy-out

Under UK legislation, should a company wish to eliminate its obligation to its defined benefit scheme, it would become liable to top up the assets to meet the cost of securing benefits in full with an insurance company. This "buy-out" cost is much higher than the IAS19 liability disclosed in the company accounts.

We estimate that the FTSE 100 companies had a total buy-out cost of nearly £500 billion and a total buy-out deficit of over £175 billion in July 2006. This measure is not a disclosure item so any estimate inevitably has a level of uncertainty.

Until recently, there were only two insurance companies prepared to take on companies' pension liabilities and so the market capacity was much less than the potential demand.

However, with many pension funds now closed to new employees, the prospect of buying out becomes more immediate. Therefore, it is perhaps not surprising that we are seeing interest from other insurance companies, investment vehicles and other organisations in taking on companies' pension schemes. For many FTSE 100 companies their schemes are too large for an immediate buy-out to be feasible but the market is now responding with new and innovative approaches that are offering options for even the larger schemes.

Pension Protection Fund

Should the sponsoring company become insolvent, members may be able to receive compensation from the Pension Protection Fund (PPF). The PPF does not pay members' full entitlements – individual members' benefits are capped and high earners, in particular, may suffer significant cut-backs in their entitlements should their scheme fall into the PPF.

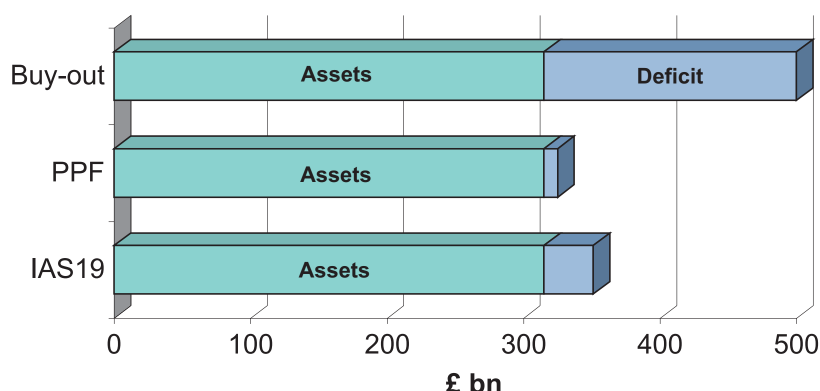
We estimate that the aggregate deficit amongst FTSE 100 companies against the cost of buying out the PPF benefits is in the region of £10 billion although the individual deficits will vary significantly between companies. This is significantly lower than the full buy-out deficit as the PPF provides only limited compensation.

We estimate that the total levy being raised this year by the PPF from the pension schemes of the FTSE 100 is likely to be in the region of £50 to £100 million. This compares to the overall levy of £575 million which the PPF originally estimated it would collect.

View a full list of our services on our website – www.lcp.uk.com

How do the different measures compare?

The following chart compares our estimates of three key measures of pension liabilities for the FTSE 100 companies.



The deficit in each case is the difference between two much larger numbers. Relatively small changes in either the assets or the liability measure can make a significant change in the deficit. The recent volatility in the overall deficit also reflects the fact that all three liability measures are calculated by reference to bond yields whereas around 60% of the assets are invested in equities.

2.4 Eliminating deficits

There are three key ways that a company can reduce its pension scheme deficit:

- injecting more cash into the scheme;
- achieving favourable investment returns so that the pension scheme assets increase more quickly than the measured value of the benefits; or
- reducing accrued benefits, although this is heavily restricted by UK legislation.

Contributions rising

For accounting periods ending in 2005 FTSE 100 companies paid contributions totalling £12.1 billion to their defined benefit pension schemes. This compares to £10.8 billion over the previous year, an increase of £1.3 billion or 12%.

On average, FTSE 100 companies paid nearly £170 to their pension schemes for each £100 of new benefits earned. This compares to £150 last year and means that, in aggregate, the companies paid £5 billion more than the IAS19 value of new benefits earned.

Last year we estimated that it would take eight years to eliminate the aggregate deficit, based on contributions paid during 2004 and using the companies' own assumptions for investment returns. On the basis of this year's contributions the period has reduced to seven years, with the target date for overall deficit elimination remaining as 2012.

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

It is clear that companies are making an increased effort to tackle their pension deficits proactively. However, it is impossible to tell whether contributions will continue to increase or whether, after a few years of one-off special contributions, they will fall back to previous levels. It is interesting to note that, as pension contributions are generally tax-deductible, one consequence of companies paying increased contributions is that the Treasury will collect less tax (all other things being equal).

Total disclosed contributions to defined contribution arrangements have risen 13% in the year to £1.3 billion, reflecting the rapidly increasing membership in defined contribution arrangements now that many defined benefit schemes are closed to new employees. This compares to a total accounting value of £7.5 billion for benefits earned under defined benefit schemes during the year.

Investment returns

Although companies are required to measure their pension liabilities under IAS19 by reference to bond yields, around 60% of pension scheme assets of the FTSE 100 companies are invested in equities. To the extent that equities deliver better investment returns than bonds, the IAS19 deficits will fall.

We estimate that the aggregate IAS19 deficit of £36 billion could be eliminated if the FTSE 100 index were to rise, from its level of around 5,900 on 10th July 2006, to over 7,200 by this time next year – a rise of 22%. This is provided real yields on high quality corporate bonds remain at their current level.

Alternatively, the aggregate IAS19 deficit could be eliminated were real bond yields to rise from 2.1% pa to 3.1% pa even if equities stood still. Yields were last at this level three and a half years ago.

It is important to note that averages and aggregates conceal a far from homogeneous picture. If the aggregate deficit were eliminated by market movements, this would still leave some companies with IAS19 deficits and some with surpluses.

It is also worth noting that, even if a company's IAS19 deficit were removed by favourable market movements, subsequent unfavourable market changes could cause a deficit to re-appear at a later date unless the scheme's assets were switched into long-dated bonds.

Reducing benefits

Legislation makes it difficult for companies to reduce accrued benefits.

As a result, the most common way for companies to control their pension liabilities is to modify benefits for future service.

Royal & SunAlliance Insurance

However, some companies have gone further. *Royal & SunAlliance Insurance* announced last year that members of its UK "final salary" scheme would have their benefits based on a potentially less generous "career average" structure with effect from 1st January 2006. The company recognised a reduction of £180 million in the deficit as a result. This

View a full list of our services on our website – www.lcp.uk.com

change was announced after consultation with employee representatives and as part of a package that saw the company significantly increase its own contributions.

Alternatives to cash funding

Although there is no substitute from the trustees' point of view for having cash paid into the pension scheme, alternative methods of providing security – so called "contingent assets" – may prove useful where cash is not readily available or where the company wants to avoid a future surplus, which may be difficult to claw back.

We found relatively few examples of FTSE 100 companies that disclosed contingent assets in their accounts. Given that contingent assets can fundamentally change a company's obligations there is a strong argument that they should be disclosed in the company's accounts. One example of such disclosure was:

- *National Grid* who disclosed that it has provided its pension scheme with letters of credit from banks, which would be triggered should National Grid Gas Plc become insolvent or certain agreed payments to the scheme fail to be made.

National Grid

Other approaches that have reportedly been used as alternatives to cash include:

- *BAE Systems*' proposal to transfer ownership of £480 million of company properties to its pension scheme as part of an attempt to address its pension deficit, which stood at £5.3 billion under IAS19 at the end of 2005.
- *J Sainsbury* who recently used company properties as collateral to raise debt, part of which went to pay £350 million towards its pension deficit, which stood at £658 million as at March 2006.

BAE Systems

J Sainsbury

Elsewhere, corporate deals included *Ericsson's* acquisition of the bulk of *Marconi*, where, as part of the deal, £490 million was paid into an escrow account in addition to a cash payment of £185 million to the pension fund. It is worth noting that the buy-out deficit in the pension fund was much larger than the accounting deficit of £109 million and, as the terms were agreed with the trustees and the Pensions Regulator, it is likely that these also took into account the change in the strength of the employer's covenant.

Ericsson

Marconi

Can companies afford the contributions?

Although much of our analysis suggests that the current IAS19 deficit is manageable for the FTSE 100 companies, there is significant variation between companies.

Two thirds of FTSE 100 companies in our survey could have paid off their pension accounting deficits from their 2005 surplus cash flow. Over 80% of companies could pay off their pension accounting deficits with three years of surplus cash flow at that level. However, some companies are finding the contributions more of a burden, for example:

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

- 15% of the FTSE 100 companies in our survey reported pension contributions of over a quarter of their surplus cash flow from both of the last two years.
- 10% of the profitable FTSE 100 companies in our survey reported pension contributions of over a quarter of pre-tax profits from both of the last two years.

Scheme funding

The Pensions Regulator released a statement in May 2006 on how it plans to regulate the funding of defined benefit pension schemes. As part of this the Regulator intends to use certain "trigger points" to help identify those schemes which it will investigate in greater detail. In particular, the Regulator may seek further explanation from schemes which do not:

- set a funding target at least equal to their PPF liability or their IAS19 liability; or
- put in place a plan to meet their deficit over 10 years or less.

Our survey identified 30 FTSE 100 companies whose current level of contributions would not clear their accounting deficits within 10 years, based upon the companies' own assumptions regarding future investment returns. We estimate that they would need to increase their total contributions by £1.3 billion per year in order to meet their deficits in 10 years time. This is an increase of over 50% from the current level of contributions that these companies are paying.

Although the other 62 companies are expected to meet their deficits within 10 years, in many cases this relies on the companies' expectations of high returns on equities being borne out in practice. For example, nearly a third of the companies would find that their contributions were no longer sufficient to pay off the deficit in 10 years if overall returns were 1% pa less than expected.

It remains to be seen how the Regulator will view companies who put forward a recovery plan that depends on achieving equity returns as high as 8.5% pa over the next 10 years.

2.5 Managing pension scheme risk to the business

It is important for companies not only to address the deficit that they are currently facing but also to take steps to control the risk of a deficit reappearing in the future.

Scheme closures

Many schemes have attempted to limit the build-up of their defined benefit obligations by closing their schemes. Half of FTSE 100 companies have disclosed that their main UK scheme has been closed to new employees although press reports and surveys suggest that only a few schemes remain open. Many companies continue to make such announcements – both *Royal Bank of Scotland Group* and *Friends Provident* have announced plans to close their schemes in the past three months. Whilst taking this step is significant and will eventually reduce the benefits being accrued it has little immediate effect on the company's accounting liability or deficit.

Royal Bank of Scotland Group
Friends Provident

View a full list of our services on our website – www.lcp.uk.com

Rentokil Initial

Last year *Rentokil Initial* went one step further and announced that it proposed to close its UK pension scheme – covering 3,000 UK employees – to all future accrual. *Rentokil Initial* also made a £200 million special contribution in December 2005 and has announced that it is reducing the risk profile of its investments significantly.

It remains to be seen whether other companies will follow *Rentokil Initial's* lead.

Exit strategy

In the longer term, a company with a pension scheme that is closed to future accrual will look to wind up the scheme and to secure the benefits by purchasing annuities.

At present, there is only limited capacity in the buy-out market – and effectively no capacity for taking on the very large schemes. However, there are signs that more insurance companies and investment vehicles are taking steps to enter (or re-enter) the market. These new entrants provide alternative ways for ongoing companies to offload their pension liabilities.

It is perhaps ironic that the supply of alternative buyout vehicles is increasing at the same time as many traditional underfunded wind ups now go to the Pension Protection Fund.

Nevertheless, the new players have brought some welcome innovation to the market. They have highlighted a number of new ways for companies to manage their pension risks.

Benefits linked to longevity

BAE Systems
British Airways

Some companies have announced innovative steps to control their mortality risks. For example, *BAE Systems* has announced that it has agreed to link members' pensions to future changes in life expectancy, thereby reducing the company's exposure to longevity risk. *British Airways* has also announced a package of proposals including "the company and staff to share [the] impact of changes in life expectancy."

2.6 Are the deficits measured correctly?

Longevity

Until recently, very few companies disclosed any information about their longevity assumptions, even though it can have a very material impact on the figures.

This year, 37 FTSE 100 companies have disclosed information about this assumption.

The disclosures reveal considerable variability in the assumptions used. This is to be expected as mortality rates are influenced by many factors such as occupation and income level. Also it is very difficult for companies to anticipate how life expectancy will improve in the future. Factors such as the possible impact of a bird flu pandemic or a ban on smoking in pubs create considerable uncertainty.

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

The impact of the mortality assumptions can be significant. For example, we estimate that the difference between the adoption of the most prudent and the most optimistic assessments of future life expectancy (as disclosed by companies in their accounts) is equivalent to more than 10% of the accounting liabilities or an aggregate deficit of maybe £40 billion across the FTSE 100 companies.

HSBC Holdings

Even within a single company there can be considerable variability – for example, the directors of *HSBC Holdings* estimate that current male French employees retiring at 65 will live for 23 more years, 3.5 years (18%) longer than their male British counterparts. We comment further in section 6 on the differences between mortality assumptions in different countries.

View a full list of our services on our website – www.lcp.uk.com

3. Developments in UK pension provision

New legislation

Last year we commented on the vast amount of new pensions legislation affecting companies and noted that David Blunkett had just been appointed Secretary of State for Work and Pensions.

Twelve months on, Mr Blunkett is no longer a cabinet minister but the burden of legislation, regulation and compliance continues to build up at an alarming rate.

Against this background, companies continue to scale back their defined benefit schemes with most being closed to new employees and some being closed for future accrual as well.

So, whilst the government can claim some success in making pension schemes more secure (so that members are more likely to receive the benefits they have been promised) this has only come at the price of greatly reduced pension provision in future.

That is not to say that a defined contribution arrangement is necessarily less valuable than a defined benefit scheme but the amounts that the average company pays to its defined contribution scheme tends to be rather less than would be required to replace the defined benefit with any certainty.

We consider some of the key developments below.

Pensions tax "simplification" and "A-Day"

On 6th April 2006 ("A-Day") the government introduced a new tax system for pensions. Companies and trustees are slowly coming to terms with the administrative consequences of this new regime.

These include redesign of administration systems, new procedures for checking that limits are not exceeded and a major overhaul of scheme documents.

For most companies, A-Day involved a major communication exercise with all members, with particular attention being paid to high earners. Individuals may register for "protection" of their existing entitlements if they exceed or expect to exceed by retirement the "Lifetime Allowance" – the maximum pension benefits to receive tax privileged status, set at £1.5 million for 2006/07.

The tax penalties for accidentally falling foul of the new requirements can be severe and unexpected.

Pension Protection Fund (PPF)

For the 2006/07 year, 80% of the PPF levy became risk-based with the amount reflecting the level of scheme underfunding (the worst funded schemes pay the most); and the viability of the sponsoring employer (the lower a company's Dun & Bradstreet (D&B) rating the higher the levy).

Lane Clark & Peacock
Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

The significant differences in the potential levy from apparently small changes in D&B ratings or in the deficit meant that companies made great efforts to have their levy assessed on the most favourable data available.

In many cases, this meant submitting valuations to the PPF and possibly making special contributions or arranging contingent assets that could be used to reduce the levy.

For 2008/09, we can look forward to a levy that will potentially reflect the risk inherent in the scheme's investment strategy as well.

The Pensions Regulator

The Regulator has been in business since April 2005 and, although he has yet to use his wide-ranging powers to order companies (or individuals) to support underfunded pension schemes, his influence has been instrumental in changing companies' behaviour.

After the failure of some high profile takeovers, such as WH Smith, due to pensions issues, pension scheme trustees now find that they are at the top of the list of people to be involved when a merger or acquisition is on the cards. Even if the parties do not apply for clearance from the Regulator, it is becoming common to see accelerated contribution payments used as a quid pro quo for the trustees agreeing to the deal. Reportedly, in Grupo Ferrovial's recent takeover bid for *BAA* a separate agreement was reached between Grupo Ferrovial and the trustees of *BAA's* pension scheme for an increase in employer contributions and a "more robust funding target" to apply in the event of a successful takeover.

WH Smith
Grupo Ferrovial
BAA

The Regulator's influence has led to a noticeable change in companies' perceptions towards their pension deficits. Several companies have made high profile announcements to the stock market on their strategies for tackling their pension deficit, including *British Airways* and *BAE Systems*.

British Airways
BAE Systems

Other companies have announced that they have reached agreement with their trustees to pay off their deficits in an accelerated time span. Examples from the FTSE 100 include:

- *Lloyds TSB Group* has agreed to clear its £3.3 billion pension deficit over the next 10 years.
- *The BOC Group* has an agreed takeover bid from Linde Group which reportedly involves the £455 million European pension deficit being addressed over a three-year period.

Lloyds TSB Group

The BOC Group
Linde Group

The Regulator has also continued to publish consultation papers and codes of practice, notably the much-awaited code on scheme funding. Although the final version was toned down compared to the first draft, it is clear that, under the new regime, trustees have much greater powers and they are expected to use these powers to make sure that their schemes are funded appropriately, prudently and over a suitable period.

A key part of the scheme funding regime is the trustees' assessment of the strength of the employer's "covenant"; that is, the sponsor's ability and willingness to fund the deficit under terms agreed between the trustee and company boards. Trustees are expected to agree a funding plan which clears the deficit as soon as the employer can reasonably afford – and, in any event, within 10 years.

View a full list of our services on our website – www.lcp.uk.com

Contingent assets

Where companies are not in a position to, or do not wish to, make full repayment of the pension deficit over a suitable period, they can provide additional security to their trustees in other ways, including:

- a guarantee from another company within the group (an overseas parent for example);
- a charge over a particular company asset or assets;
- a letter of credit; and
- an escrow account.

Such "contingent assets" provide additional security to the pension scheme, as companies face up to having to treat trustees more like banks and other lenders.

One reason why companies may find contingent assets attractive is that they avoid locking away cash which, under current UK legislation, would be difficult for the company to reclaim should the pension scheme go into surplus.

It is interesting to note that, should pension scheme accounting deficits be measured as debt, then they would make up a sizeable proportion of companies' debts – we estimate the total net debt of the FTSE 100 companies (excluding financial companies) would increase by about 15%.

Trigger points

The Pensions Regulator has powers to intervene where he believes that trustees and companies have not complied appropriately with the scheme funding requirements. In deciding whether or not to intervene, the Regulator has identified certain "trigger points":

- a funding target less than the PPF deficit or the IAS19 deficit; or
- a recovery period greater than 10 years.

When a scheme triggers one of these points, the Regulator may seek further information and intervene if he deems it necessary. As with clearance applications, the company accounting numbers are a key part of the Regulator's approach to scheme funding.

Age discrimination

The next major piece of legislation to affect companies sponsoring pension schemes is age discrimination.

Although it was anticipated that pension schemes (which by their very nature provide benefits that vary by age) would be exempt from most of the requirements, the detailed regulations are far from clear and schemes and their sponsoring employers must face up to further time and expense to comply with the new legislation by 1st October 2006.

Lane
Clark &
Peacock

Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

Pensions white paper – Turner report

The Pensions Commission, chaired by Lord Turner, recommended a number of changes to the UK pension system to avoid large-scale pensioner poverty in future. These changes included:

- an increase in state retirement age;
- higher state pensions, with a consequent reduction in means testing; and
- the introduction of a national pension savings scheme (NPSS).

The white paper sets out some of the government's proposals for making these reforms over the coming years.

Overall impact

The continuing weight of legislation, regulation and compliance will encourage companies to reduce future pension commitments, as they devote their time and resources to complying with the new legislation and funding their obligations for past benefits.

In the short term, we are likely to see continuing increases to the contributions paid to pension schemes but, in the longer term, companies will inevitably look to ways to contain costs.

It would be ironic if the upshot of the NPSS was that a 3% compulsory employer contribution to a savings account became the norm for employer pension provision in the private sector.

View a full list of our services on our website – www.lcp.uk.com

4. Accounting standards for pensions

Which accounting standard?

Previous years' surveys have examined FRS17 disclosures which, for many companies, were still shown only in notes to the accounts while figures in the primary statements followed SSAP24, which is much less prescriptive.

For accounting periods beginning on or after 1st January 2005, EU regulations now require listed companies to prepare accounts in accordance with international financial reporting standards (IFRS) and, in particular, to use IAS19 for pensions disclosures.

Therefore, during this period of transition, our survey for this year includes a mixture of companies who have either:

- adopted IAS19 in accordance with IFRS (51 companies);
- adopted FRS17 early (12 companies); or
- disclosed FRS17 figures in notes to the accounts whilst accounting under SSAP24 (29 companies).

Comparison of different accounting standards.

The most significant difference between the two standards is the treatment of gains and losses.

Under FRS17, gains and losses (which occur when the previous year's assumptions are not borne out in practice) are recognised immediately in the Statement of Total Recognised Gains and Losses ("STRGL"). A similar option exists under IAS19 to recognise gains and losses in the Statement of Recognised Income and Expenditure ("SORIE"). This is called the "fair value" approach.

However, there are further options under IAS19 to recognise gains and losses through the income statement (formerly the profit and loss account). These are called "spreading" approaches. At one level, immediate recognition of gains and losses is permitted directly in the income statement or, as a minimum, gains and losses outside a 10% "corridor" can be recognised in the income statement by amortising them over the employees' future working lives.

The three options available under IAS19 give rise to significantly different entries in the balance sheet and the income statement.

Of those 51 companies that reported under IAS19, eight have chosen to spread the recognition of gains and losses under IAS19. This has led to the recognition of £2.3 billion of losses being deferred for these eight companies – in effect £2.3 billion of deficit is being held off their balance sheets. The largest unrecognised loss of £1.1 billion (out of its total pension deficit of £2.7 billion) belongs to *Barclays*.

Barclays

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

Further review of accounting standards

The Accounting Standards Board (ASB) has recently published a Financial Reporting Exposure Draft (FRED) setting out a proposed amendment to FRS17. This considers the impact of regulatory changes including:

- the obligation on solvent companies to pay the buy-out cost if they wish to sever their obligation to their pension scheme;
- the establishment of the PPF; and
- the establishment of the Pensions Regulator.

The review also addresses differences between FRS17 and IAS19 and whether additional disclosure should be included such as the size of the buy-out deficit and the PPF levy.

"Daft" accounting standards?

Interestingly, Sir David Tweedie, the architect of FRS17 in the UK, has recently acknowledged the "daft" consequences of the current method of determining corporate pension liabilities. In particular, he noted that companies who switched their pension scheme assets more into bonds to avoid balance sheet volatility under FRS17 have actually created volatility by diving in on a very short supply of long-dated bonds.

The International Accounting Standards Board (IASB) and the US Financial Accounting Standard Board (FASB) have also indicated that they may be reviewing their accounting standards on pensions in the near future.

It seems that we are in for a further period of uncertainty and inconsistency as companies continue to report under a variety of different pension accounting standards.

View a full list of our services on our website – www.lcp.uk.com

5. LCP's analysis of FRS17 / IAS19 disclosures

We have analysed 92 FTSE 100 companies reporting in 2005. 51 of these companies are now reporting under IAS19, and of the remaining companies, 12 have adopted FRS17 in their primary statements with the 29 other companies disclosing FRS17 information under the transitional requirements whilst continuing to use figures calculated under SSAP24 in their primary statements.

We have concentrated on the financial position of the defined benefit schemes in which the companies' employees participate. Many companies offer post-retirement healthcare, which we have excluded from our analysis where possible. Overseas pension arrangements have been included.

The disclosures

The average pension note now runs to over four pages, with some companies dedicating over 10 pages of their accounts to pensions. This reflects the growing importance of pension deficits, as well as the more extensive disclosures that FRS17 and IAS19 demand.

It has been noticeable that there is no single consensus on the format of IAS19 disclosures. Unlike FRS17 which, in its three-year transition period, achieved a good level of consistency between companies, the IAS19 disclosures are presented in a variety of different formats, which can make them difficult to follow and does not make comparison easy.

5.1 Analysis of results

Funding levels

IAS19 (and FRS17) takes a snapshot of the surplus or deficit at the company's year-end and, if the company has not chosen to "spread" gains and losses, this is the number that appears on the balance sheet.

A full list of the disclosed surpluses and deficits of the companies in our survey is set out in appendix 1.

This year five companies out of the 92 in our survey reported a surplus in their 2005 accounts. They were: *Associated British Foods, Gallaher Group, Johnson Matthey, Old Mutual* and *Schroders*.

Gallaher Group and *Schroders* moved into surplus this year. The other three companies maintained their surplus reported last year whilst *The British Land Company*, which reported a surplus last year, had a funding level of just 92% this year reflecting significant losses from updated assumptions.

For the second year running the highest funding level was 105% for *Johnson Matthey*, as at 31st March 2005. Several companies saw their funding levels improve significantly over the year, as a result of special contributions. These include *Enterprise Inns* which revealed a funding level of 77% as at September 2004, which has increased to 99% as at September 2005. *Rentokil Initial* also revealed an increase in its funding level of over 15% over the year reflecting a significant company contribution.

Associated British Foods
Gallaher Group
Johnson Matthey
Old Mutual
Schroders
The British Land Company
Enterprise Inns
Rentokil Initial

Lane Clark & Peacock
Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

On the other hand, 30 companies have seen a reduction in their funding ratios this year.

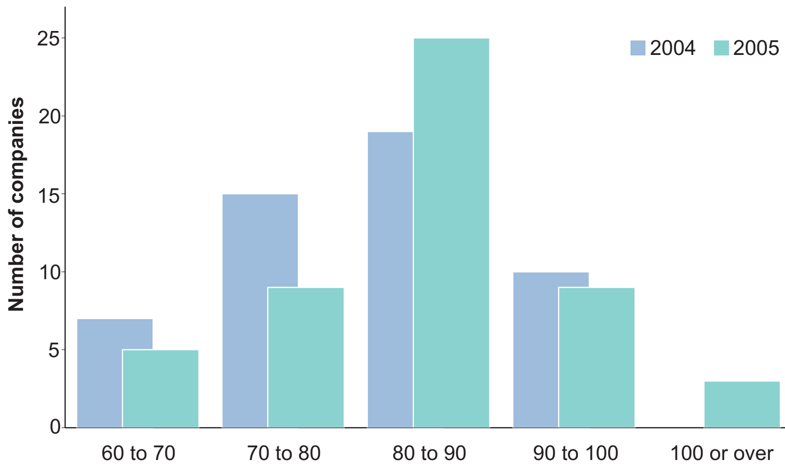
More recently, *Yell Group* has released updated figures showing that its funding level improved from 60% at 31st March 2005 to 87% at 31st March 2006 as a result of a significant deficit contribution.

Yell Group

Changes over 2005

The chart below shows how funding levels have changed over the year for the 51 FTSE 100 companies in our survey who have December 2005 year-ends – all these companies are accounting under IAS19.

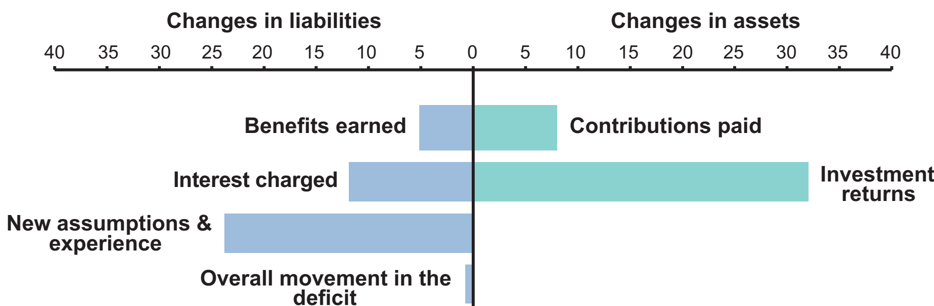
Ratio of assets to IAS19 liabilities at end of December (%)



Sources of deficits and surpluses

Of those 51 companies with December year-ends, high investment returns (£32 billion over 2005) have been consumed by interest charges on the liabilities (£12 billion), additional benefits earned by employees (£5 billion) and an increase in the IAS19 value placed on the projected benefits (£24 billion) due to revised assumptions and experience. Aggregate contributions of £9 billion were insufficient to make up the shortfall and so the companies' deficits were broadly unchanged in absolute terms over 2005.

IAS19 sources of assets and liabilities for companies with December year-ends only (£ bn)



In percentage terms, the average funding ratio rose over the calendar year from 82% to 84%. This is because the assets and liabilities grew significantly over the year and so the deficit shrank in relative terms.

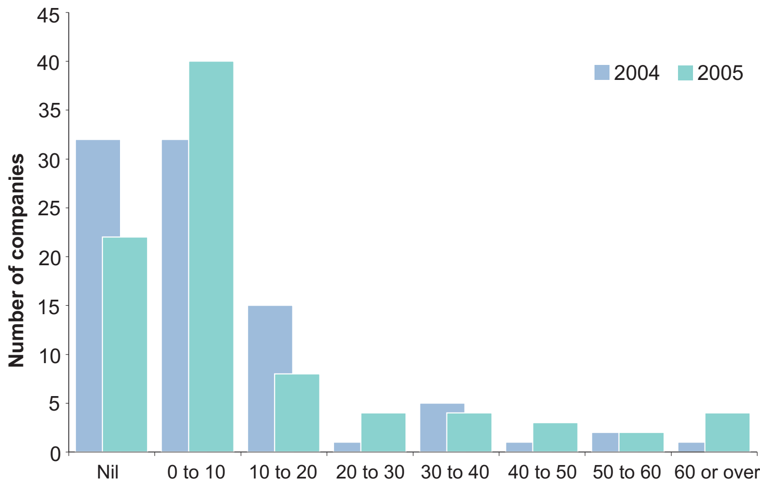
View a full list of our services on our website – www.lcp.uk.com

What are companies doing to tackle their deficits?

Contributions to companies' pension schemes have to pay for the extra benefits earned by employees before they can start to reduce the deficit.

The chart below shows the "excess" contributions that companies paid during the year (ie contributions over and above the FRS17 or IAS19 value of the benefits earned during the year) as compared to the deficit disclosed in the accounts at the end of the year.

Proportion of year-end deficits paid off over the year (%)



There is a noticeable increase in the proportion of deficits being paid off compared to last year. This year 17 companies paid off in excess of 20% of their year-end deficit, compared to just ten companies last year. Two of the highest ratios of deficit paid off were *3i Group* and *United Utilities*, who both paid excess contributions worth more than 70% of their 2005 year-end deficits.

3i Group
United Utilities

However, 22 companies paid contributions over the year which were less than the FRS17 or IAS19 value of benefits earned over the same period – even though they disclosed an accounting deficit.

For example, *Reed Elsevier* paid £47 million contributions over 2005 compared to £91 million of benefits that were earned by employees and a year-end IAS19 deficit of £405 million.

Reed Elsevier

Prudential paid contributions of £25 million over 2005. Against this, they disclosed that the IAS19 cost of benefits earned by employees was £65 million over 2005 and their recognised IAS19 deficit at the end of 2005 was £796 million.

Prudential

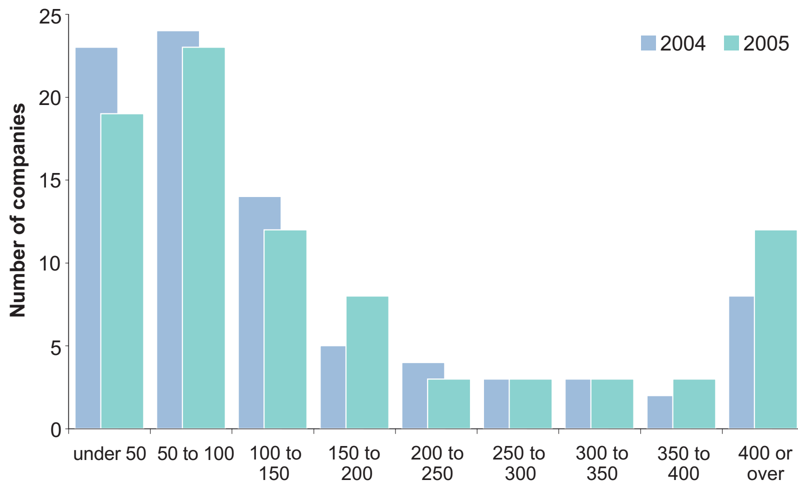
View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

Pension schemes vs shareholders

The following chart shows how pension deficits compare to dividends paid. Nearly half of FTSE 100 companies disclosed pension deficits in 2005 that were less than their declared shareholders' dividends in 2005.

Percentage of deficit that could be paid off with one year's declared dividends (%)



For example, *Vodafone* declared dividends of £2.7 billion in 2005, significantly more than its accounting deficit of £136 million.

Vodafone

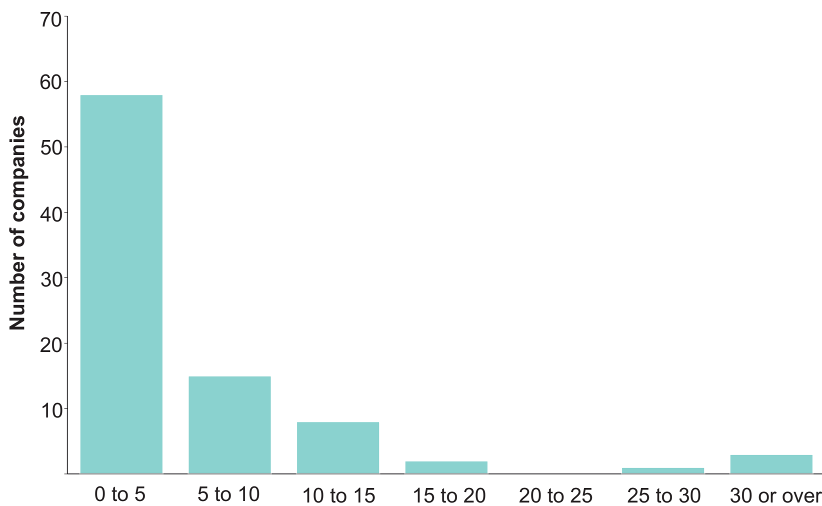
On the other hand, *ICI* declared dividends of £92 million in 2005 compared with its accounting deficit of £1.5 billion.

ICI

Overall, 24 companies declared dividends in excess of twice the amount of their pension deficit.

The chart below summarises the ratio of deficits to market capitalisation (at their year-ends) for the 87 FTSE 100 companies with a deficit in our survey. It shows that reported deficits for some schemes are generally small compared to the size of the company. However some are significantly larger.

Accounting deficits as a proportion of market capitalisation (%)

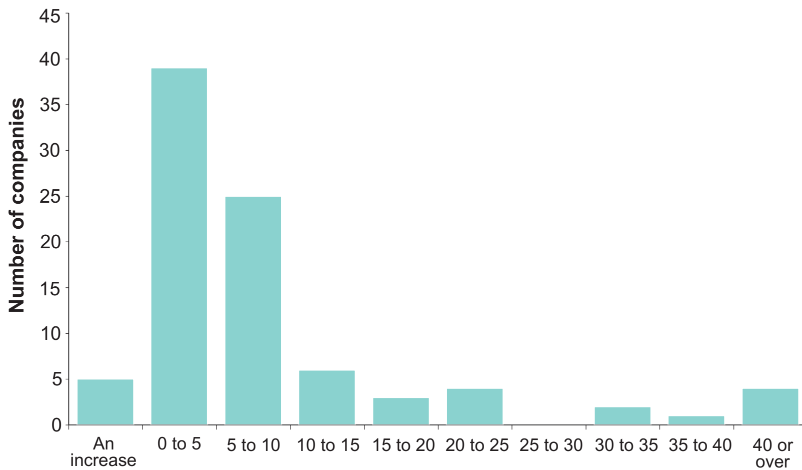


Appendix 2 lists those companies with the largest liabilities or deficits compared to market capitalisation.

View a full list of our services on our website – www.lcp.uk.com

The following chart shows the impact on shareholders' equity (including minority interests) of recognising the pension deficit on the balance sheet (net of deferred tax where disclosed and net of any unrecognised gains and losses or asset limit).

Percentage reduction in shareholders' equity from recognising the pension deficit/surplus on the balance sheet (%)



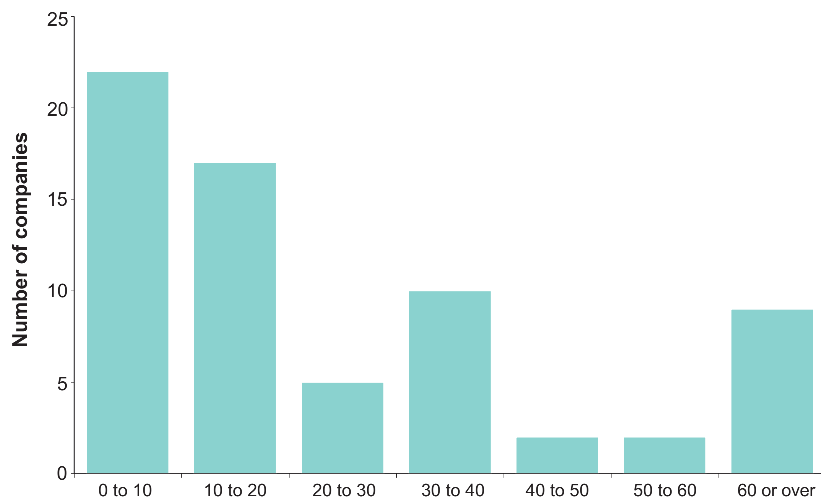
National Grid

Seven companies are facing reductions of over 30% in their balance sheet net worth from the adoption of IAS19. The largest reduction is for *National Grid* – as at 31st March 2005 it would have seen a 80% reduction in shareholders' equity from £1,391 million to £284 million had it fully adopted FRS17.

Pension deficits as company debt

The Pensions Regulator is encouraging trustees to operate in a similar manner to banks and other holders of debt. The chart below compares the accounting deficit to the net debt that companies have disclosed. For some companies the pension scheme is a significant creditor when considered in this way.

Gross pension deficit as a percentage of net debt (%)



ITV

For example, *ITV* disclosed net debt at 31st December 2005 of £481 million, up from £327 million at the start of the year. This compares to the IAS19 deficit of £532 million at 31st December 2005 demonstrating that the pension scheme is a significant creditor.

Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

5.2 Key assumptions

We consider below the various assumptions used to place an accounting value on retirement benefits. Where a company operates pension schemes in more than one country we have considered the assumptions used for the UK if separately given. Where a company has disclosed a range of assumptions, we have taken the mid-point.

Our analysis is of the assumptions disclosed as at the accounting year-end.

Mortality

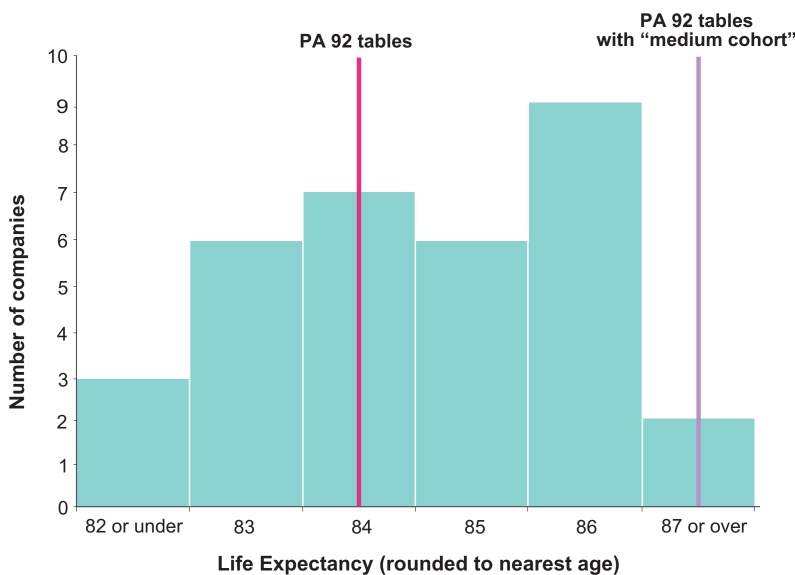
We note the increased level of disclosure of mortality assumptions this year. Some 37 companies disclosed the assumption compared to only two companies last year.

It is likely that this trend is driven by the IAS19 standard which requires that any "material actuarial assumptions" [para 120A (n) (vi)] be disclosed. FRS17 does not have such an explicit requirement. Of those who did not report under IAS19, only *Wolseley* and *Smiths Group* disclosed their mortality assumptions.

Wolseley
Smiths Group

The following chart shows the range of life expectancies assumed by FTSE 100 companies at December year-ends. A total of 33 companies disclosed sufficient information to derive a life expectancy for current UK retirees at age 60. The average assumption was that male employees who retire at age 60 would live to about age 85.

Life expectancy assumptions reported in 2005
Males retiring at age 60 on the accounting date



The two lines show the life expectancies produced by two standard actuarial tables commonly used for assessing the mortality of pension schemes. The "PA92" tables were released in 1999 and are based on experience during 1991-94.

The "PA92" tables included an allowance for future improvements in life expectancy but more recent research shows that certain people, particularly

View a full list of our services on our website – www.lcp.uk.com

the "cohort" born between 1925 and 1945, were living much longer than expected. The "medium cohort" adjustment reflects these findings.

The chart shows considerable variation between companies' views of life expectancy for their former employees.

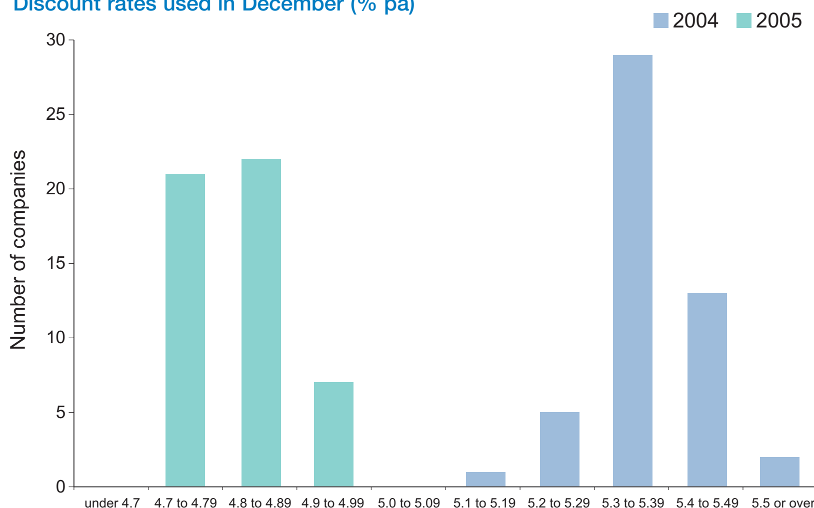
Discount rates

The discount rate assumption used by each company is set out in appendix 1.

The discount rate is the annual rate by which the projected future benefits are discounted back to the balance sheet date. FRS17 sets out explicitly how the discount rate should be derived, ie based on the yield on AA-rated corporate bonds. Under IAS19 there is potentially a greater range for an appropriate rate since IAS19 states that the discount rate should be based on "high quality" corporate bonds which could include bonds rated below or above AA.

The yields on high quality corporate bonds, and hence the discount rates, will fluctuate from day to day in line with market conditions. It is therefore sensible to compare the discount rates used by companies with the same year-ends.

Discount rates used in December (% pa)



The average discount rate has fallen from 5.32% pa in December 2004 to 4.77% pa in December 2005 reflecting significant falls in bond yields. We estimate that this alone could have added nearly 10% to companies' pension liabilities – equivalent to increasing the aggregate deficits by about £30 billion.

We have also noticed that the range of discount rates disclosed is narrower this year. The difference between the highest and lowest discount rate used has fallen from 0.65% pa to 0.25% pa. This may be a result of closer scrutiny from auditors now that pension deficits are being recognised in the main body of the financial statements.

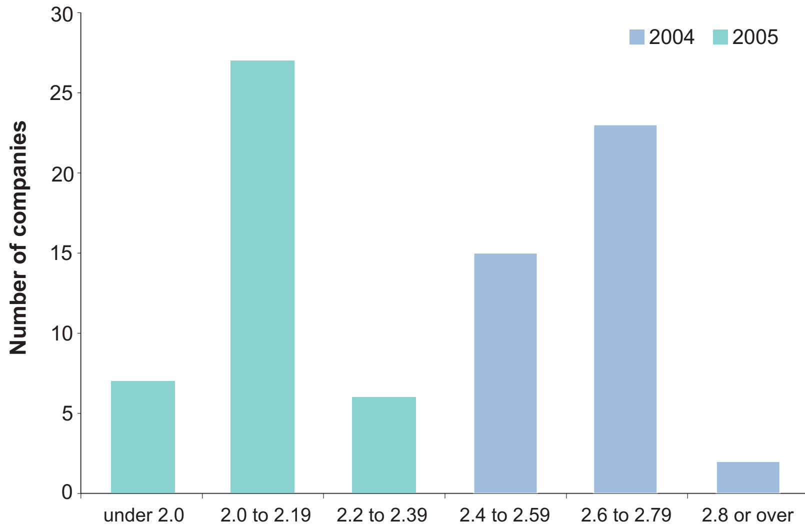
The typical FTSE 100 company has pension liabilities that are linked to price inflation. It is therefore the discount rate net of assumed future price inflation which is the key assumption.

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

The chart below shows the difference between the discount rate and the assumption for future price inflation as at 31st December 2004 and 2005, for companies with December accounting year-ends. There is a marked shift downwards.

Discount rates used in excess of inflation used in December (% pa)

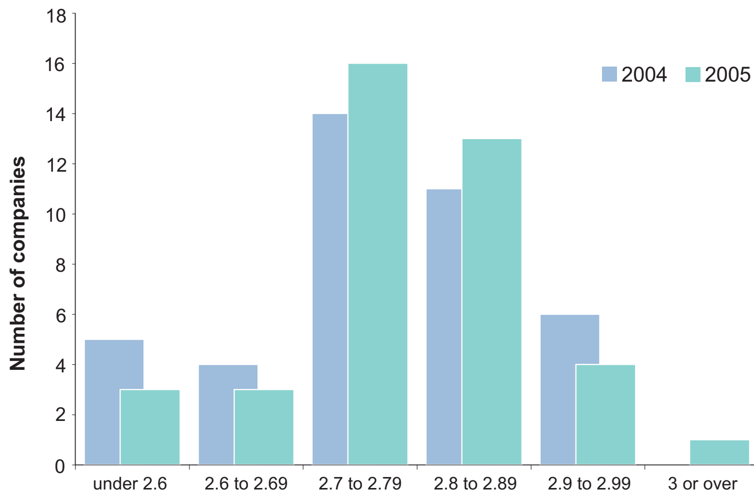


Inflation

Details of the assumption for future price inflation used by each company are set out in appendix 1.

The chart below shows that there has been a slight increase in the assumption for long-term retail price inflation used by companies with year-ends in December. An increase in the price inflation assumption will lead directly to a higher level of projected benefit payments, and hence a larger value being placed on those benefits.

Inflation used in December (% pa)



View a full list of our services on our website – www.lcp.uk.com

Salary growth

The assumed rate of salary growth affects the disclosed IAS19 liability and the cost of benefits being earned. A lower assumption for salary growth produces a lower projected pension and hence a lower pension scheme deficit as well as a lower charge to operating income.

Details of the salary assumptions used by each company are set out in appendix 1.

The average salary growth rate has fallen marginally to 1.4% pa above price inflation this year, from 1.5% pa last year. Of the 80 companies which disclosed sufficient information to analyse, most maintained their 2004 assumption for salary increases above price inflation, but 17 have reduced the assumption and 15 have increased it.

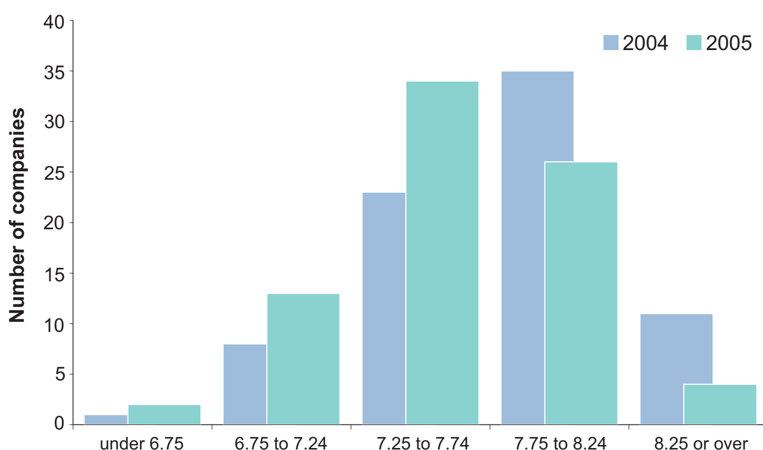
Expected return on equities

The expected future return on assets for IAS19 is required to be "based on market expectations… for returns over the entire life of the related obligation". This contrasts with FRS17 where the expected return should be based on long-term expectations for the actual assets held at the accounting date.

Under IAS19, several companies have chosen to disclose just the overall expected rate of return rather than break it down into separate assumptions for each asset class, as is required under FRS17.

For those companies where we could determine the equity return assumption, there is a wide range of values, reflecting subjectivity in setting this assumption.

Expected long-term rate of return on equities (% pa)



The lowest assumption was 6% pa as disclosed by *Enterprise Inns* and the highest was 8.5% pa as disclosed by *British Airways*.

The average expected rate of return on equities was 3.3% pa higher than the long-term yields available on gilts as at the balance sheet dates. This difference represents companies' views of the so-called "equity risk premium" (the additional return expected from investing in equities, compared with risk-free assets such as gilts, to compensate for the increase in risk).

Enterprise Inns
British Airways

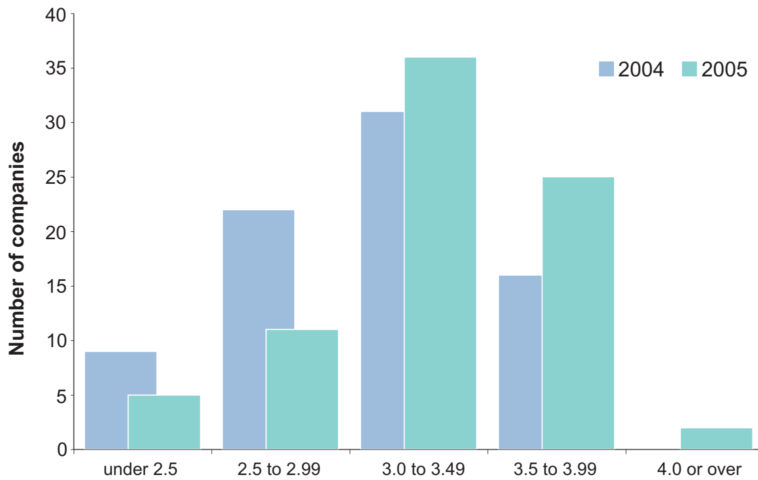
Lane Clark & Peacock
Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

The average equity risk premium has risen – the previous year's figure was 3.16% pa – although this may be influenced by the significant falls in gilt yields rather than genuine changes in companies' views of the equity risk premium.

Where disclosed, seven companies increased their assumed equity return and 50 reduced it, with 21 maintaining the same assumption for both years' accounts.

Expected long-term rate of return on equities over gilt yields (% pa)

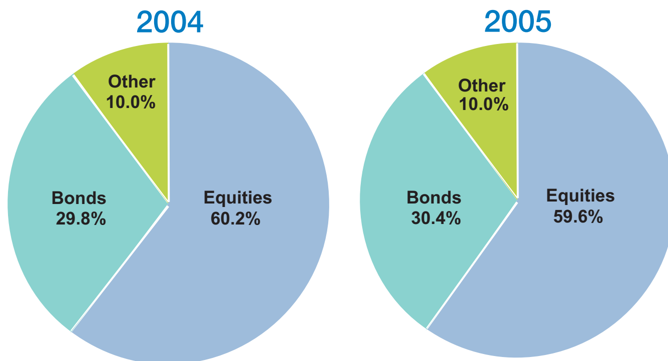


5.3 Investment strategy

Aggregate pension scheme assets have increased significantly, partly as a result of increased contributions but mainly due to rising equity and bond markets. We estimate that total pension scheme assets across the UK schemes of the FTSE 100 amounted to a little over £300 billion as at mid-July 2006, which compares to about £260 billion at the same time last year.

Asset allocations

The chart below compares the distribution of UK pension scheme's assets (or worldwide if the UK figure is not separately given) in 2004 and 2005 for the companies in our survey.



There has been a slight overall move from equities into bonds, which is more significant once account is taken of the outperformance of equities relative to bonds over the period. Some pension schemes made significant switches from equities into bonds.

View a full list of our services on our website – www.lcp.uk.com

3i Group's pension scheme has increased its bond holding from 23% to 44% of total assets. *Cable & Wireless'* pension scheme has reduced its equity allocation by 14% and increased the allocation to bonds and property. Each company also paid a substantial special contribution during the year.

There has also been greater disclosure of alternative investments such as hedge funds and the use of financial derivatives. For example, *Capita Group* has disclosed an 8% increase in its pension schemes' allocation to "equities/ hedged funds/absolute returns".

3i Group
Cable & Wireless

Capita Group

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

6. Accounting for pensions in Europe

This is the third year that LCP has conducted a survey of the pension commitments of Europe's largest companies. We have analysed the pension cost disclosures made by the 50 European companies comprising the Dow Jones STOXX 50℠ blue chip index. This covers companies in the UK (16), France (8), Germany (8), Switzerland (5), the Netherlands (5), Italy (3), Spain (3), Sweden (1) and Finland (1) – details of each company included are shown in appendix 3.

As previous surveys have shown, the size of pension liabilities sponsored by these companies is substantial – in excess of €650 billion (£450 billion). Defined benefit pension schemes are common throughout Europe and in North America where many blue chip European companies also have operations.

Therefore, for a proper understanding of these companies' finances, it is important to have meaningful information about their pension obligations.

The requirement for companies listed in the EU to report in accordance with IFRS has meant that, for many companies, the quality of pension cost disclosures has improved in 2005. Nevertheless, some disclosures remain poor and do not provide sufficient information for detailed analysis.

Other conclusions from our survey are that:

- the combined pension deficit in 2005 was €136 billion (£94 billion);
- companies may be understating pension deficits on their balance sheet by €53 billion (£37 billion) due to the "spreading" options permitted in the accounting standards used; and
- Spain, Germany and the Netherlands have the largest average pension deficits, followed by the UK.

Lifting the veil

Pensions accounting disclosure in Europe is in a state of flux as companies move from localised accounting methodologies to more transparent international standards of reporting.

In 2004, the 50 largest European companies collectively used a dozen different local accounting standards of varying quality, making direct comparisons between companies difficult and in some cases masking the true extent of pension liabilities.

In 2005, the companies collectively adopted four different sets of accounting regulations to measure and disclose pension liabilities. Of the 50 companies, 39 reported under IAS19 and six adopted the US accounting standard. Five companies had year-ends prior to 31st December and so did not have to report under IFRS in 2005.

Whilst this is a significant reduction from the 12 different pensions accounting standards adopted in 2004, we will need to wait until 2006 before the majority of European companies report on an equal footing.

View a full list of our services on our website – www.lcp.uk.com

Last year we reported that the overall deficit for companies in the Dow Jones STOXX 50SM was €116 billion (£82 billion) as at 31st December 2004. Had the companies reported under IFRS in 2004, we estimate that the deficit would have been shown as €132 billion (£93 billion) – some €16 billion (£11 billion) more than suggested in the 2004 accounts.

Double standards

As well as reporting under different standards, companies may adopt various options under those standards and this makes comparison difficult. For example, as discussed in section 4, IAS19 permits different methods of recognising a pension deficit.

Of the 39 European companies who reported under IAS19 in 2005, 26 used the "spreading" method, as did the six companies who reported under the US accounting standard. Under this approach, the deficit or surplus in the pension scheme is not generally shown in full on the balance sheet.

We estimate that the combined pension liabilities shown on the balance sheets of the 50 European companies would be higher by €53 billion (£37 billion) if a "fair value" approach were used rather than a "spreading" approach.

Earlier this year the US accounting standards board (FASB) proposed to amend the US pensions standard such that any deficit or surplus is fully recognised on the balance sheet. It remains to be seen whether the IASB takes steps to remove the "spreading" option from IAS19.

Significant country variations

The combined reported pensions deficit of the companies in the Dow Jones STOXX 50SM blue chip index in 2005 was €136 billion (£94 billion). The average company's deficit varied significantly by country:

Country	2005 average deficit (€ bn)	2004 average deficit (€ bn)
Spain	6.6	6.4
Germany	4.5	4.3
Netherlands	2.5	2.5
UK	2.5	2.5
France	2.2	1.9
Italy	1.8	1.2
Switzerland	1.0	1.1
Sweden	0.6	1.2
Finland	0.1	0.05

These average deficits have been calculated as the market value of assets less the reported value of the liabilities for each company by country, as shown in appendix 3, divided by the number of companies for that country.

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

Spain, Germany and the Netherlands have the largest average pension deficits, followed by the UK.

In Germany and Spain, pension arrangements have traditionally not been funded externally but are backed with company assets. For our survey, we have defined the "deficit" as the pension liability in excess of externally held assets, which tends to bring out a relatively high average deficit for those countries in particular.

Strength of the sponsoring company

Where a deficit exists, the amount of the deficit is, effectively, a "loan" from the scheme to the sponsoring company. This means that the beneficiaries are relying on the sponsoring company to remain in business and to make good the deficit in due course if they are to receive their full entitlements.

In some countries, such as the UK, Germany and Sweden, there is an insurance arrangement to cover benefits should a company become insolvent. However, the insurance may not cover the full level of the anticipated benefits and the best security for members is a strong and successful employer who is willing and able to stand behind the pension promise.

The smaller the deficit in relation to the size of the company, the easier it will be to manage that deficit. For example, *Ericsson* and *Groupe Société Générale* disclosed pension deficits of around 1% of their market capitalisation compared to an average across the 50 companies of 4%.

Ericsson
Groupe Société Générale

Further detail is given in appendix 3.

Life expectancy

The life expectancy of pension scheme members is one of the most important assumptions in calculating the value placed on the pension liabilities. This year, although 16 of the 50 companies have provided some information about the mortality tables used, in many cases the information was incomplete.

This is a particular concern, as the assumptions commonly adopted in some European countries are very different from those used in other countries, with no obvious reason for the difference.

A recent survey of mortality tables commonly used in different countries by the Cass Business School* showed that the assumed life expectancy for a 65 year old male in France was 24.2 years, 60% higher than for a 65 year old male in Denmark, at 15.1 years.

We estimate that adding a further three years to the assumed life expectancy would add around €60 billion (£41 billion) to the pensions deficit for the 50 companies in our survey.

Contributions

The companies in our survey contributed a total of €29 billion (£20 billion) to their pension arrangements in 2005 compared to €21 billion (£14 billion) in 2004.

* Cass Business School: Mortality Assumptions used in the Calculation of Company Pension Liabilities in the EU.

View a full list of our services on our website – www.lcp.uk.com

As we noted last year, some European countries, notably Germany, have effectively been granted an exemption from the EU Directive on occupational retirement provision in respect of their internally funded arrangements. This reflects the fact that, historically, such arrangements have not been funded.

Nevertheless, some German companies have started to fund their pension obligations through newly available products. In 2005 *BASF* paid €3.7 billion (£2.5 billion) into such an arrangement. We expect this trend to increase in the future, particularly amongst international companies.

BASF

Wide variations in pension scheme information

The standard and volume of disclosure information continues to vary. For example, *Siemens* devoted 17 pages of its accounts to pensions, whereas *Carrefour* provided only one page of pensions information.

Siemens

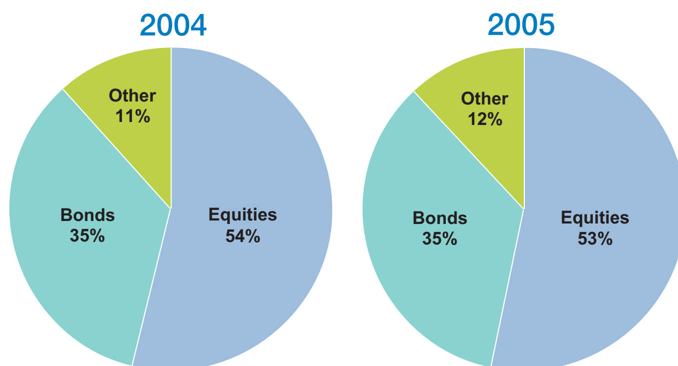
Carrefour

Asset allocation

This year for the first time we have looked at the type of assets that European companies hold to back their pension liabilities. Overall, assets were invested across a wide range of asset classes, with 53% in equities and 35% in bonds, and the remaining 12% invested in property, cash and other asset classes.

The investment proportions vary considerably by country. UK companies invested most heavily in equities (62%) whereas German and Swiss companies invested most heavily in bonds (46%).

As the charts below show, over the past year companies have, on average, slightly decreased the proportion of assets held in equities, despite good equity performance in 2005.



View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

Glossary

Surplus cash flow

For the purposes of our survey, we have defined "surplus cash flow" (also known as "free cash flow") as cash flow generated from operating activities having allowed for interest (paid and received), tax and capital expenditure but before acquisitions, ordinary dividends and capital financing. These adjustments are based on figures in the cash flow statement and **not** the profit & loss or income statements. We have also stripped out pension contributions for the purpose of comparisons.

In effect surplus cash flow is a measure of the cash flow available after a company has met all of its operating obligations including reinvestment in the business. In this sense it is generally a good measure of a company's ability to meet one-off cash requirements such as for acquisitions, share buy-backs or plugging pension deficits.

Surplus cash flow is not a defined term under IFRS or UK GAAP but many companies report this statistic (normally with the above definition although there are some variations) and it is sometimes used as a performance measure.

Net debt

For the purposes of our survey, we have defined "net debt" to be the total borrowings, including both short-term and long-term bank loans, bonds and finance leases, offset by cash and cash equivalents and short-term investments, which can include some derivatives. For some companies this figure is negative, in which case it is normally referred to as "net funds".

Net debt is a commonly used measure for the debt in a company. For financial companies (such as banks and insurance companies) debt is an integral part of their operating activities. For this reason we have excluded financial companies from any comparisons involving net debt as such comparisons would be misleading.

Shareholders' equity/net assets

Shareholders' equity (or shareholders' funds) is the balance sheet measure of the capital in a company that belongs to shareholders. We have included minority interests in this measure (as well as ordinary shareholders' equity), although generally minority interests tend not to be material. Shareholders' equity is defined as the total assets less current and long-term liabilities (including debt). For this reason it is often referred to as "net assets".

Shareholders' equity is a defined term under IFRS and UK GAAP and it is a required disclosure on the balance sheet.

View a full list of our services on our website – www.lcp.uk.com

Appendix 1 – FTSE 100 accounting disclosure listing

This table shows the key disclosures made by the companies in the FTSE 100 as at 1st January 2006 that reported FRS17 or IAS19 figures in their 2005 (and 2004) accounts. The source of the data is each company's annual report and accounts for the accounting period ending in 2005. The market value of assets and surplus/(deficit) figures before tax relate to the worldwide position of each company, not just the UK schemes. All figures are rounded to the nearest million pounds. The assumptions for salary growth, price inflation and the discount rate refer to those disclosed for the companies' main UK schemes where available. "ND" means no UK or European figures were disclosed.

			2005						2004					
Company	Year-end	Accounting standard adopted	Market value of assets £ m	FRS17 surplus/ (deficit) £ m	Discount rate % pa	Salary growth % pa	Price inflation % pa	Expected return on equities % pa	Market value of assets £ m	FRS17 surplus/ (deficit) £ m	Discount rate % pa	Salary growth % pa	Price inflation % pa	Expected return on equities % pa
3i Group	Mar	FRS17	367	(23)	5.40	4.50	3.00	7.70	272	(83)	5.50	4.40	2.90	7.90
Alliance & Leicester	Dec	IAS19 - SORIE	1,230	(84)	4.90	4.50	2.75	7.50	1,060	(67)	5.40	4.50	2.75	7.50
Alliance UniChem	Dec	IAS19 - SORIE	154	(69)	4.80	3.80	2.80	7.40	125	(53)	5.30	3.90	2.90	7.50
Amvescap	Dec	IAS19 - spreading	147	(47)	4.00	4.20	ND	ND	122	(43)	4.63	4.20	ND	ND
Anglo American	Dec	IAS19 - SORIE	2,053	(259)	4.70	3.00	2.70	7.70	1,809	(292)	5.30	3.50	2.70	7.90
Associated British Foods	Sep	FRS17	2,149	79	5.00	4.50	2.80	6.50	1,918	84	5.60	4.80	2.80	7.00
AstraZeneca	Dec	IAS19 - SORIE	4,274	(974)	4.90	3.90	2.70	8.30	3,736	(914)	5.30	3.90	2.70	8.30
Aviva	Dec	IAS19 - SORIE	8,209	(1,471)	4.80	4.60	2.80	8.00	6,286	(893)	5.40	4.50	2.70	8.20
BAA	Mar	FRS17	1,675	(192)	5.40	4.30	2.80	7.70	1,526	(154)	5.50	4.40	2.90	7.70
BAE Systems	Dec	IAS19 - SORIE	12,461	(5,306)	4.80	3.80	2.80	8.00	10,143	(4,339)	5.30	3.70	2.70	8.30
Barclays	Dec	IAS19 - spreading	16,390	(2,697)	4.80	4.30	ND	ND	13,697	(2,319)	5.40	4.30	ND	ND
BG Group	Dec	IAS19 - spreading	400	(247)	4.80	4.90	2.90	8.00	309	(170)	5.30	4.80	2.80	8.20
BHP Billiton	Jun	SSAP24	790	(149)	4.45	3.98	2.35	7.55	656	(124)	5.53	4.00	2.50	8.15
The BOC Group	Sep	FRS17	2,258	(280)	5.00	4.40	2.90	7.70	1,894	(309)	5.50	4.40	2.90	8.50
Boots Group	Mar	SSAP24	3,013	(83)	5.40	4.40	2.90	7.70	2,836	(58)	5.50	4.40	2.90	ND
BP	Dec	IAS19 - SORIE	19,005	(1,444)	4.75	4.25	2.50	7.50	16,501	(2,390)	5.25	4.00	2.50	7.50
Brambles Industries	Jun	SSAP24	195	(121)	5.00	4.00	2.80	7.50	154	(85)	5.80	4.30	3.00	8.00
British Airways	Mar	SSAP24	10,595	(1,531)	5.40	4.30	2.80	8.50	9,767	(1,140)	5.60	4.00	2.50	8.40
British American Tobacco	Dec	IAS19 - spreading	3,824	(670)	4.70	5.00	3.00	7.10	3,328	(418)	5.30	4.80	2.80	7.50
The British Land Company	Mar	FRS17	51	(4)	5.30	5.10	2.90	7.00	44	0	5.50	5.10	2.90	7.00
BT Group	Mar	SSAP24	29,576	(4,781)	5.40	3.73	2.70	8.00	26,900	(5,136)	5.50	3.63	2.60	8.20
Cable & Wireless	Mar	SSAP24	1,831	(151)	5.40	3.20	2.70	8.00	1,600	(403)	5.50	4.60	2.80	8.00
Cadbury Schweppes	Jan	IAS19 - SORIE	2,294	(331)	4.75	4.20	2.70	7.70	1,884	(456)	5.30	4.50	2.70	8.00
Capita Group	Dec	IAS19 - SORIE	395	(43)	4.80	3.70	2.70	7.00	319	(44)	5.40	3.75	2.75	7.00
Carnival	Nov	SSAP24	119	(23)	4.80	4.20	2.70	7.70	105	(20)	5.20	4.20	2.70	7.70
Centrica	Dec	IAS19 - SORIE	2,570	(820)	4.85	4.35	2.85	7.90	2,041	(719)	5.40	4.30	2.80	8.10
Compass Group	Sep	SSAP24	1,052	(532)	5.00	3.20	2.70	7.50	850	(426)	5.60	3.20	2.70	8.00
Daily Mail and General Trust	Oct	SSAP24	1,446	(209)	5.00	4.30	2.75	7.80	1,197	(226)	5.50	4.30	2.75	8.00
Diageo	Jun	FRS17	4,144	(1,069)	4.90	3.90	2.50	7.50	3,730	(905)	5.70	4.40	3.00	8.20
Dixons Group	Apr	SSAP24	456	(187)	5.50	4.20	2.70	8.20	418	(126)	5.90	4.30	2.80	8.40
Enterprise Inns	Sep	FRS17	17	0	5.00	ND	2.80	6.00	13	(4)	5.50	3.90	2.90	6.50
Friends Provident	Dec	IAS19 - SORIE	1,004	(67)	4.75	3.50	2.85	7.00	795	(25)	5.50	3.50	2.90	7.10

Appendix 1 – continued

Company	Year-end	Accounting standard adopted	2005 Market value of assets £m	2005 FRS17 surplus/ (deficit) £ m	2005 Discount rate % pa	2005 Salary growth % pa	2005 Price inflation % pa	2005 Expected return on equities % pa	2004 Market value of assets £ m	2004 FRS17 surplus/ (deficit) £ m	2004 Discount rate % pa	2004 Salary growth % pa	2004 Price inflation % pa	2004 Expected return on equities % pa
Gallaher Group	Dec	IAS19 - SORIE	1,024	36	4.80	3.75	2.75	8.00	899	(22)	5.30	3.80	2.80	7.50
GlaxoSmithKline	Dec	IAS19 - SORIE	8,377	(1,749)	4.75	4.00	2.75	7.75	6,746	(1,500)	5.25	4.00	2.50	8.25
GUS	Mar	SSAP24	964	(101)	5.40	4.70	2.90	8.00	811	(178)	5.50	4.60	2.80	8.00
Hammerson	Dec	IAS19 - SORIE	34	(17)	4.75	3.00	2.50	ND	26	(13)	5.75	3.00	2.50	ND
Hanson	Dec	IAS19 - SORIE	1,992	(21)	4.80	4.25	ND	7.00	1,742	(49)	5.30	4.50	ND	7.25
HBOS	Dec	IAS19 - SORIE	5,343	(1,792)	4.85	3.30	ND	ND	4,183	(1,716)	5.45	3.80	ND	ND
Hilton Group	Dec	IAS19 - SORIE	357	(144)	4.80	5.60	2.60	7.50	291	(129)	5.30	4.20	2.70	8.00
HSBC Holdings	Dec	IAS19 - SORIE	13,800	(2,287)	4.75	3.20	2.70	8.00	10,820	(2,875)	5.30	3.20	2.70	8.10
ICI	Dec	IAS19 - SORIE	8,189	(1,491)	4.80	4.20	2.70	8.20	7,632	(937)	5.30	4.00	2.60	8.20
Imperial Tobacco Group	Sep	SSAP24	2,810	(166)	4.85	3.75	2.80	7.40	2,427	(292)	5.05	3.80	2.90	7.25
InterContinental Hotels Group	Dec	IAS19 - SORIE	312	(65)	4.70	4.30	2.80	7.50	526	(162)	5.30	4.30	2.80	8.00
International Power	Dec	IAS19 - spreading	198	(42)	4.70	4.40	2.90	7.10	159	(25)	5.30	4.40	2.90	7.50
ITV	Dec	IAS19 - SORIE	2,072	(532)	4.90	4.00	2.75	7.50	1,685	(672)	5.40	4.25	2.75	7.50
Johnson Matthey	Mar	FRS17	724	34	5.40	4.30	2.80	8.00	659	34	5.50	4.00	2.50	8.00
Kelda Group	Mar	SSAP24	592	(102)	5.40	3.90	2.70	7.30	543	(105)	5.50	3.80	2.60	7.35
Kingfisher	Jan	SSAP24	887	(298)	5.30	4.30	2.70	7.80	909	(270)	5.60	4.30	2.70	8.00
Land Securities	Mar	SSAP24	126	(11)	5.40	4.25	3.00	7.50	105	(17)	5.50	4.00	2.75	7.50
Legal & General	Dec	IAS19 - SORIE	1,089	(215)	4.70	3.25	ND	7.50	947	(159)	5.25	3.25	ND	8.00
Liberty International	Dec	IAS19 - SORIE	42	(2)	4.80	4.80	2.80	ND	36	(1)	5.30	4.60	2.60	ND
Lloyds TSB Group	Dec	IAS19 - spreading	14,026	(3,294)	4.80	3.98	2.70	8.00	11,648	(3,218)	5.30	4.14	2.60	8.20
Man Group	Mar	SSAP24	145	(33)	5.40	5.50	2.90	8.20	128	(34)	5.50	5.50	2.90	8.20
Marks & Spencer Group	Apr	FRS17	3,957	(657)	5.50	3.70	2.90	8.25	3,634	(649)	5.60	3.50	2.70	8.35
Wm Morrison Supermarkets	Jan	FRS17	1,218	(376)	5.25	4.75	3.00	7.00	179	(68)	5.50	4.75	3.00	7.00
National Grid	Mar	SSAP24	14,087	(1,553)	5.40	3.90	2.90	7.80	13,432	(1,846)	5.50	3.90	2.90	8.00
Next	Jan	SSAP24	235	(93)	5.25	4.25	2.75	6.75	202	(86)	5.50	4.25	2.75	7.00
Northern Rock	Dec	IAS19 - SORIE	257	(54)	4.75	4.50	2.75	ND	199	(53)	5.30	4.50	2.75	ND
O2	Mar	SSAP24	343	(101)	5.50	4.40	2.90	7.70	278	(84)	5.70	4.30	2.80	7.80
Old Mutual	Dec	IAS19 - spreading	508	11	4.95	4.05	2.90	6.95	428	(2)	5.30	4.90	2.90	7.90
Pearson	Dec	IAS19 - SORIE	1,500	(303)	4.85	4.50	2.80	ND	1,280	(335)	5.40	4.80	2.80	ND
Persimmon	Dec	IAS19 - SORIE	165	(74)	4.75	3.60	2.60	7.50	133	(66)	5.35	3.65	2.65	7.00
Prudential	Dec	IAS19 - SORIE	4,622	(796)	4.80	4.80	ND	7.10	4,092	(825)	5.30	4.80	ND	7.50
Reckitt Benckiser	Dec	IAS19 - SORIE	818	(147)	4.80	4.80	2.80	7.40	734	(157)	5.30	4.80	2.80	7.80
Reed Elsevier	Dec	IAS19 - SORIE	2,575	(405)	4.90	4.00	ND	ND	2,204	(321)	5.40	4.40	ND	ND
Rentokil Initial	Dec	IAS19 - SORIE	875	(182)	4.70	3.60	ND	ND	585	(312)	5.30	3.50	ND	ND
Reuters Group	Dec	IAS19 - SORIE	1,041	(297)	4.75	4.00	2.75	ND	905	(250)	5.25	4.00	2.75	ND
Rexam	Dec	IAS19 - SORIE	2,357	(514)	4.75	4.25	2.75	6.95	2,089	(477)	5.30	4.30	2.80	7.38
Rio Tinto	Dec	IAS19 - SORIE	2,957	(187)	4.80	4.80	2.80	7.30	2,475	(233)	5.30	4.90	2.90	7.90
Rolls-Royce Group	Dec	IAS19 - SORIE	5,563	(1,394)	4.70	4.40	2.90	7.10	4,698	(1,209)	5.30	4.40	2.90	7.60

Company	Year-end	Accounting standard adopted	2005 Market value of assets £ m	2005 FRS17 surplus/ (deficit) £ m	2005 Discount rate % pa	2005 Salary growth % pa	2005 Price inflation % pa	2005 Expected return on equities % pa	2004 Market value of assets £ m	2004 FRS17 surplus/ (deficit) £ m	2004 Discount rate % pa	2004 Salary growth % pa	2004 Price inflation % pa	2004 Expected return on equities % pa
Royal & SunAlliance Insurance	Dec	IAS19 - SORIE	4,967	(425)	4.70	4.00	2.50	7.30	4,226	(658)	5.20	4.00	2.50	7.30
Royal Bank of Scotland Group	Dec	IAS19 - SORIE	17,388	(3,735)	4.80	4.00	2.70	7.70	14,798	(2,940)	5.40	4.00	2.70	8.10
Royal Dutch Shell	Dec	IAS19 - spreading	31,642	(595)	4.70	3.80	ND	ND	26,902	(1,529)	5.10	3.80	ND	ND
SABMiller	Mar	SSAP24	499	(56)	ND	ND	ND	ND	449	(76)	ND	ND	ND	ND
J Sainsbury	Mar	SSAP24	2,979	(494)	5.50	2.75	2.75	8.00	2,810	(680)	5.50	2.75	2.75	8.25
Schroders	Dec	IAS19 - SORIE	481	9	4.80	4.20	ND	ND	389	(31)	5.30	4.40	ND	ND
Scottish & Newcastle	Dec	IAS19 - SORIE	1,997	(313)	4.90	3.80	2.60	7.80	1,738	(397)	5.40	4.00	2.50	7.80
Scottish & Southern Energy	Mar	FRS17	1,653	(205)	5.40	4.30	2.80	8.20	1,500	(178)	5.50	4.30	2.80	8.20
Scottish Power	Mar	SSAP24	2,669	(502)	5.40	4.40	2.90	7.30	2,487	(462)	5.50	4.30	2.80	7.45
Severn Trent	Mar	SSAP24	1,079	(309)	5.50	4.25	2.75	8.25	937	(368)	5.50	4.25	2.75	8.50
Smith & Nephew	Dec	IAS19 - SORIE	414	(96)	4.80	4.80	ND	7.00	299	(135)	5.30	4.90	ND	7.50
Smiths Group	Jul	FRS17	2,893	(140)	5.00	3.40	2.40	8.00	2,558	(160)	5.70	3.60	2.60	8.25
Standard Chartered	Dec	IAS19 - SORIE	1,122	(264)	4.90	5.30	2.80	7.75	996	(78)	5.40	5.30	2.80	8.40
Tate & Lyle	Mar	SSAP24	1,013	(128)	5.40	4.50	2.80	7.80	970	(150)	5.50	4.50	2.80	8.00
Tesco	Feb	SSAP24	2,718	(735)	5.40	3.90	2.60	8.20	1,979	(674)	5.70	3.80	2.50	8.10
Unilever	Dec	IAS19 - SORIE	10,968	(2,848)	4.70	4.20	2.70	7.60	9,477	(2,964)	5.30	4.30	2.80	8.00
United Utilities	Mar	SSAP24	2,303	(80)	5.40	4.20	2.80	7.60	1,849	(378)	5.50	4.30	2.80	7.60
Vodafone Group	Mar	SSAP24	874	(136)	5.40	4.80	2.80	7.70	641	(165)	5.50	4.50	2.50	7.50
Wolseley	Jul	SSAP24	514	(191)	5.00	3.25	2.75	7.30	400	(183)	5.70	3.50	2.99	7.00
WPP	Dec	IAS19 - SORIE	453	(231)	4.70	4.30	2.80	7.30	393	(202)	5.30	4.30	2.80	7.50
Xstrata	Dec	IAS19 - SORIE	49	(12)	4.80	4.20	2.80	7.80	44	(13)	5.40	4.10	2.70	8.00
Yell Group	Mar	SSAP24	151	(99)	5.40	4.40	2.90	7.70	122	(66)	5.40	4.40	2.90	7.70

The 2005 figures are as at the end of accounting periods ending in 2005 (apart from Cadbury Schweppes which has a balance sheet date of 1st January). The 2004 figures are as at the start of the accounting period. All figures shown above are taken from FRS17 or IAS19 disclosures. The accounting standard refers to the standard that was adopted for the main body of the financial statements. Those companies which reported under SSAP24 disclosed FRS17 information in the notes to their accounts which is used for the figures above. Further explanation of the accounting standards can be found in section 4 of the survey.

The market value of assets and surplus/(deficit) figures before tax relate to the worldwide position of each company, not just the UK disclosure. Traditionally, some companies with overseas pension plans do not fund them via an external scheme, instead backing the pension plan with company assets, which may result in a larger deficit being disclosed. All figures are rounded to the nearest million pounds. The figures have been converted to Sterling where a company has reported figures in its accounts in a different currency.

The assumptions for salary growth, price inflation and the discount rate refer to those disclosed for the companies' main UK scheme(s). Where a company has disclosed a range of assumptions, we have taken the mid-point. Where a company operates pension schemes in more than one country, we have considered the assumptions used for UK if separately given, or Europe otherwise. "ND" means no UK or European figures were disclosed.

We have excluded from our survey the following seven companies who had no evidence of significant defined benefit provision: Antofagasta, British Sky Broadcasting, Cairn Energy, Kazakhmys, Party Gaming, Sage Group and Shire Pharmaceuticals. P&O have also been excluded as they did not produce 2005 accounts.

The following six companies have entered the FTSE 100 index since 1st January 2005 and hence are not included in our survey: British Energy Group, Corus, Drax Group, ICAP, Lonmin and Vedanta Resources. The following six companies have exited the FTSE 100 index since 1st January 2005: BAA, Cable & Wireless, Daily Mail and General Trust, Ladbrokes (formerly Hilton Group), O2 and P&O.

Appendix 2 – FTSE 100 accounting risk measures

The tables below show the key results of analysis of the disclosures made by the companies in the FTSE 100 as at 1st January 2006 that reported FRS17 or IAS19 figures in their 2005 accounts.

Largest liabilities

Name	2005 Liabilities £ m	*2004 Liabilities £ m*
BT Group	34,357	*32,036*
Royal Dutch Shell	32,237	*28,431*
Royal Bank of Scotland Group	21,123	*17,738*
BP	20,449	*18,891*
Barclays	19,087	*16,016*
BAE Systems	17,767	*14,482*

Largest deficits

Name	2005 Deficit £ m	*2004 Deficit £ m*
BAE Systems	5,306	*4,339*
BT Group	4,781	*5,136*
Royal Bank of Scotland Group	3,735	*2,940*
Lloyds TSB Group	3,294	*3,218*
Unilever	2,848	*2,964*
Barclays	2,697	*2,319*

Largest liabilities compared to market capitalisation

Name	Liabilities £ m	Market Cap £ m	2005 Liabilities/ Market cap %
British Airways	12,126	2,857	424
ICI	9,680	3,955	245
BT Group	34,357	17,579	195
Royal & SunAlliance Insurance	5,392	3,662	147
BAE Systems	17,767	12,256	145
National Grid	15,640	15,156	103

View a full list of our services on our website – www.lcp.uk.com

Largest deficit compared to market capitalisation

Name	Deficit £ m	Market Cap £ m	2005 Deficit/ Market Cap %
British Airways	1,531	2,857	54
BAE Systems	5,306	12,256	43
ICI	1,491	3,955	38
BT Group	4,781	17,579	27
Rolls-Royce Group	1,394	7,516	19
Rexam	514	2,805	18

Highest funding levels

Name	Assets £ m	Liabilities £ m	2005 Assets/ Liabilities %	*2004 Assets/ Liabilities %*
Johnson Matthey	724	689	105	*105*
Associated British Foods	2,149	2,070	104	*105*
Gallaher Group	1,024	988	104	*98*
Old Mutual	508	497	102	*100*
Schroders	481	472	102	*93*
Enterprise Inns	17	17	99	*77*

Largest employer contributions

Name	2005 Contribut'ns £ m	*2004 Contribut'ns £ m*
HSBC Holdings	1,339	*251*
Royal Dutch Shell	702	*854*
GlaxoSmithKline	673	*469*
BP	607	*389*
Unilever	572	*533*
Royal Bank of Scotland Group	452	*1,146*

View a full list of our services on our website – www.lcp.uk.com

Appendix 2 – continued

Largest service cost*

Name	2005 Service Cost £ m	*2004 Service Cost £ m*
Royal Dutch Shell	640	*594*
BT Group	540	*439*
Royal Bank of Scotland Group	526	*480*
BP	429	*404*
HSBC Holdings	366	*326*
Barclays	361	*331*

Largest employer contributions compared to service cost*

Name	Contributions £ m	Service Cost £ m	2005 Contribut'ns/ Service Cost %	*2004 Contribut'ns/ Service Cost %*
Rentokil Initial	211	14	1,528	*68*
Enterprise Inns	2	0.3	800	*333*
3i Group	72	12	600	*240*
ITV	142	26	546	*146*
United Utilities	369	71	519	*103*
Cable & Wireless	128	27	474	*97*

Highest employer contributions compared to dividends declared

Name	Contributions £ m	Dividends £ m	2005 Contribut'ns/ Dividends %	*2004 Contribut'ns/ Dividends %*
ICI	152	92	165	*205*
Rentokil Initial	211	133	158	*7*
Royal & SunAlliance Insurance	215	138	156	*113*
Cable & Wireless	128	87	147	*52*
Smith & Nephew	75	53	142	*40*
United Utilities	369	325	114	*15*

View a full list of our services on our website – www.lcp.uk.com

The source of the data is each company's annual report and accounts for the accounting period ending in 2005. The figures relate to the worldwide position of each company (not just the UK disclosure) but excludes healthcare and defined contribution plans where possible.

The surplus/(deficit) figures are before allowing for deferred tax.

Traditionally, some companies with overseas pension plans do not fund them via an external scheme, instead backing the pension plan with company assets, which may result in a larger deficit being disclosed.

The source of market capitalisation figures is the FTSE European Monthly Reviews and FTSE All-Share Index Series Weightings reports as at the companies' year-ends.

*The service cost (representing the value of benefits earned over the accounting period) includes the value of any past service benefits awarded to members.

Lane
Clark &
Peacock

Actuaries & Consultants

View a full list of our services on our website – www.lcp.uk.com

Appendix 3 – Dow Jones STOXX 50SM blue chip disclosure listing

Company	Country	Accounting date	Market value of assets € m	Value of liabilities € m	Liabilities as % of market capitalisation	2005 Surplus/ (deficit) € m	2004 Surplus/ (deficit) € m
ABN AMRO	NL	31/12/05	10,212	12,403	30%	(2,191)	(1,961)
Allianz	DE	31/12/05	8,287	17,159	34%	(8,872)	(7,130)
Anglo American	UK	31/12/05	2,980	3,356	8%	(376)	(413)
Assicurazioni Generali	IT	31/12/05	657	3,496	11%	(2,839)	(1,471)
AstraZeneca	UK	31/12/05	6,203	7,617	12%	(1,414)	(1,294)
Aviva	UK	31/12/05	11,914	14,049	62%	(2,135)	(1,264)
AXA	FR	31/12/05	4,693	11,421	26%	(6,728)	(5,704)
BBVA	ES	31/12/05	627	6,026	12%	(5,399)	(5,482)
BSCH	ES	31/12/05	10,175	22,461	32%	(12,286)	(11,223)
Barclays	UK	31/12/05	23,788	27,702	48%	(3,914)	(3,282)
BASF	DE	31/12/05	11,015	11,907	35%	(892)	(3,610)
BNP Paribas	FR	31/12/05	1,735	3,151	6%	(1,416)	(1,814)
BP	UK	31/12/05	27,583	29,679	15%	(2,096)	(3,383)
BT Group	UK	31/03/05	42,925	49,864	195%	(6,939)	(7,271)
Carrefour	FR	31/12/05	299	990	4%	(691)	(342)
Credit Suisse	CH	31/12/05	11,622	13,169	25%	(1,547)	(1,170)
DaimlerChrysler	DE	31/12/05	34,348	41,514	102%	(7,166)	(6,644)
Deutsche Bank	DE	31/12/05	9,323	9,221	22%	102	51
Deutsche Telekom	DE	31/12/05	901	7,016	19%	(6,115)	(4,688)
Diageo	UK	30/06/05	6,014	7,566	21%	(1,552)	(1,281)
E.ON	DE	31/12/05	8,097	17,712	29%	(9,615)	(9,519)
Eni	IT	31/12/05	359	1,410	2%	(1,051)	(896)
Ericsson	SE	31/12/05	1,784	2,371	6%	(587)	(1,224)
Fortis	NL	31/12/05	4,384	7,489	21%	(3,105)	(3,282)
France Telecom	FR	31/12/05	204	647	2%	(443)	(394)
GlaxoSmithKline	UK	31/12/05	12,158	14,696	12%	(2,538)	(2,124)
Groupe Société Générale	FR	31/12/05	1,924	2,484	6%	(560)	(339)
HBOS	UK	31/12/05	7,755	10,355	19%	(2,600)	(2,429)
HSBC Holdings	UK	31/12/05	20,029	23,348	15%	(3,319)	(4,070)
ING	NL	31/12/05	12,937	15,782	27%	(2,845)	(2,427)
Lloyds TSB Group	UK	31/12/05	20,357	25,138	63%	(4,781)	(4,556)
L'Oréal	FR	31/12/05	1,302	2,543	14%	(1,241)	(1,143)
Nestlé	CH	31/12/05	13,876	14,448	14%	(572)	(1,856)
Nokia	FI	31/12/05	1,276	1,385	2%	(109)	(54)
Novartis	CH	31/12/05	13,562	13,202	12%	360	868
Phillips	NL	31/12/05	20,830	21,134	65%	(304)	(882)
Rio Tinto	UK	31/12/05	4,292	4,563	11%	(271)	(330)
Roche	CH	31/12/05	6,968	9,374	11%	(2,406)	(1,970)
Royal Bank of Scotland Grp	UK	31/12/05	25,236	30,657	38%	(5,421)	(4,162)
Royal Dutch Shell	UK	31/12/05	45,924	46,787	27%	(863)	(2,164)
SAP	DE	31/12/05	270	299	1%	(29)	(10)
Siemens	DE	30/09/05	21,479	24,977	44%	(3,498)	(3,086)
Suez	FR	31/12/05	2,561	5,469	18%	(2,908)	(2,787)
Telecom Italia	IT	31/12/05	-	1,494	6%	(1,494)	(1,292)
Telefónica	ES	31/12/05	-	2,090	4%	(2,090)	(2,551)
Tesco	UK	26/02/05	3,945	5,012	15%	(1,067)	(954)
Total	FR	31/12/05	6,274	9,647	8%	(3,373)	(2,755)
UBS	CH	31/12/05	15,733	16,680	21%	(947)	(1,432)
Unilever*	NL	31/12/05	15,989	20,140	35%	(4,151)	(4,193)
Vodafone Group	UK	31/03/05	1,268	1,466	1%	(198)	(234)

This table shows the key disclosures made by the European companies in the Dow Jones STOXX 50SM blue chip index. The index consists of 50 stocks covering the market sector leaders in Europe. The source of the data is each company's annual report and accounts for the accounting period ending in 2005.

The market value of assets and surplus/(deficit) figures before tax relate to the worldwide position of each company. The figures have been converted to Euros where a company has reported figures in its accounts in a different currency.

View a full list of our services on our website – www.lcp.uk.com

Country	Code	Number	Market value of assets € m	Value of liabilities € m	Liabilities as % of market capitalisation	2005 Surplus/ (deficit) € m	2004 Surplus/ (deficit) € m
Finland	FI	1	1,276	1,385	2%	(109)	(54)
France	FR	8	18,992	36,352	10%	(17,360)	(15,278)
Germany	DE	8	93,720	129,805	36%	(36,085)	(34,636)
United Kingdom	UK	16	262,371	301,855	25%	(39,484)	(39,211)
Italy	IT	3	1,016	6,400	5%	(5,384)	(3,659)
Netherlands	NL	5	64,352	76,948	34%	(12,596)	(12,745)
Spain	ES	3	10,802	30,577	17%	(19,775)	(19,256)
Sweden	SE	1	1,784	2,371	6%	(587)	(1,224)
Switzerland	CH	5	61,761	66,873	15%	(5,112)	(5,560)
TOTAL		**50**	**516,074**	**652,566**	**21%**	**(136,492)**	**(131,623)**

Notes:
* Unilever includes Unilever NV and Unilever plc.

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock
Actuaries & Consultants

Notes

Notes

View a full list of our services on our website – www.lcp.uk.com

Lane Clark & Peacock

Actuaries & Consultants

Notes

Lane
Clark &
Peacock

Actuaries & Consultants

30 Old Burlington Street
London W1S 3NN
Tel: 020 7439 2266
Fax: 020 7439 0183

St Paul's House
St Paul's Hill
Winchester
Hampshire SO22 5AB
Tel: 01962 870060
Fax: 01962 849802

Alexander Forbes House
6 Bevis Marks, London
EC3A 7AF
Tel: 020 7439 2266
Fax: 020 7439 0183

* LCP DC Link Ltd
Churchgate
New Road, Peterborough
Tel: 01733 353600
Fax: 01733 353656

LCP Belgium
Marcel Thirylaan 200
Avenue Marcel Thiry 200
B – 1200 Brussel
Bruxelles, Belgium
Tel: +32 (0)2 774 94 93
Fax: +32 (0)2 774 92 57

LCP Libera AG
Stockerstrasse 34
Postfach
8022 Zurich
Switzerland
Tel: 41 (0)43 817 7300
Fax: 41 (0)43 817 7399

PO Box 12
Maison Allaire
Smith Street, St Peter Port
Guernsey GY1 4AG
Tel: 01481 711830
Fax: 01481 730455

* Union House
Union Street, St Helier
Jersey JE4 8UU
Tel: 01534 887600
Fax: 01534 702780

ACTUARIAL CONSULTANCY
OF THE YEAR

LCP is a limited liability partnership registered in England and Wales with registered number OC301436. LCP is a registered trademark in the UK (Regd. TM No 2315442) and in the EU (Regd. TM No 002935583).
All partners are members of Lane Clark & Peacock LLP.
A list of members' names is available for inspection at 30 Old Burlington Street W1S 3NN, the firm's principal place of business and registered office.
The firm is regulated by the Institute of Actuaries in respect of a range of investment business activities.
LCP is part of the Alexander Forbes group of companies, one of the top 10 international risk and financial services organisations, employing over 5,500 people in more than 30 countries.
Alexander Forbes is a public company listed on the JSE in South Africa.

A member of the Multinational Group of Actuaries & Consultants. www.mgac.org. Main offices in:

AFRICA AUSTRALIA EUROPE NORTH AND CENTRAL AMERICA

* No regulated business is carried out from these offices

07-06