



Actuaries & Consultants



Accounting For Pensions 2009

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1. Main findings

1.1 Deficits rise to record levels

- Lane Clark & Peacock LLP (“LCP”) estimates that under the accounting standard IAS19, the aggregate FTSE 100 UK pensions deficit stood at £96 billion at mid-July, the highest deficit ever recorded. This is despite the fact that the full extent of pension schemes’ financial difficulties is masked by recent levels of corporate bond yields.
- We estimate that this position was made up of £388 billion of liabilities offset by £292 billion of assets in FTSE 100 UK pension schemes.
- Since we published our report in August last year, the financial world has fundamentally changed. Following the collapse of Lehman Brothers on September 15th 2008, asset values fell sharply, leaving pension funds weakened financially.
- Paradoxically, for a short period in the immediate aftermath of the Lehman Brothers’ collapse, deficits reported on company balance sheets under IAS19 actually fell, as corporate bond yields rose. This highlights a fundamental shortcoming of the accounting standard.
- Further details and analysis can be found in section 2.2.

1.2 IAS19 under severe strain

- Before the credit crunch, credit spreads (ie the difference between yields on corporate and government bonds) had been stable for a number of years as had the relationship between pension liabilities measured by IAS19 and typical trustee funding measures. Consequently, if company accounts showed a worsening deficit under IAS19, this was a reliable warning that the trustee funding measure was likely to have deteriorated similarly, with potential implications for increased contributions after the next trustee funding valuation.
- In the current economic climate, however, IAS19 has become an unreliable indicator.
- Not only have the IAS19 numbers diverged from trustee funding numbers but the wide range of corporate bond yields means that there is no longer a reliable comparison of the pension numbers for two companies reporting at the same date.
- Some commentators have suggested that IAS19 should be amended so that discount rates are based on gilt yields at the balance sheet date. Such a change would help to address the issues described above but at the cost of potentially overstating the ultimate cost of providing pensions. At mid-July 2009, we estimate that such a change would potentially have added £125 billion to the deficit figure above.

- This may put further pressure on companies to close their defined benefit pension schemes. In any event, corporate bond yields have shown signs of returning to more “normal” levels in recent months. We therefore question whether there is any immediate need to amend the standard.
- Further details and analysis can be found in section 2.3.

1.3 Income statements may now have to weather the storm

- The International Accounting Standards Board (“IASB”) is expected to announce proposals that would move potentially volatile pension scheme gains and losses into the income statement for the first time.
- Where pension liabilities are material relative to the size of the company, this could have a significant effect on reported company profits. We calculate that, had these proposed changes applied for 2008, pre-tax profits for 48 FTSE 100 companies with December year-ends (ie post-Lehman Brothers’ insolvency) would be over 70% lower, at £13 billion rather than the £46 billion actually posted, with some individual company profits being wiped out under the new proposals.
- Further details and analysis can be found in section 4.

1.4 Dealing with pension risk

- FTSE 100 pension schemes were hit hard by post-Lehman Brothers’ markets – we estimate that the 48 companies reporting in December 2008 disclosed pension-related investment losses of £42 billion, whereas they had anticipated gains of £18 billion in their profit figures for 2008.
- However, companies that had previously taken measures to reduce pension risk were far better placed to deal with the financial turbulence toward the end of 2008. We found that 23 companies of the FTSE 100 disclosed, in their annual report, measures taken to reduce pension risk. Some steps taken include a substantial reduction in equity holdings, use of financial swaps and the purchase of annuities.
- Examples of companies that took such steps – and therefore protected themselves from the worst effects of falling equity values – include *Standard Life* (pension assets rose by 14% over 2008), *Rolls-Royce Group* (up by 8%), and *Friends Provident* (up by almost 3%).
- The disparity in pension performance between those that took steps to reduce risk and FTSE 100 companies generally raises the question of whether some companies are paying sufficient attention to their pension risks.
- Further details and analysis can be found in section 2.5.

1.5 Pension risk compared with other financial risks

- Our research found that 46 of the 90 FTSE 100 companies who have defined benefit arrangements referred to pensions as a principal or key risk to their business in their most recent annual report.
- However, only a few disclosed details of how they deal with pension risks moving forward. In particular, we found only 17 companies that disclosed a substantive policy for managing pension risk.
- This compares poorly with the comprehensive disclosure approach of FTSE 100 companies in relation to other financial risks such as changing interest rates on company debt, movements in foreign exchange rates and rising fuel prices.
- We see company policy on pension risk as a crucial disclosure issue where pension risks are material. It should be treated in the same way that companies treat other financial risks.
- Further details and analysis can be found in sections 2.6 and 2.7.

1.6 We are continuing to live longer

- On average, FTSE 100 companies have assumed their male pensioners will live for 0.7 years longer than they assumed last year. On top of this, FTSE 100 companies assume that members will gain an extra 1.7 years of life expectancy over the coming 20 years, compared to 1.3 years last year.
- As a result, we estimate that FTSE 100 companies have added £8 billion to their balance sheet liabilities. Increasing life expectancy is a risk that has been notoriously difficult to manage cost-effectively but solutions are now being developed.
- This year saw the first longevity hedge deal by a UK pension scheme, as *Babcock International* transferred longevity risk for pensioners to the capital markets. LCP expects a number of deals of this type from FTSE 100 companies in the coming months.
- Further details and analysis can be found in section 2.9.

1.7 Support for final salary eroded further

- Recent events have demonstrated that the potential volatility of defined benefit pension schemes poses significant threats to employers' ability to compete and thrive. Therefore, more companies are taking action to replace their defined benefit schemes with arrangements that they believe will be more sustainable.
- Only four FTSE 100 companies reported defined benefit schemes open to new UK employees in their 2008 reports. One of the four, *BP*, has since announced plans to close its scheme to new members. Others have announced measures to reduce or freeze benefits completely for existing members.

- With the Chancellor's 2009 Budget delivering proposals to reduce the tax relief available on pensions savings to high earners, pension provision will become much less attractive to senior executives than it is to their workforces. This decoupling of interests of management and employees is likely to provide more impetus to the shift away from providing defined benefit pensions.
- Further details and analysis can be found in section 2.4.

1.8 International schemes sponsored by FTSE 100 companies

- Overseas pension and other post-retirement liabilities are significant for many FTSE 100 companies.
- Local legislation, custom and practice are often different from the UK. For example, different rules on funding pension schemes in overseas territories mean that the funding levels are not directly comparable to those in the UK.
- Many companies adopt different assumptions for calculating their IAS19 liabilities overseas from those that they use in the UK. It is not always clear that such different treatment is justifiable.
- Risk mitigation is a key issue for FTSE 100 companies in respect of their overseas schemes as well as for their UK arrangements. A number of companies have made some disclosure of the measures that they have taken to manage pensions risks although, as for the UK, many others have made no disclosure.
- Some FTSE 100 companies face risks as a result of their participation in overseas multi-employer schemes. The level of contributions, particularly those due on withdrawal from the scheme, are often outside the control of the company.
- Post-retirement medical plans are not common in the UK but a number of FTSE 100 companies have liabilities overseas, particularly in the USA. FTSE 100 companies disclosed healthcare liabilities totalling £11 billion in their 2008 accounts.
- Further details can be found in section 6.

VIEWPOINT

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Lane Clark & Peacock LLP (“LCP”) estimates that under the accounting standard IAS19, the aggregate FTSE 100 UK pensions deficit stood at £96 billion at mid-July, the highest deficit ever recorded. This is despite the fact that the full extent of pension schemes’ financial difficulties is masked by the level of corporate bond yields.

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Bob Scott
Partner, LCP



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VIEWPOINT

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The disparity in pension performance between those that took steps to reduce risk and FTSE 100 companies generally raises the question of whether some companies are paying sufficient attention to their pension risks.

Jerome Melcer
Partner, LCP

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2. Summary of UK findings

2.1 Introduction – content overview

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

By analysing their pension disclosures we aim to measure the exposure that companies have to their pension obligations, particularly in the context of their market capitalisation, and we identify the steps that companies are taking to address their pensions issues.

FTSE 100 companies scrutinised

This report covers 90 of the FTSE 100 companies, analysing annual reports based on FTSE 100 constituents as at 31st December 2008. Ten companies were excluded as their reports did not show evidence of significant funded defined benefit pension schemes. A full list and summary details of the 90 companies' key pension disclosures are set out in appendix 1.

We have also included updated analysis of the 26 FTSE 100 companies who published accounts before 30th June 2009 for accounting years up to 31st March 2009.

All the UK companies analysed have reported under international accounting standards (IAS19 for pension costs) as required under EU regulations.

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

2.2 Pension scheme deficits

Balance sheets protected by high bond yields in spite of tumbling assets

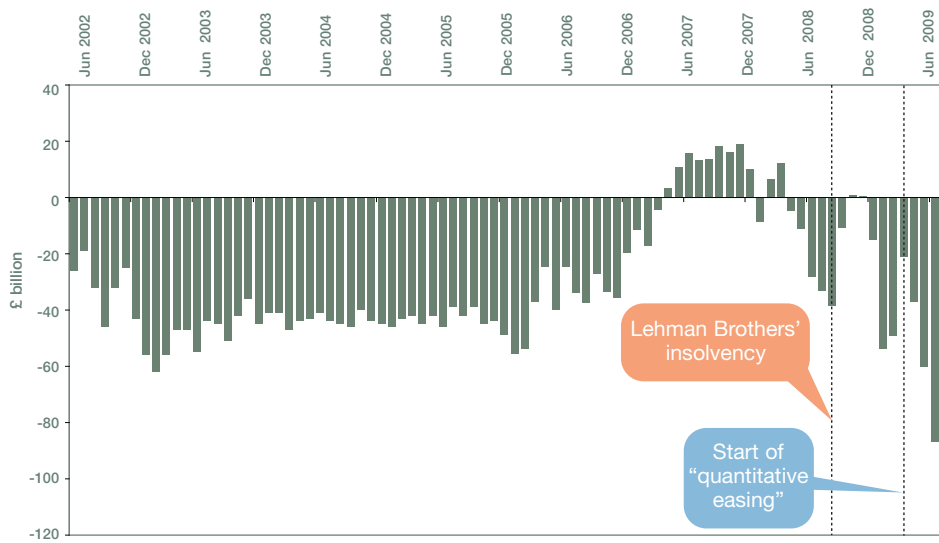
Financial markets and economies have fundamentally changed since last year. The collapse of Lehman Brothers in September 2008 sent shock waves across the financial markets, causing assets to tumble, banks to disclose huge losses and government bailouts to be announced. The effects of the credit crunch have been widespread, leaving virtually no part of any economy or market untouched. It is therefore no surprise that this has had a material impact on company pension schemes although the impact on the figures in the accounts is less marked than might have been expected.

Lane Clark & Peacock LLP ("LCP") estimates that under the accounting standard IAS19, the aggregate FTSE 100 UK pensions deficit stood at £96 billion at mid-July, the highest deficit ever recorded. This is despite the fact that the full extent of pension schemes' financial difficulties is masked by the level of corporate bond yields.

We estimate that this position was made up of £388 billion of liabilities, offset by £292 billion of assets in FTSE 100 UK pension schemes.

The chart below shows how the position has developed over the past seven years. Our figures exclude, where possible, the overseas pension schemes sponsored by FTSE 100 companies and any employee benefits other than pensions. The figures do include unfunded pension promises. We have included a separate analysis of overseas arrangements in section 6.

Estimated IAS19 position for UK schemes of FTSE 100 companies (£ billion)



For pension schemes of the FTSE 100, the short period following the Lehman Brothers' insolvency in September showed a sharp reduction in deficits. This was due to:

- Increased corporate bond yields, which cut the reported value of pension liabilities by £57 billion; and
- Lower inflation forecasts which reduced those liabilities by a further £34 billion.

These factors more than offset the falls in asset values, which wiped around £51 billion off FTSE 100 pension scheme assets.

Overall, despite the economic turmoil, company balance sheets initially benefited from the full post-Lehman Brothers' effect, returning briefly to overall surplus during October and November 2008.

The position then remained highly volatile throughout the first quarter of 2009.

Since then, in the wake of the government's programme of "quantitative easing", deficits have ballooned, driven by a combination of higher expectations for future inflation and narrowing credit spreads on corporate bonds, leading to an estimated deficit of £96 billion in mid-July – the highest ever recorded.

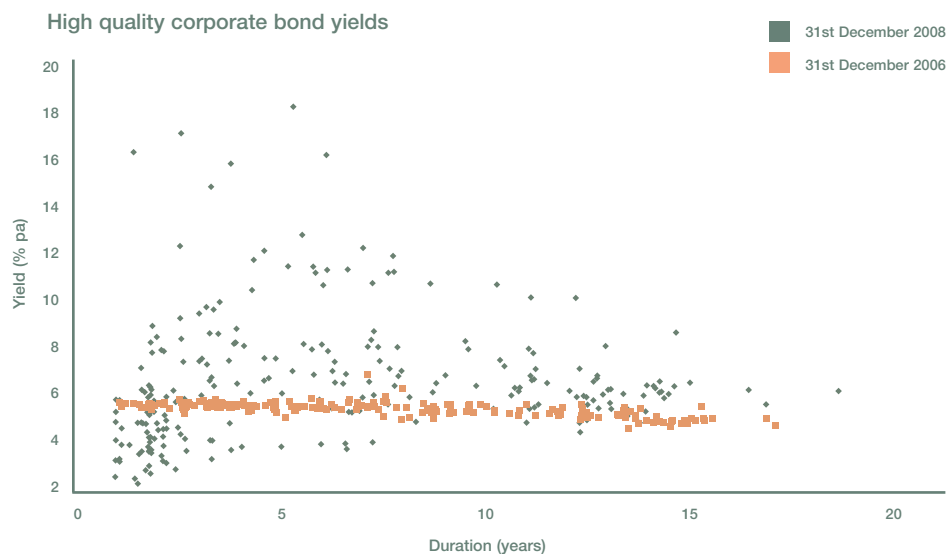
2.3 IAS19 under strain

The cracks in IAS19 that we reported were beginning to appear last year have become crevasses. We see the emergence of two major issues in relation to the standard, which are both linked to the use of discount rates based on yields on high quality corporate bonds, as required under IAS19 (the discount rate is a key assumption in placing a value today on future pension liabilities).

Numbers are no longer comparable

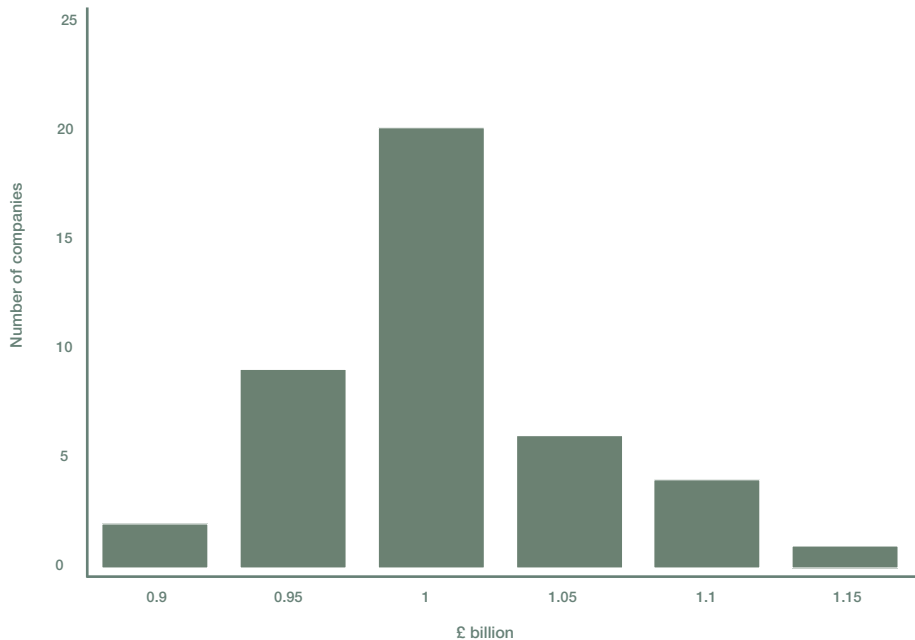
IAS19 now fails a key test of any accounting standard; it no longer allows users of accounts to make a meaningful comparison between the pension numbers of two companies, even those reporting as at the same date.

This is because whereas it was once the case that yields on high quality corporate bonds fell into a narrow range – thus forcing companies to use similar discount rates – the credit crunch has scattered corporate bond yields. The graph below illustrates this.



For companies reporting as at December 2008, the range of discount rates used was from 5.6% pa to 6.75% pa. To illustrate the impact of this wide range of discount rates, we estimated how each FTSE 100 company, reporting as at December 2008, would value the same pension liabilities, but using the actual discount rates they disclosed. The chart overleaf demonstrates how such a range of values confounds attempts by the reader to compare pension liabilities of FTSE 100 companies reporting as at December 2008.

Range of values placed on identical liabilities under IAS19



As can be seen, the range of results is extremely wide, with a 25% difference between the highest and lowest value. So, for a pension scheme with liabilities that on average would be valued at £1 billion, FTSE 100 companies reporting as at 31st December 2008 would have disclosed pension liabilities spread over a range spanning £900 million at the lower end and £1.15 billion at the top end.

Numbers no longer relate to cash funding measures

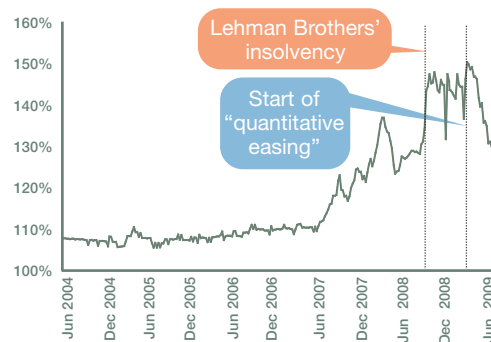
Before the credit crunch, credit spreads had been stable for a number of years as had the relationship between pension liabilities measured under IAS19 and typical trustee funding measures. Consequently, if company accounts showed a worsening deficit under IAS19, this was a reliable warning that the trustee funding measure is likely to have deteriorated similarly, with potential implications for increased contributions after the next trustee funding valuation.

In the current climate, IAS19 has diverged widely from typical funding targets used in the UK – to such an extent that the Pensions Regulator stated in June 2009 that IAS19 and FRS17 accounting numbers are no longer a reliable measure for funding purposes. This means that the information provided in company accounts bears even less relationship to the calculations that drive cash contributions and this, in turn, has led to confusion amongst users of accounts.

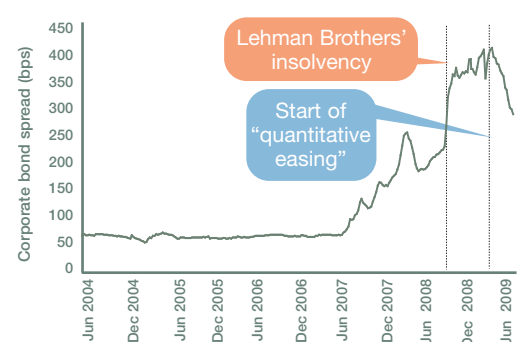
This is illustrated in the two charts below.

- The chart on the left shows a typical trustee funding target as a percentage of the IAS19 liability. The proportion was reasonably stable until mid-2007, but has increased since then.
- The chart on the right, which shows the credit spread on high-quality corporate bonds demonstrates that the credit crunch is the cause of this disruption.

Trustee funding liability as a proportion of IAS19 liability



Credit spread on high quality corporate bonds



Some commentators have suggested that IAS19 should be amended so that discount rates are based on gilt yields at the balance sheet date. Such a change would help to address the issues described above but at the cost of potentially overstating the ultimate cost of providing pensions. This may put further pressure on companies to close their defined benefit pension schemes.

In any event, the charts above show a recent decline in credit spreads and, should this trend continue, the disparity between IAS19 figures and trustee funding bases should reduce.

At present, the IASB is not due to address discount rates until after 2012, with its efforts presently focused on the treatment of gains and losses (see section 4).

2.4 Defined benefit scheme changes

Is the end in sight?

Over the last year, there has been a flurry of activity as more companies seek to close down their defined benefit pension schemes thereby preventing the build-up of further open-ended liabilities.

Within the FTSE 100, only *BP*, *Cadbury*, *Diageo*, and *Tesco* disclose in their 2008 reports having defined benefit schemes open to new UK employees, only one of which (*BP*'s) is based on final salary.

However, since publishing its report, *BP* has recently announced its intention to close its final salary scheme to new members, replacing it with what it refers to as a

BP
Cadbury
Diageo
Tesco

“flexible benefits” arrangement for new employees, but leaving existing members unaffected.

Meanwhile, others have taken more drastic action. *Barclays* and *Morrisons* have both announced plans to cease accrual of all final salary benefits to existing members, with *Barclays* proposing a “cash balance” alternative and *Morrisons* moving to a career average arrangement.

Some companies whose schemes were already closed to new members have adopted measures that restrict how benefits accrue, rather than freezing benefits completely. For example, *Legal & General Group* and *Marks & Spencer Group* announced proposals to cap pensionable salary increases to 2.5% pa and 1% pa respectively in a bid to reduce costs and risk.

It is only a matter of time before other companies emulate the sorts of actions taken by these large companies.

We look in more detail at different types of pension arrangements and the corresponding risks borne by the company and employees in section 3.

2.5 Investment risk

Changes to future benefits may have cut the cost of providing pensions to employees, but companies are still exposed to a variety of risks through pension liabilities previously built up, and the assets held to meet them.

The fallout from the Lehman Brothers’ collapse has highlighted the scale of those risks. The 48 FTSE 100 companies reporting full-year results as at 31st December 2008 disclosed losses amounting to £42 billion on their pension assets over the year, or 16.3% of assets held at the start of the financial year.

These are not merely paper losses. A large pension deficit on the company balance sheet can affect capital raising and complicate corporate transactions. Larger funding deficits will lead pension trustees to put pressure on companies to allocate more of their free cashflow to bring down those deficits, rather than paying dividends or investing in the business. For example, following losses of £6.8 billion on pension assets over the year to 31st March 2009, *BT Group* announced that deficit funding would increase to £525 million per year, equivalent to more than 50% of forecast free cashflow.

Some companies have disclosed the steps taken to reduce pension-related investment risks. We found that 23 companies of the FTSE 100 disclosed such measures in their most recent annual report, including a substantial reduction in equity holdings, use of financial swaps and the purchase of annuities.

However, companies are not presently required to disclose full details of pension assets nor whether risk reduction measures, such as financial swaps, are in place. This means that it is difficult to assess how exposed a company may be to adverse conditions. Unfortunately, the situation will remain unclear until companies are required to disclose greater detail on pension assets – we note that such changes have been proposed by standard-setters and are encouraged on a voluntary basis.

Barclays
Morrisons

Legal & General
Group
Marks & Spencer
Group

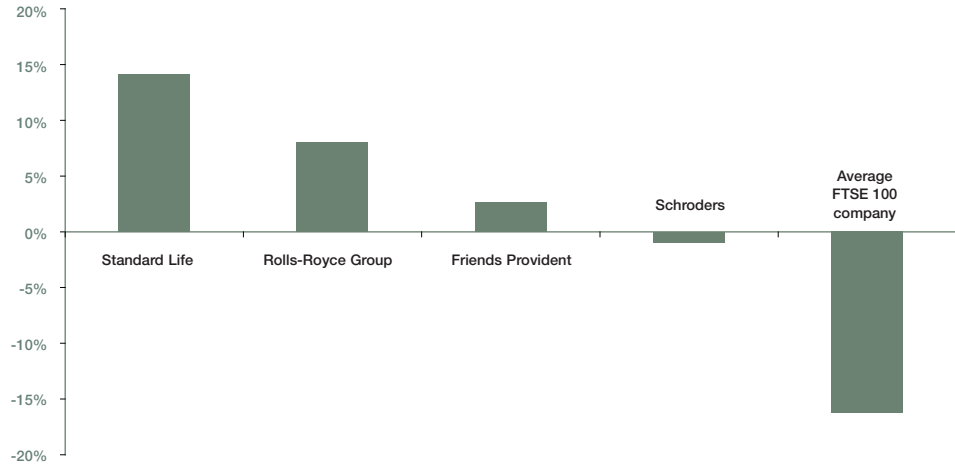
BT Group

Standard Life
 Rolls-Royce Group
 Friends Provident
 Schroders

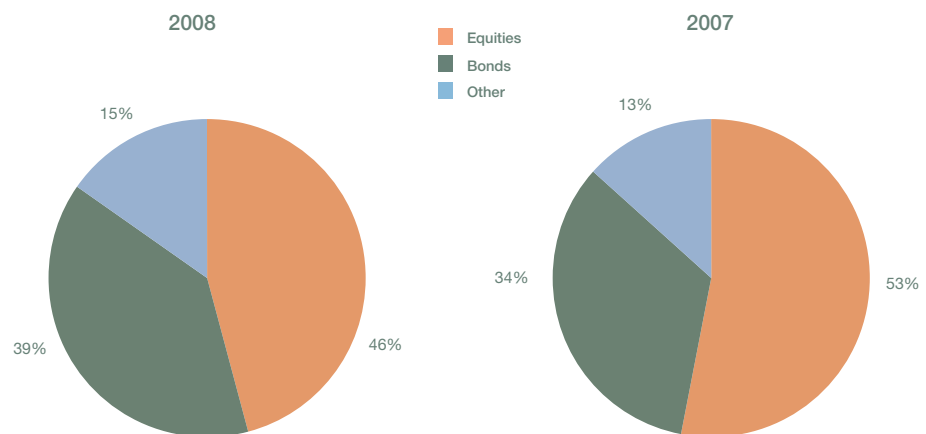
UK FINDINGS

Where action had previously been taken to manage these risks, companies were far better protected against the financial storm in late 2008 and early 2009. The chart below shows how measures taken protected balance sheets for some companies in those difficult conditions.

Performance of pension assets over year to 31st December 2008 (%)



Looking at information disclosed in company reports, there is a continued downward trend in the proportions held in equities by the schemes of FTSE 100 companies, reducing from 53% in 2007 to 46% in 2008. The charts below compare asset allocations as revealed by FTSE 100 companies in their 2007 and 2008 reports.



The fall over the year is likely to be attributable mainly to the relative weakness in equity markets, rather than widespread selling of equity holdings in order to reduce pension risks.

Although companies disclosed 15% of their assets, on average, as “other” (ie not equities or bonds) they do not generally provide sufficient information for a more detailed breakdown into alternative asset classes.

Those companies that have not put in place measures to reduce pension risk may nevertheless have assessed those risks and concluded that they are manageable in the context of the overall business. Other companies may be in the process of taking steps to de-risk, in conjunction with the scheme trustees. However, de-risking can be expensive as companies lock in to lower expected returns. The price of stability is to increase expected contributions.

2.6 Pension risk compared with other financial risks

Pensions aside, companies face a variety of other large and volatile financial risks, some with the potential for causing substantial harm to corporate financial health. These risks include adverse movements in interest rates (which can increase the cost of corporate debt), exchange rates (which can reduce the value of revenues or assets denominated in foreign currencies), and commodity and fuel prices (which drive operating and manufacturing costs).

There are strict disclosure requirements governing financial risk and, as a result, FTSE 100 companies set out details of their policies for managing these. The following excerpt from the report of a FTSE 100 company is a typical introduction to such a disclosure:

“The Group’s policies for risk management are established to identify the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. These policies, and the systems used to monitor activities, are reviewed regularly.”

FTSE 100 companies also take action to mitigate financial risks that are seen as excessive. For example, travel companies use financial instruments to hedge against adverse movements in fuel prices, and mining companies do the same for risks arising from changing commodity prices.

Overall, when it comes to financial risks other than pensions, FTSE 100 companies provide shareholders with comfort that they have a policy in place for dealing with these risks moving forward.

Pensions is a key risk for many FTSE 100 companies - of the 90 FTSE 100 companies with significant defined benefit pension liabilities, 46 named pensions in their annual report as either a “principal risk and uncertainty” or a key financial risk. Whilst disclosure requirements do not at present require companies to set out their policy for managing pension risk moving forward, we would expect this to be a concern for shareholders of such companies where pensions is identified as a key risk.

We reviewed FTSE 100 reports for references to a company policy on this issue, either as part of a company’s overall financial risk management process, or through a separate statement on pension risk.

We concluded that for many FTSE 100 companies, and non-financial companies in particular, there was little or no disclosure on company policy for managing pension risk moving forward.

AstraZeneca
Diageo

Barclays
HBOS
Lloyds TSB
Group
Royal Bank Of
Scotland Group

Aviva
Barclays
Lloyds TSB
Group

Out of 90 FTSE 100 companies with pension liabilities, only 17 disclosed what we saw as a substantive company policy for managing pension risk. Of those, the majority were financial companies.

The superior disclosure performance by financial companies is not surprising, given that banks and insurers are required to address pension risk specifically as part of their modelling of regulatory capital requirements.

Examples of non-financial companies that disclosed a substantive policy were:

- *AstraZeneca*, who set out group-wide “Financing Principles”, which it applies in funding its pension arrangements; and
- *Diageo*, who state “*The group’s objective for the investment strategy is to achieve a target rate of return in excess of the return on the liabilities, while taking an acceptable amount of investment risk relative to the liabilities*”. The statement then sets out in detail how *Diageo* intend to achieve this objective.

We noted a number of companies disclosing actions to mitigate their pension risk, such as paying contributions or reviewing fund performance, but they did not articulate a clear statement as to how this risk will be managed going forward.

For non-financial companies, the relative lack of disclosure is a concern and, in particular, for those FTSE 100 companies most affected by their pension liabilities. Out of the ten companies most affected by pensions (when ranked by IAS19 pension liabilities as a proportion of market capitalisation) the only companies that disclosed a policy for managing pension risk were financial companies. These were *Barclays*, *HBOS*, *Lloyds TSB Group* and *Royal Bank Of Scotland Group*.

In a post-Lehman Brothers world, where investors are more keenly aware of the implications of unmanaged financial risk, this seeming lack of meaningful disclosure on the management of pension risk is a potential concern for shareholders and other users of company reports.

2.7 Connecting up all the risks

The separate treatment of pension risk, compared to other financial risks, can lead to unexpected consequences, for example:

- Some companies whose pension schemes invest heavily in equities, state that their exposure to equity price risk is not material.
- Some companies do not disclose a link between pension risks and other financial risks. For example, utility companies benefit from high inflation on the operating side (as this can drive up customer revenue) but may then lose out through higher pension liabilities.

One solution would be for companies to set out a “joined-up” risk disclosure, covering both financial and pension risks together. We note that some financial companies already take this approach in their risk disclosures (for example *Aviva*, *Barclays* and *Lloyds TSB Group*). In this respect, financial companies again seem to

be leading the way in connecting up these risks – we have seen evidence of this in the work that we have done with many on modelling regulatory capital.

2.8 Scheme contributions

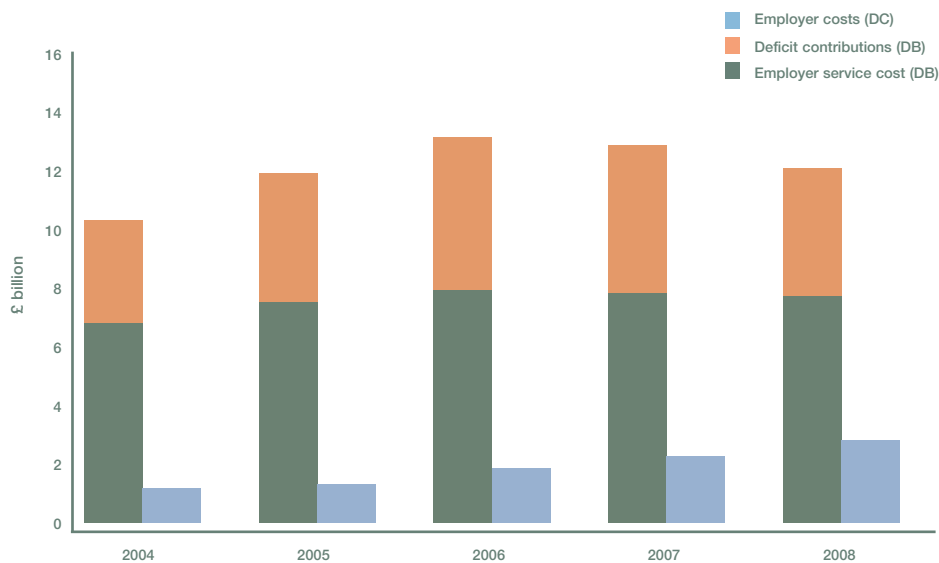
Payments to defined benefit scheme ease slightly

FTSE 100 companies paid £12.3 billion to their defined benefit pension schemes for accounting periods ending in 2008. This is slightly down from the £12.9 billion paid into schemes by the same companies for the previous year.

The largest reported contribution was by *British Airways* at £944 million, up by more than £400 million on contributions paid over the previous year. The top six contributions are shown in appendix 2.

For accounting periods ending in 2008, payments to defined contribution pension arrangements have increased by nearly 30% to £2.8 billion compared to the previous year.

The chart below shows how company payments to defined contribution pension arrangements have more than doubled over the last five years, and how contributions to defined benefit schemes have eased slightly from their peak in 2006.



With many companies considering the closure of their defined benefit schemes to existing members, the employer’s “service cost” is likely to reduce in future; and, in due course, payments to defined contribution pension arrangements will overtake those to defined benefit schemes.

The overriding feature yet to appear is the impact that difficult market conditions will have on deficit funding as trustees now put pressure on companies to make good new shortfalls.

Further discussion on how contributions interact with other company cashflows can be found in section 3.

British Energy
Group

Babcock
International

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2.9 Life expectancy

Longevity becomes key?

Companies have again re-visited and increased life expectancies they assume for pension scheme members. On average, FTSE 100 companies have in 2008 increased expected longevity by 0.7 years for their current UK pensioners, with assumed life expectancy for males, from 60, now reaching 26.1 years on average (2007: 25.4 years). We estimate this increase has added an extra £5 billion of liabilities to company balance sheets.

Companies have also made greater allowance for future improvements in life expectancy, with companies assuming the average male reaching age 60 in 20 years' time will then live 1.7 years longer than a 60 year old today (2007: 1.3 years), adding a further £3 billion to liabilities since 2007.

Individually, some companies hiked their assumptions considerably, with *British Energy Group* adding over three years to the life expectancy for a male currently aged 65, and over five years to the expected improvements over the next two decades compared to 2007.

Some companies have disclosed that they revised their mortality assumption in the light of findings from a formal trustee-driven scheme funding valuation. With the Pensions Regulator highlighting the importance of the allowance for mortality, we may see more companies revising their assumptions in the coming months, as they complete their scheme funding valuations.

The seemingly eternal upward trend is making companies consider their longevity risk more carefully, and look for ways to reduce it. At the same time, banks and insurance companies have been looking for ways to diversify their risk and design innovative products to bring to market. As a result, 2009 has seen the first longevity swap deal for a pension scheme, with *Babcock International* hedging its current pensioner mortality risk in a deal with Credit Suisse.

2.10 Looking ahead

What does the future hold?

Given the recent financial turmoil, the future economic climate is more uncertain than ever. Companies are finding themselves in a rapidly changing financial environment, and consequently the accounting position of their retirement obligations, in say a year's time, may look very different from the current position.

Set out overleaf are three possible economic scenarios that may be borne out over the next year as the UK attempts to recover from recession, together with possible effects on the FTSE 100 pension position over the same period.

Economic scenario	Estimated IAS19 deficit in July 2010
 Optimistic Recovery to normal conditions by late 2009	£20 billion
 Middle of the road Economies will struggle throughout 2009 More bank regulation and lending control “Quantitative easing” Continued deleveraging by banks, households and companies Unprecedented government bond issuance leading to: <ul style="list-style-type: none"> • fiscal tightening • inflationary pressures • competitive currency devaluations 	£50 billion
 Gloomy Serious economic deterioration Bank initiatives fail Debt and fiscal burden Echoes of 1990’s Japan	£100 billion

Although some commentators may expect equities to “bounce back” from their current lows, this is by no means certain and, coupled with other uncertainty about future inflation and gilt yields, the position we may see in twelve months’ time is very unclear.

UK pension liabilities are generally linked to inflation, but capped at a maximum of 5% pa. It is interesting to note that should the UK see very high long-term inflation (above 5% pa), members’ benefits would fall in real terms, which is likely to improve the accounting position. For example, were long-term inflation to rise to 7% pa pension deficits might be better than that under the “middle of the road” scenario above, even with the relatively weak equity markets that one might expect in those circumstances.

*Morrisons**Tesco**Barclays**British Sky
Broadcasting
Group**Tullow Oil*

3. Developments in UK pension provision

Alternatives to final salary

As discussed in section 2.4, more and more companies are turning their backs on final salary schemes. Some are looking to other forms of defined benefit to provide employees in retirement, where risk is shared between employee and employer. Many companies, particularly those outside the FTSE 100, are looking to cut their losses altogether and move straight to defined contribution pension arrangements, leaving employees to deal with the significant investment and mortality risks that employers used to bear.

With defined contribution pension arrangements now becoming the rule rather than the exception, defined benefit pension provision is no longer a HR vehicle for attracting and retaining staff, rather an onerous legacy for the companies that once offered it.

Different schemes and different risks

As reported in section 2.4, companies are offering various types of arrangement that provide employees an income on retirement. We have set out below details of the main types of arrangement together with how risks are shared between employer and employee.

Type	What is it?	Examples of FTSE 100 companies that offer this to new employees
Final salary	Benefits build up each year as a fixed proportion of salary on retirement (eg 1/60th). All risk remains with employer, unless the employer fails.	<i>None disclosed</i>
Career average	Similar to final salary, but based on average salary over an entire working lifetime. Earlier years' earnings are usually revalued in line with inflation. Earnings growth risk is largely removed, but all other risks remain with the employer, unless the employer fails.	<i>Morrisons Tesco</i>
Cash Balance	Fixed percentage of salary (eg 20%) is paid by the company into a pot. It attracts guaranteed investment returns until retirement, when the sum is used to purchase an annuity from the open market. Longevity risk and most interest rate and inflation risks are passed to member. Employer retains investment risk.	<i>Barclays</i>
Defined contribution	Company pays a fixed percentage of salary each year (eg 10%) into a pot which accumulates investment returns until retirement. The sum at retirement is then used to buy an annuity from the open market. All risks are passed to members.	<i>Most of the FTSE 100, for example: British Sky Broadcasting Group Tullow Oil</i>

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Employees take on more risk

As companies move away from final salary arrangements, employees must bear a greater burden of risk. However, it should be noted that risk can be accompanied by reward, with defined contribution pension arrangements offering the prospect for certain employees reaping the benefit of favourable experience to increase their benefits post retirement.

With defined contribution pension arrangements still in their relative infancy, we will have to wait several years before generations of the population begin to retire from these arrangements. Only then will we fully understand whether experience and the level of retirement savings have been sufficient to meet the expectations of today's workforce. However, many commentators have expressed concern that current payments to defined contribution pension arrangements may be inadequate to provide post-retirement benefits at a similar level to the average benefit provided by defined benefit schemes.

Trustees and companies de-risk further

Not only are companies looking to provide less risky future benefits to employees, but they are also looking to work with trustees of their schemes to reduce the risk in providing benefits already granted to members.

September 2008 saw the first £1 billion buy-in, with Prudential taking on the responsibility for benefits payable to current pensioners by the Trustee of the *Cable & Wireless* Superannuation Fund.

However, the Lehman Brothers' crisis in the same month has meant that bulk annuity markets have seen a considerable reduction in buyout and buy-in activity since then, as a result of:

- insurers adopting more conservative pricing bases, pushing up premiums;
- illiquid investment markets, impeding asset transfers; and
- the erosion of confidence in financial institutions.

Nevertheless, we expect that buyout and related activity will pick up over the next few months as confidence begins to return to financial markets.

In particular, in July 2009, *RSA Insurance Group* announced the biggest pension risk transfer arrangement by a UK pension scheme to date, with the group passing to Goldman Sachs all risks relating to £1.9 billion of its pensioner liabilities. The deal employed an innovative structure that allowed the *RSA Insurance Group* schemes to keep control of the assets, thus providing additional security against the risk of provider default.

The introduction of longevity protection products, such as swaps, has made it possible to hedge against the risk of the rising cost of members living longer. Together with interest rate and inflation hedging instruments, companies and trustees can now pick off pension risks one by one when the price is right – in effect allowing them to operate like insurance companies – and carry out a “DIY buyout”.

Cable & Wireless

RSA Insurance Group

*Babcock
International*

This year saw the first longevity hedge deal by a UK pension scheme, as *Babcock International* transferred longevity risk for pensioners to the capital markets. LCP expects a number of deals of this type as this new market evolves and matures. Deals will be limited mainly to larger schemes, which are best placed to manage the complexities of these new instruments for risk transfer.

Contingent assets prove popular

With company cashflows under severe pressure, there is growing tension between trustees' requirements for contributions to meet ever increasing deficits, shareholders' demands for dividends and companies' needs for capital expenditure. The question of how to allocate available funds is proving increasingly difficult. This is particularly the case for the large number of companies undertaking scheme funding valuations with effective dates during the first quarter of 2009, at what may well prove to be the point of maximum disruption by financial markets. Of the 61 FTSE 100 companies that disclose the date of the next UK scheme funding valuation, 27 face a valuation that falls within that quarter.

The Pensions Regulator has released guidance over the past nine months that has attempted to help trustees and companies address funding valuations in the current economic downturn. The Regulator is concerned that pension scheme trustees may be disadvantaged compared with shareholders. For instance, it is keen to ensure that the extent of pension schemes' financial difficulties is not masked by using less prudent funding assumptions. However it has conceded that, if cashflow is tight, pension contributions can be back-end loaded to enable companies to maintain the cashflow needed to ensure they are able to continue to trade.

Another way of mitigating company cash costs now, whilst offering trustees the prospect of more support in the future, is to link the amount of future contributions to a company's financial performance. From the trustees' perspective, this shares some similarities with a "debt for equity" swap, a type of arrangement frequently used in the banking world.

We have also seen further evidence that contingent assets are becoming a popular way of giving trustees greater security from sponsors without the need for tying company cash irrevocably to pensions. We have seen the number of companies disclosing that they are making use of such assets increase by two thirds since last year.

3i Group, British Airways, Experian, Scottish & Southern Energy, SABMiller, Smith & Nephew and *Standard Life* all disclosed that significant company guarantees were in place for some or all of their defined benefit schemes.

AstraZeneca, Diageo, National Grid, Smiths Group and *Xstrata* all reported that some or all of their schemes had either escrow accounts or letters of credit in place to provide additional security to members of their schemes. *Cable & Wireless* operate an arrangement that provides support to its scheme on specific trigger events linked to company financial performance. *Whitbread* disclosed that the company had given undertakings to the trustees of its scheme that are similar to some of the banking covenants it has in place.

3i Group

British Airways

Experian

*Scottish & Southern
Energy*

SABMiller

Smith & Nephew

Standard Life

AstraZeneca

Diageo

National Grid

Smiths Group

Xstrata

Cable & Wireless

Whitbread

However, there are now signs that some companies, having previously pledged assets to their pension schemes, are looking to loosen those arrangements, to provide support for the business. For example, earlier this year, *Marks & Spencer Group* announced a change to its contingent asset arrangement whereby property income, which is presently being paid to its pension scheme, would instead be deferred if dividends to shareholders are not being paid. In July 2009, *British Airways* announced that it had reached agreement with the pension trustees for present financial guarantees to be released subject to a suitable alternative form of security.

Budget discourages executive support of pensions

Earlier this year Alistair Darling, Chancellor of the Exchequer, delivered his second Budget, revealing plans to reduce the tax relief available on retirement saving to high earners from April 2011. Covering not only employee and employer pension contributions to money purchase arrangements but also accrual of final salary benefits, all individuals with total income of £150,000 pa or more will be affected.

It is the Government's intention that those with income (ie not just earnings) over this threshold will experience a progressive reduction in tax relief enjoyed on pension savings, such that those earning more than £180,000 pa will receive relief at only the basic rate of tax (currently 20%).

The Government is expected to consult on this over the summer, when further details of how these changes will be implemented is expected to become clearer.

Effectively, many executives will have no material tax incentive to make long-term saving. As such, these changes can only result in company executives becoming much less interested in their own pension provision. As a result, the corporate view of company pension provision may also change, prejudicing yet further the future of defined benefit pension schemes (or indeed any quality pension scheme).

2012 auto-enrolment

Companies must now also face the financial headache of Government pension reforms that are expected to come into effect in 2012. These reforms will require the automatic enrolment of all employees aged between 22 and State Pension Age to a minimum standard pension arrangement. Broadly speaking, employers will be required to auto-enrol their employees into either a defined benefit scheme of sufficient quality or to a defined contribution pension arrangement with a minimum employer contribution rate of 3% of pay within a stated range for every individual on their payroll.

The Department for Work and Pensions has calculated the additional cost to UK companies of the minimum employer contributions to be around £2.5 billion pa. However, the cost for employers does not stop there as these measures will incur additional set-up costs, estimated to amount to £350 million, and further ongoing costs of around £100 million pa.

With changes needed to be implemented within the next three-year planning cycle, employers need urgently to evaluate whether their existing pension schemes meet the quality requirements and the impact on their payroll costs of auto-enrolment.

Marks & Spencer Group

British Airways

Many employers may cut back existing provision to mitigate cost increases from increased pensions take-up rates. The overall effect is likely to spread corporate budgets even more thinly, potentially reducing existing provision and perhaps having a knock-on effect on workers' pay.

There remains considerable political risk associated with auto-enrolment. With an election due within the next nine months, opposition politicians have stated that they are yet to be convinced by details of the current government's proposed system. In particular, there is concern over the complexity of the proposed arrangements.

This uncertainty inevitably means that planning for these changes is difficult.

4. Accounting standards for pensions

Income statements vulnerable

The IASB is now expected to take forward its earlier proposals to change the way companies account for pensions in financial reporting.

Their proposals were twofold:

- to reform the way in which potentially volatile movements in pension assets and liabilities (the so-called “actuarial gains and losses”) are reflected in financial statements; and
- to eliminate the corridor mechanism used by some companies to smooth out the pension amounts recognised on the balance sheet (it is still in use by nine FTSE 100 companies).

This is a major change in how pensions are reflected in company accounts, with ramifications for the reporting of company profits.

What are actuarial gains and losses?

From year to year, pension assets and liabilities chart an unpredictable course. To allow a smoother stream of reported profits, companies have until now been allowed to include in the calculation of profit and loss their predictions of how pension assets and liabilities will move through the year. The differences between a) what companies predict and b) what actually happens are termed “actuarial gains and losses”. For assets, this will be the extent to which assets outperform or underperform predictions (which can be large, especially where a scheme is heavily invested in equities). For liabilities this is mainly the impact of changes in assumptions – eg discount rate or longevity.

Accounting impact

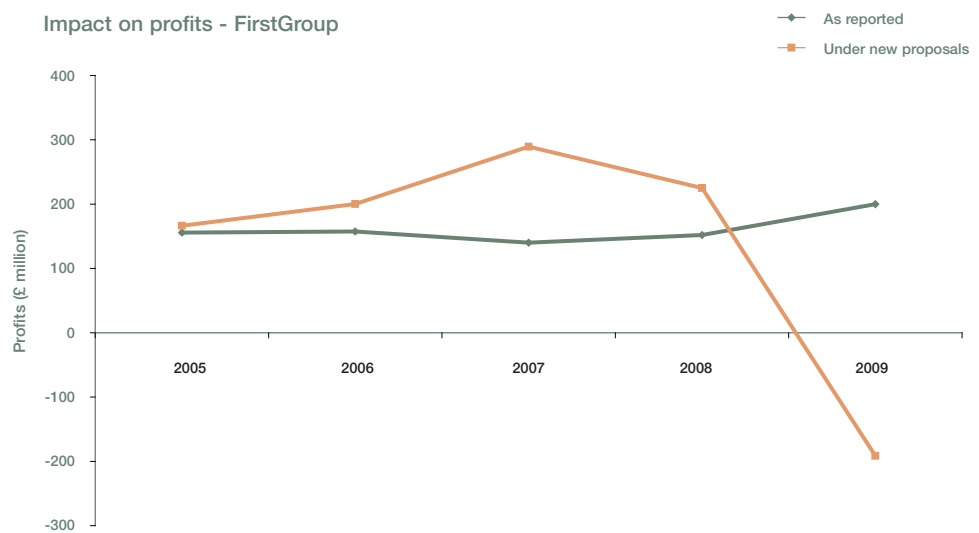
We estimate that had the IASB’s proposals been adopted for 2008, the combined reported pre-tax profits of £46 billion for the 48 FTSE 100 companies with year-ends in December would have been slashed by over 70% to £13 billion.

We have also looked at pre-tax profits for the last five years for two FTSE 100 companies with substantial pension schemes: *BT Group* and *FirstGroup*. We then considered the impact on profits for those years had the IASB’s present proposals been in force over that period with actuarial gains and losses recognised immediately in profit and loss. Our findings are set out in the charts overleaf.

Impact on profits - BT Group



Impact on profits - FirstGroup



As can be seen, the proposed change would have had an unpredictable effect on reported numbers.

Such a change in practice will require the readers of accounts to have a deeper understanding of how the pension scheme affects company profits. Readers of accounts will need to attempt to strip out the effect of pensions on profits before forming conclusions on the performance of the company's core business. As a result, we expect little known measures, such as "EBITDAP" (earnings before interest, tax, depreciation, amortisation and pensions), to gain wider recognition.

Recognition of actuarial gains and losses directly in profit and loss will undoubtedly prove unpopular with finance directors, and we expect such profit vulnerability would focus companies' minds on improving the risk management of their pension schemes.

IFRIC14

This year has seen a variety of treatments of IFRIC 14, which is the guidance released by the IASB setting out how companies' actual commitments to fund pension schemes could affect what they disclose on their company balance sheet.

We note that where companies have mentioned IFRIC 14, they say either:

- they are affected by IFRIC 14;
- they are accounting under IFRIC 14 but they are not affected; or
- they are not yet accounting under IFRIC 14 (the guidance only applies to accounting periods starting on or after 1st January 2008).

Whether or not a company can show a pension surplus on its balance sheet hinges mainly on whether the scheme's rules would allow the company to benefit economically from any emerging surplus. Effectively this requires the rules to contain provisions for an unconditional refund of surplus back to the employer at some point in the future.

Companies now have to scour their scheme rules in search of such provisions which effectively dictate whether potentially large sums can or cannot be recognised on their balance sheet. With 2009 being the first time in which all companies must consider IFRIC 14, we expect more companies to disclose its effects over the next year.

5. Analysis of FTSE 100 IAS19 disclosures

We have analysed 90 FTSE 100 companies reporting in 2008. Ten companies were excluded as there was no evidence in their reports of significant funded defined benefit pension schemes. A full listing can be found in appendix 1.

We have concentrated on the financial position of the defined benefit schemes in which the companies' employees participate. Some companies offer post-retirement healthcare, which we have excluded from our analysis where possible, as this report focuses on pension provision. Overseas pension arrangements have been included, except where otherwise indicated.

The disclosures

The average pension note runs to over four pages, with most companies also having several paragraphs of pension commentary in the main body of their reports. Once again, the longest disclosure was by *Friends Provident*, which has 14 pages of its report dedicated to pensions.

For many FTSE 100 companies, pensions are financially significant and the volume of information disclosed in the accounts reflects this. However, for those companies whose pension arrangements are not so material, the minimum disclosure requirements under IAS19 can be quite onerous.

5.1 Analysis of results

Funding levels

IAS19 takes a snapshot of the accounting 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.

This year the number of companies reporting that they have at least enough assets to meet their accounting liabilities in their 2008 accounts remained stable compared to their 2007 accounts. 28 companies out of the 90 FTSE 100 companies disclosed assets equal to or in excess of their accounting liabilities, the same number as last year.

A full list of the disclosed accounting surpluses and deficits of the FTSE 100 companies is set out in appendix 1.

Cable & Wireless disclosed the highest IAS19 funding level over 2008 of 120%, as at 31st March 2008, and more than half of the 90 companies reported being more than 90% funded on an accounting basis.

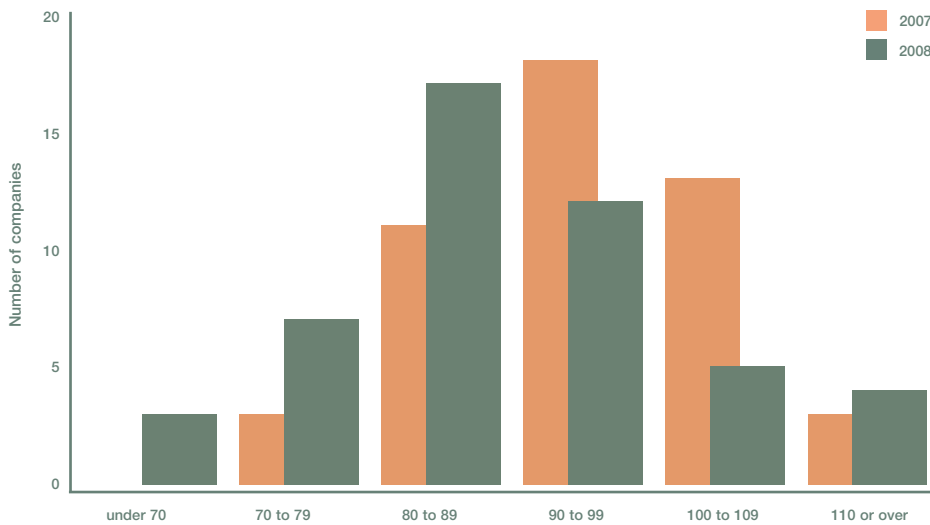
Changes over 2008

The chart below shows how worldwide funding levels have changed over the year for the 48 FTSE 100 companies in our report that have December 2008 year-ends.

Friends Provident

Cable & Wireless

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



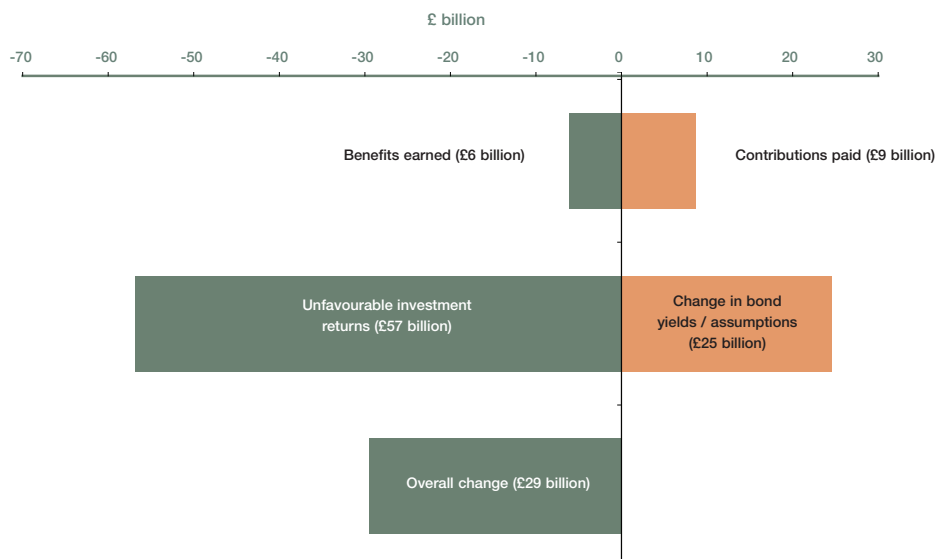
The median reported IAS19 funding level for companies with December year-ends decreased by 7% from 97% in 2007 to 90% in 2008.

However, the story is different for companies with other accounting dates. The 31 companies reporting in the first quarter of 2008 disclosed on average an improvement of around 6% in their IAS19 funding compared to their 2007 disclosures.

Sources of deficits and surpluses

For the 48 companies with December year-ends, worldwide deficits increased by £29 billion in absolute terms over 2008. Negative investment returns (£42 billion) and interest charges (£15 billion) have been partly offset by the reduced IAS19 values placed on the projected benefits (£25 billion). Aggregate contributions paid (£9 billion) have exceeded the IAS19 cost of extra benefits earned by employees (£6 billion). The overall effect is a net increase in deficits of £29 billion.

IAS19 sources of deficits and surpluses for companies with December year-ends only (£ billion)



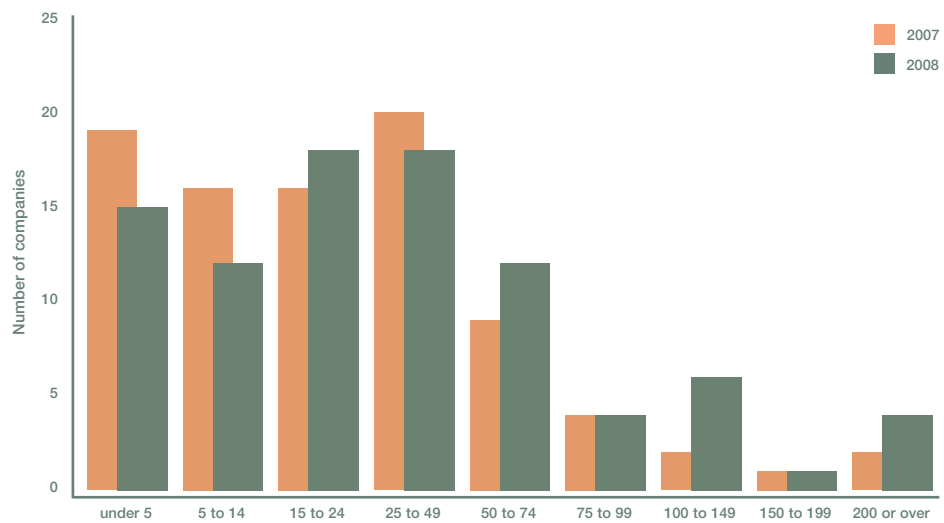
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Pension scheme risk for companies

Whilst corporate bond yields used to discount pension scheme liabilities have continued to be high, thus reducing the value placed on company accounting liabilities, the fall in equity markets, and hence the value of companies, means pension scheme liabilities represent a larger proportion of company market capitalisations.

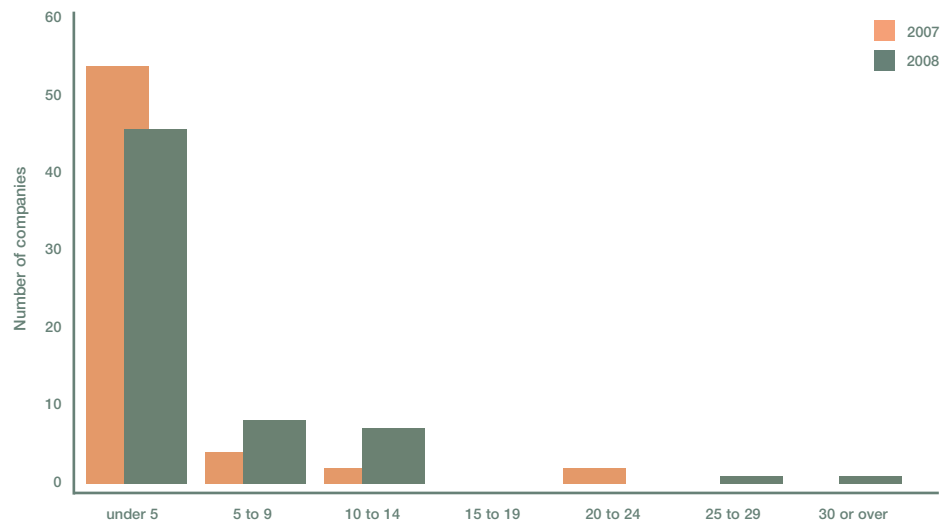
The chart below shows the size of accounting liabilities relative to a companies' market capitalisations. For some companies, the size of the pension scheme dwarfs the value of the company itself.

Accounting liabilities as a proportion of market capitalisation (%)



Comparing the size of pension scheme deficits to market capitalisation tells a similar story. Deficits represent a greater proportion of company market capitalisations compared to previous years, with *BAE Systems*¹ deficit representing 31% of the company's market capitalisation compared to 11% at its accounting date last year.

Accounting deficits as a proportion of market capitalisation (%)



¹BAE Systems allocated £891 million of its 2008 deficit (£450 million in 2007) to equity accounted investments and other participating employers.

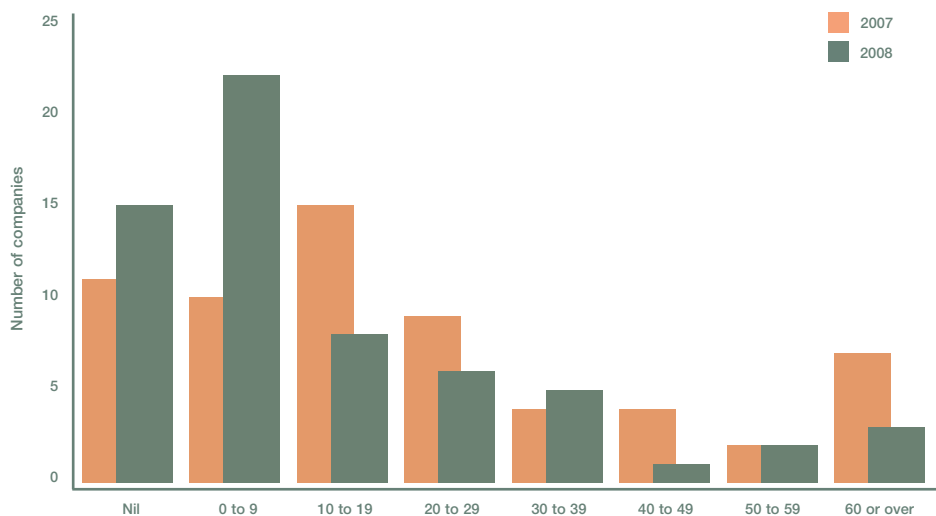
What have companies done to tackle their deficits?

Despite the global recession, companies continue to pay high levels of contributions, though not quite at the levels paid in recent years. This may reflect companies being tied into existing recovery plans agreed as part of scheme funding valuations. Most companies pay contributions at a rate greater than the IAS19 value of benefits earned over the year, which if IAS19 assumptions were borne out in reality would reduce the IAS19 deficit.

However, 19 companies paid lower contributions than the value of the IAS19 liabilities earned over the year. *HBOS* paid lower contributions than the total value of the benefits earned by employees but still managed to reduce its deficit by around £800 million largely through the change in financial assumptions used to value IAS19 liabilities.

The chart below shows the “excess” contributions that companies paid during the year (ie contributions over and above the 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 (%)



Despite reduced cashflow in the general economy, companies have continued to pay off a considerable proportion of their deficits over the year. The highest proportion of deficit paid off was by *Morrisons* which paid off 69% of its year-end deficit.

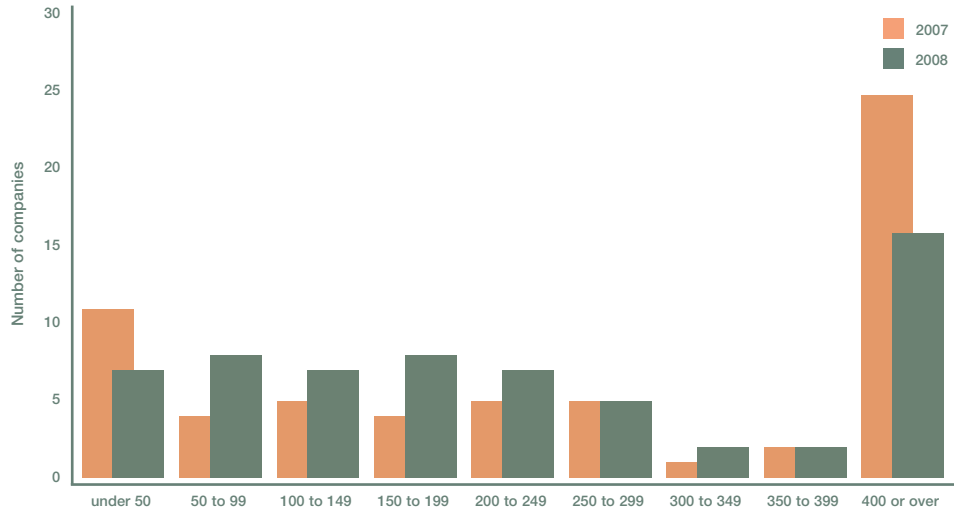
Pension schemes versus shareholders

The chart overleaf shows how pension scheme deficits compare to dividends paid. Of the 62 FTSE 100 companies with a pension deficit, 46 disclosed that they paid dividends to shareholders that were greater than or equal to the pension deficit in 2008 and, in 31 cases, the dividends were greater than or equal to double the 2008 deficit.

HBOS

Morrisons

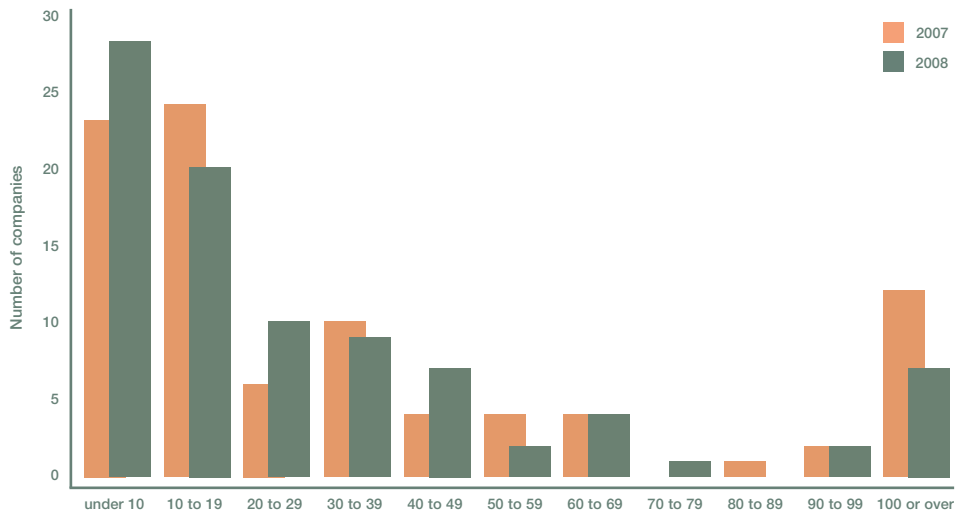
Percentage of deficit that could be paid off with one year's declared dividends (%)



However, looking overall, FTSE 100 companies with schemes in deficit paid an increased level of dividends in 2008 (£52 billion) compared to 2007 (£45 billion).

The chart below shows the company contributions paid over the 2008 and 2007 accounting years as a percentage of dividends paid over the same accounting years and illustrates the amount of cash paid to shareholders in preference to the pension scheme. In 2008, only five companies paid more contributions into their pension schemes than they paid in dividends over the 2008 accounting year.

Contributions paid as a proportion of dividends paid (%)



5.2 Key assumptions

We consider below the various assumptions used to place an IAS19 value on pension 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.

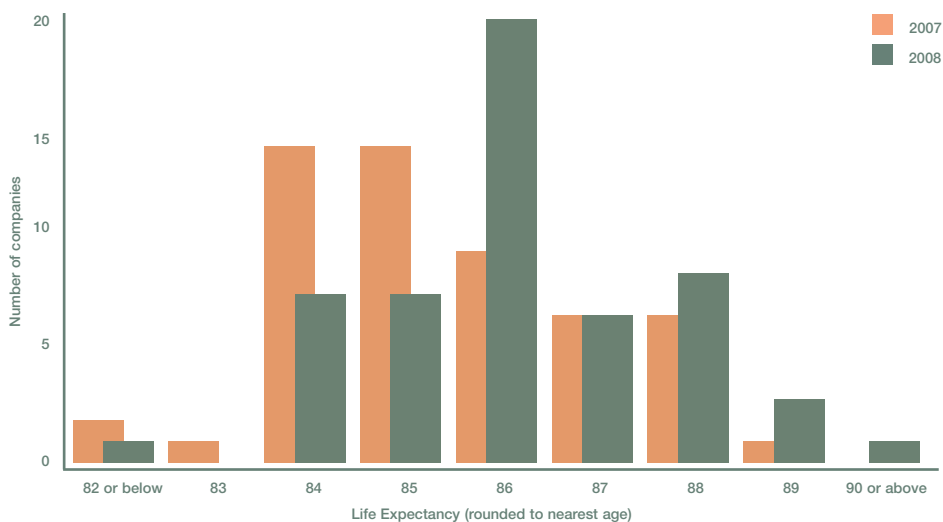
Life expectancy

Under the IAS19 standard, companies are required to disclose any “material actuarial assumptions”. Whilst no specific mention is made of mortality assumptions, the majority of companies have disclosed this assumption. 80 of the 90 companies with defined benefit pension schemes have provided sufficient information for us to derive basic mortality statistics – specifically a male life expectancy at age 60 in the UK. This is a marginal improvement on last year, when 78 companies disclosed meaningful mortality assumptions. 58 companies provided previous year comparators to allow us to analyse to what extent companies have revised their assumptions over their accounting year.

The following charts show the range of life expectancies assumed under IAS19 by FTSE 100 companies for males retiring on the balance sheet date.

Life expectancy assumptions reported in 2008

Males retiring at age 60 on the accounting date



The average assumption was that male members in the UK who retire at age 60 on the accounting date would live to 86.1 years – up from 85.4 years in their 2007 accounts. Companies continue to revise their life expectancy assumptions upwards; 44 companies have disclosed that they moved to more conservative longevity assumptions in 2008, adding 1.0 years on average to the assumed life expectancy. *3i Group* has adopted the strongest mortality assumptions, assuming that male pensioners currently aged 60 will live for a further 30.2 years.

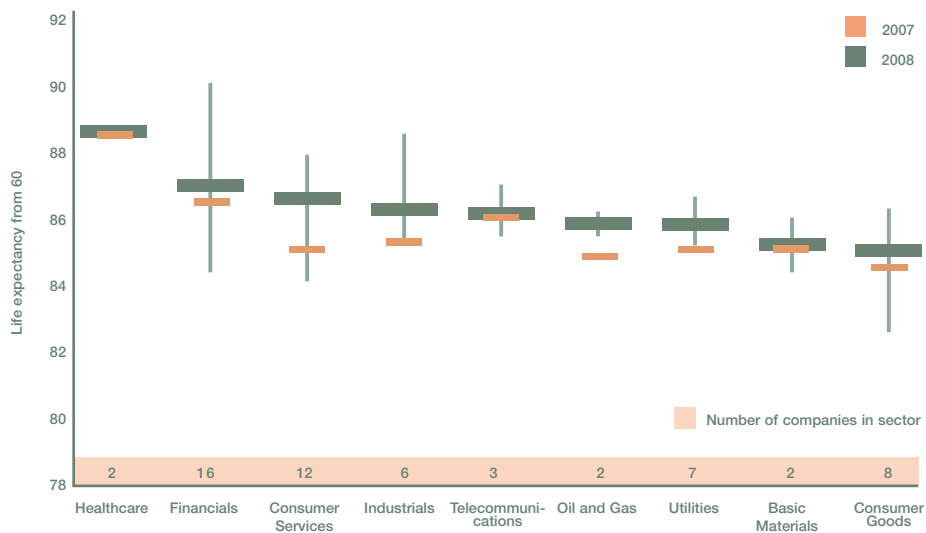
3i Group

Research has shown that two of the main factors influencing life expectancies are socio-economic group and income. In this respect it is interesting to analyse the FTSE 100 companies' assumed life expectancies by the sector in which the company operates as this should loosely be connected to the socio-economic group and income levels of the employees.

In the charts below the horizontal bars show the average life expectancy for a male aged 60 in the UK for each sector. The vertical lines show the extent of the variation within each sector, which clearly increases the greater the number of companies within the sector¹.

Life expectancy assumptions reported in 2008 split by sector

Males retiring at age 60 on accounting date



This chart shows that the highest assumed life expectancies are found in the healthcare, financials and consumer services sectors. The lowest assumed life expectancies are found in the utilities, basic materials and consumer goods sectors. Compared to the same chart in our 2007 report, there is less variability in the assumed life expectancies between sectors, perhaps as result of a general strengthening in mortality assumptions across all companies. Notably, *3i Group* and *British Energy Group* have increased their current longevity assumptions by well over three years compared to last year's accounts.

Future improvements in mortality

As well as setting assumptions to estimate how long current pensioners will live on average, companies must also decide how quickly life expectancies for future pensioners will increase as a result of future improvements in mortality. Allowing for future improvements can result in a significant increase in reported pension scheme liabilities, and therefore deficits. Several companies have indicated that they have assumed future rates of improvement at no less than a minimum rate or "underpin" and this practice is becoming more prevalent in companies' pension accounting disclosures.

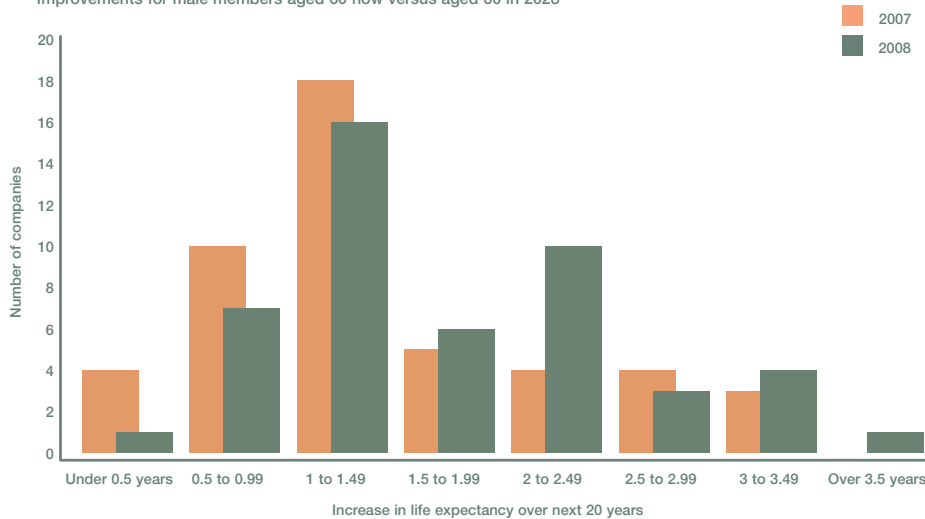
¹The sector is the Industry Classification Benchmark as published by FTSE.



54 companies disclosed enough information in their accounts to analyse how their allowance for future improvements in mortality has changed over their accounting year. The chart below shows the allowance that these companies have made for increases to longevity over a period of 20 years.

Additional life expectancy improvements reported in 2008

Improvements for male members aged 60 now versus aged 60 in 2028



The rise in the use of underpins to the rate of future improvements has led to an increase in the assumed life expectancy of a 60 year old in 20 years' time of 1.1 years, from 26.7 years in 2007 to 27.8 years in 2008.

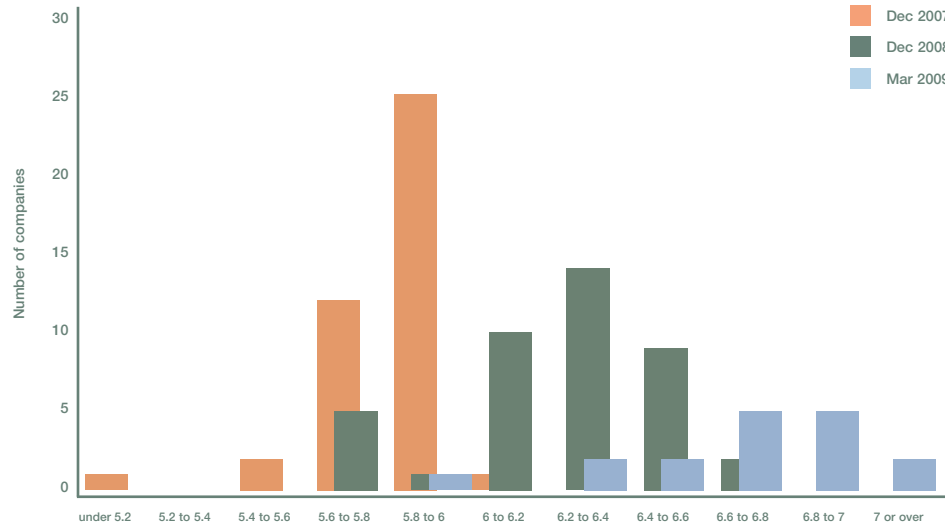
Discount rates

The discount rate assumption used by each company for its main UK pension scheme is set out in appendix 1.

The discount rate is used to calculate a present value of the projected pension benefits. Under IAS19 the discount rate should be based on "high quality" corporate bonds and the term of the corporate bonds should be consistent with the estimated term of the pension obligations.

The yields on high quality corporate bonds, and hence the discount rates, will fluctuate from day to day in line with market conditions. We have analysed March 2009 year-ends (where data was available at time of writing) in addition to December 2008 year-ends.

Discount rates used in December 2007, 2008 and March 2009 (% pa)



As corporate bond yields rose, the average discount rate also rose, from 5.8% pa in December 2007, to 6.2% pa in December 2008, and to 6.6% pa in March 2009. We estimate that the impact of these increases was to take 16% off companies' reported pension liabilities by the end of March 2009 – equivalent to about £50 billion across the FTSE 100. However, the second quarter of 2009 saw a reversal of this trend, as corporate bond yields fell sharply.

The range of discount rates continued to widen over the year to 31st March 2009 against a background of highly dispersed corporate bond yields.

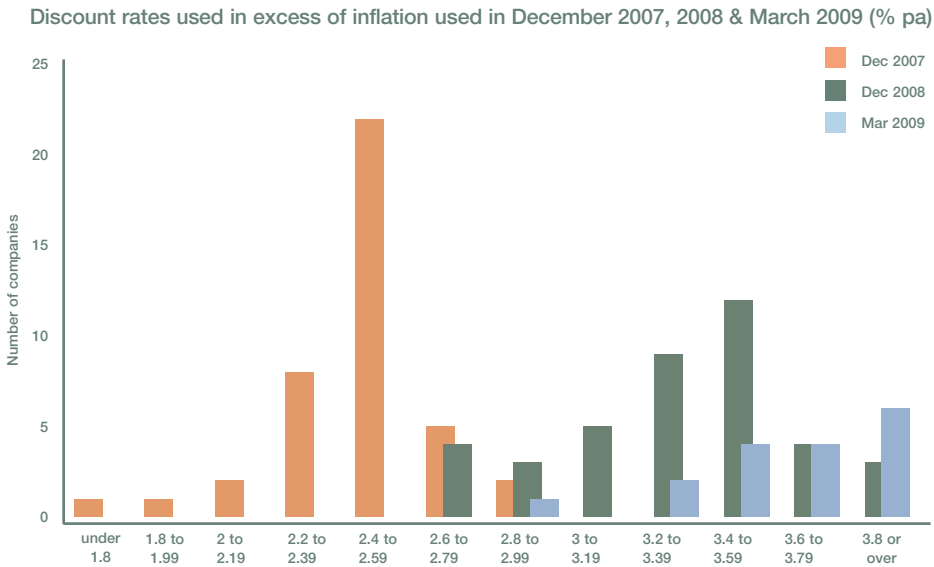
As at December 2008, the highest discount rate (6.75% pa) was disclosed by *Barclays* and the lowest (5.6% pa) was disclosed by *InterContinental Hotels Group*. As at March 2009, the highest discount rate (7.0% pa) was disclosed by *British Airways* and *Land Securities Group*. The lowest (5.8% pa) was disclosed by *British Land Company*.

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.

The chart below shows the difference between the discount rate and the assumption for price inflation (the net discount rate) for companies reporting as at 31st December 2007, 31st December 2008 and 31st March 2009.

The net discount rate has widened since December 2007, due to a combination of rising corporate bond yields and, following Lehman Brothers' collapse, decreasing expectations of future inflation. This has had the effect of reducing companies' reported pension liabilities.

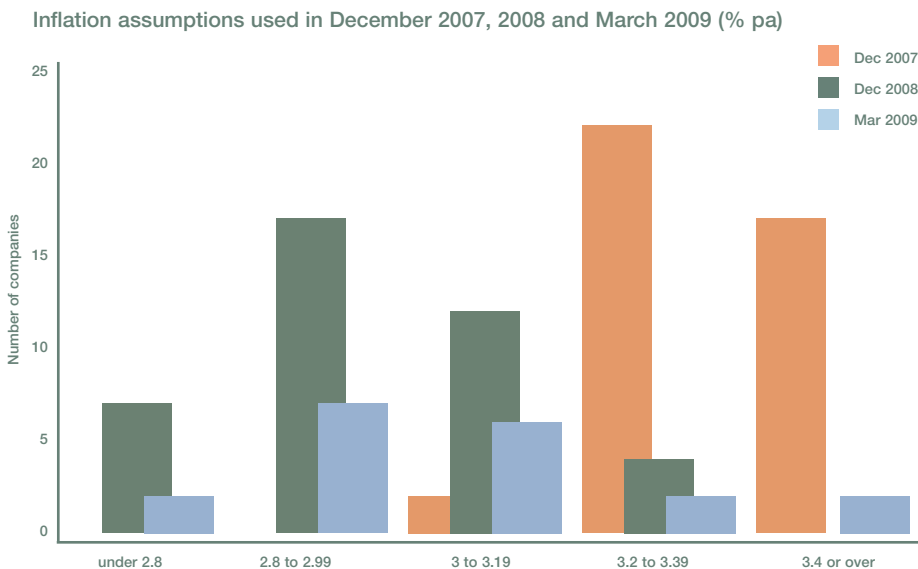
Barclays
InterContinental
Hotels Group
British Airways
Land Securities
Group
British Land
Company



Inflation

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

The chart below shows that the average long-term inflation assumption decreased from December 2007 to December 2008 but that it then increased for companies with March 2009 year-ends. 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, all other things being equal.



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Land Securities

Experian

FirstGroup

There is currently considerable uncertainty about the level of future inflation over the long term, which is illustrated by the wide range of assumptions adopted at 31st March 2009: *Land Securities* and *Experian* adopted an inflation assumption of 3.4% pa whereas *FirstGroup* adopted an assumption of 2.6% pa.

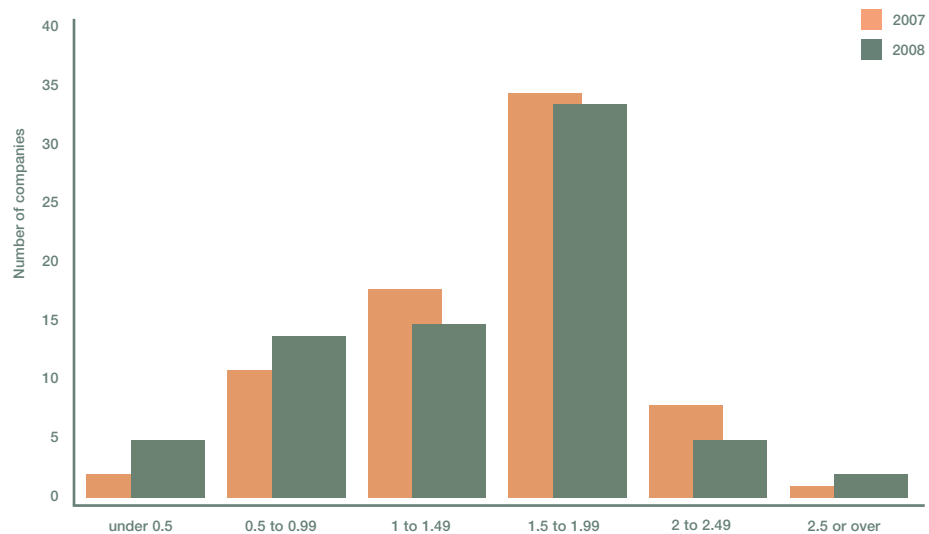
The Bank of England publishes statistics for future price inflation rates implied by gilt spot rates. This showed long-term price inflation implied by 20-year gilt spot rates was around 3.5% pa at December 2007 and around 3.2% pa at the end of December 2008 and March 2009.

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 lower pension liabilities as well as a lower charge to operating income.

The average real salary increase (ie the increase above inflation) has fallen slightly over the year and so this will have helped reduce deficits further. This is shown below.

Salary growth rates used in excess of inflation (% pa)



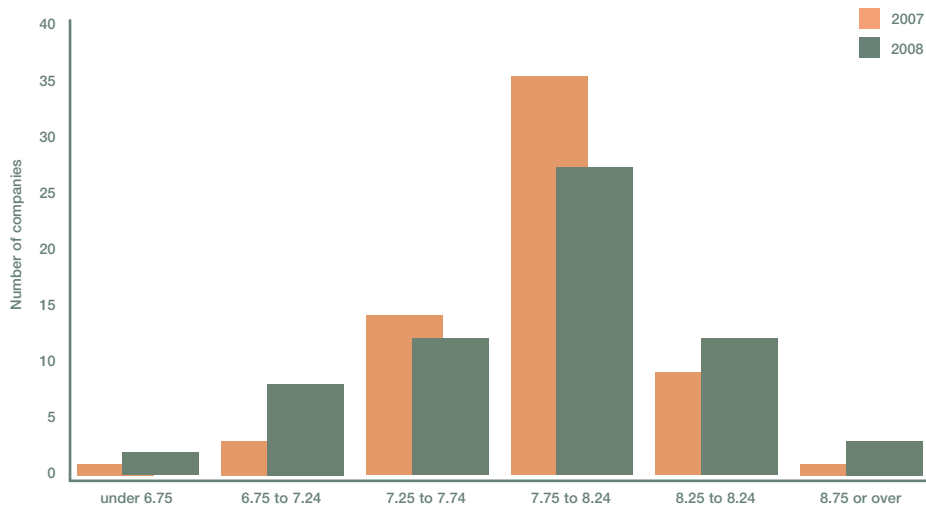
The average real salary growth rate has decreased from last year from 1.29% pa above price inflation to around 1.19% pa above price inflation. Of the 75 companies which disclosed sufficient information to analyse, 13 companies have decreased their assumption for real salary increases and 7 have increased it. *WPP* disclosed one of the largest decreases in its assumption for real salary increases compared to last year, reducing its assumption by 1.3% pa.

WPP

Expected return on equities

Under IAS19 companies are not required to provide a breakdown of their assumed asset returns on each asset class, as was required under FRS17, but can instead simply provide an overall expected return for the pension assets. 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 6.3% pa as disclosed by *Aviva* and the highest was 9.1% pa by *Experian*.

The average expected rate of return on equities was 3.5% pa² 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" (which is the additional return expected from investing in equities, compared with risk-free assets such as gilts, to compensate for the increase in risk). The average equity risk premium has increased from 3.2% pa last year.

Where disclosed, 27 companies increased their assumed equity return, 25 reduced it and 13 companies did not alter their assumption from the previous year.

² Return calculated relative to published 20-year Bank of England spot yields at the appropriate balance sheet date.

6. Non-UK schemes of the FTSE 100

We have separately analysed the disclosures made by FTSE 100 companies in relation to their non-UK arrangements and compared these to their UK disclosures.

6.1 Key findings

- Overseas pension and other post-retirement liabilities are significant for many FTSE 100 companies.
- Local legislation, custom and practice are often different from those in the UK. For example, different rules on funding pension schemes in overseas territories mean that the funding levels are not directly comparable to those in the UK.
- Many companies adopt different assumptions for calculating their IAS19 liabilities overseas from those that they use in the UK. It is not always clear that such different treatment is justifiable.
- Risk mitigation is a key issue for FTSE 100 companies in respect of their overseas schemes as well as for their UK arrangements. A number of companies have made some disclosure of the measures that they have taken to manage pensions risks although, as in the UK, many others have made no disclosure.
- Some FTSE 100 companies face risks as a result of their participation in overseas multi-employer pension schemes. The level of contributions, particularly those due on withdrawal from the scheme, are often outside the control of the company.
- Post-retirement medical plans are not common in the UK but a number of FTSE 100 companies have liabilities overseas, particularly in the USA.

6.2 Analysis of disclosures

Significance of overseas arrangements

50 FTSE 100 companies provided separate details of overseas pension liabilities amounting to £56 billion, of which at least a third was for US plans. The average IAS19 funding level in 2008 was 73% for their overseas pension arrangements compared to 98% for the UK schemes of the same companies.

A further ten global companies, with total global pension liabilities of £88 billion, disclosed some information on their overseas pension arrangements but did not provide sufficient breakdown by country or region for us to analyse them.

Figure 1 below shows the 15 companies with the largest disclosed non-UK pension liabilities relative to market capitalisation at their 2008 year-end. *Invensys*, *Rexam* and *Royal Bank Of Scotland Group* all have non-UK liabilities which exceed 50% of market capitalisation.

Invensys

Rexam

*Royal Bank Of
Scotland Group*

Disclosed non-UK pension liabilities as % of Market Capitalisation

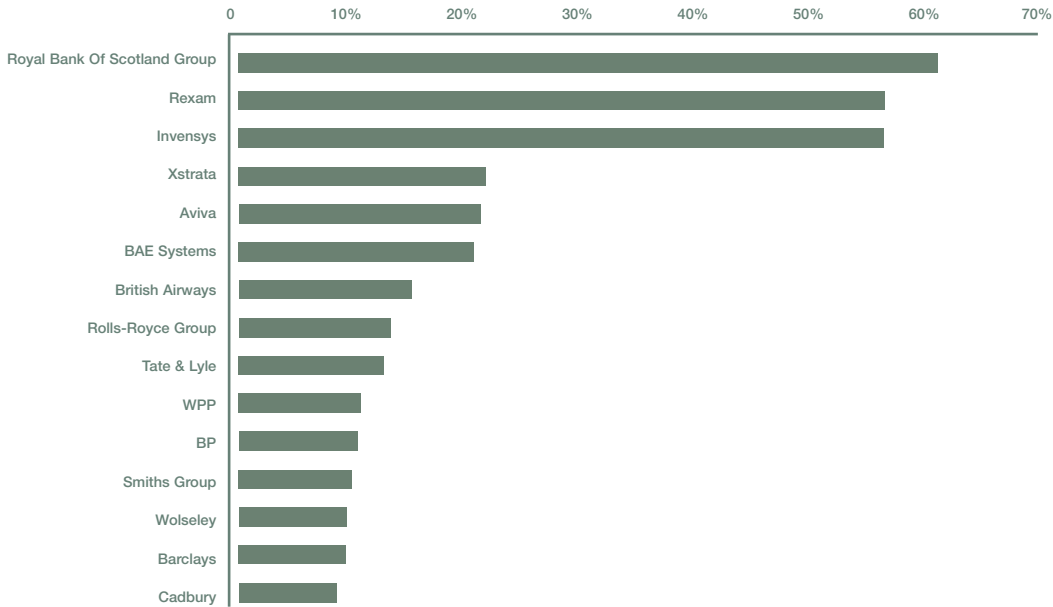
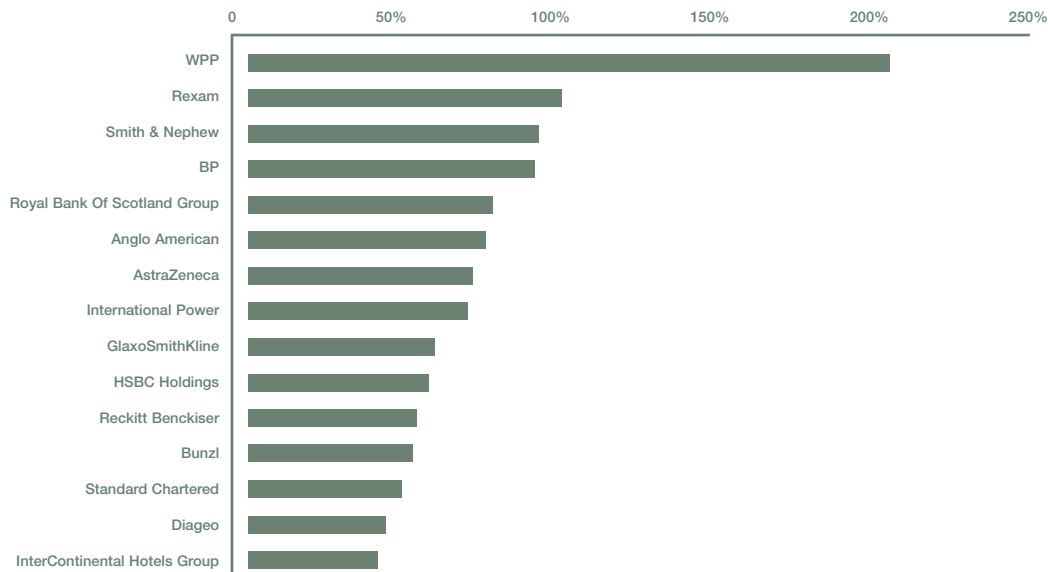


Figure 2 below shows the 15 companies with the highest overseas pension liabilities relative to UK pension liabilities. Twelve of these companies have overseas liabilities which are more than 50% of their UK liabilities. *WPP* has disclosed that its overseas liabilities are double its UK liabilities.

Disclosed non-UK liabilities as % of UK liability



NON-UK FINDINGS

WPP

Aviva
BHP Billiton
WPP

Diageo
Unilever
Invensys
HSBC
Holdings
Smith &
Nephew

NON-UK FINDINGS

6.3 Managing risks overseas

From our own experience of working with international companies, many have global benefits committees and have drawn up global guidelines for the operation of their worldwide pension schemes. Many FTSE 100 companies have significant overseas pension liabilities which potentially carry a significant amount of risk. These risks need to be managed appropriately at a local and group level.

Nevertheless, we found very little information in the pensions disclosures of FTSE 100 companies on the processes that companies have adopted to manage these risks.

Aviva, BHP Billiton and WPP are three examples of companies who have provided some relevant information on their global policies.

Examples of steps that companies have taken to reduce overseas pensions risks are given below.

Company	Reported risk mitigation
Diageo	Hedged approximately 40% of its £1.3 billion Irish pension liabilities against future movements in interest rates and inflation through the use of financial swaps.
Unilever	Have set up set up a Contractual Trust Arrangement in Germany, with initial assets of €300 million, to partially fund previously unfunded liabilities. Unilever has also insured its pension liabilities in Denmark which resulted in a cash refund of €42 million.
Invensys	Has de-risked their £1.2 billion US scheme investment portfolio and now has only 11% in equities.
HSBC Holdings	Is progressively moving to defined contribution pension arrangements around the world. 50% of its employees are now in defined contribution arrangements with a total employer contribution of \$508 million in 2008.
Smith & Nephew	Has closed major schemes to new hires.

6.4 Consistency of assumptions

Discount rates

As for the UK, companies use a wide range of discount rates to value their pension liabilities in other countries.

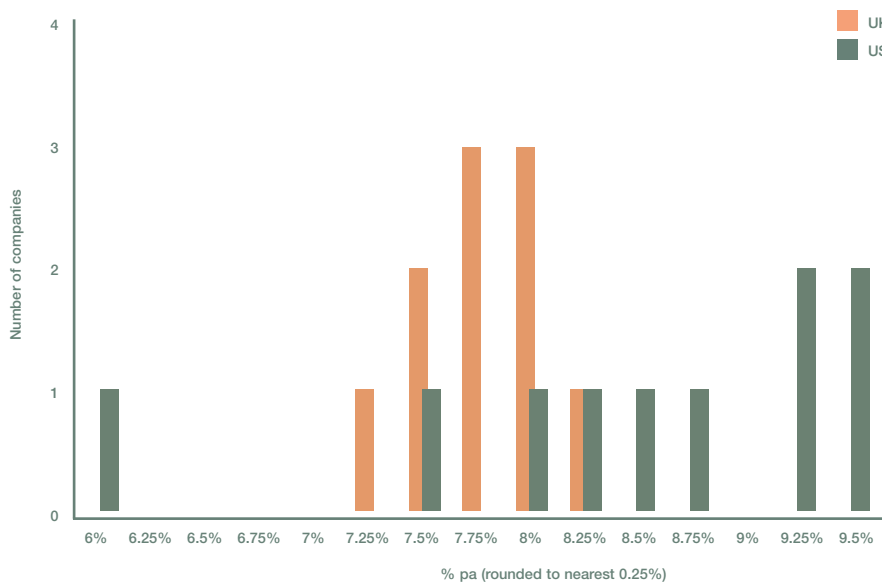
FTSE 100 companies with December 2008 year-ends disclosed discount rates in the range:

- 5.6% pa to 6.5% pa for US plans; and
- 5.4% pa to 5.9% pa for plans in the Eurozone.

Expected return on equities

A number of companies disclose the expected returns on equities for their US schemes. This reveals that companies are using much wider range of assumptions for their US schemes (6% pa to 9.5% pa) than they do for their UK schemes. It is not clear why the range should be so much greater for US schemes.

Expected return on equities for companies with US and UK schemes reporting at 31st December 2008



6.5 Life expectancy

As we have highlighted in previous years' reports, companies adopt a range of different assumptions about life expectancy.

The table below shows the average life expectancy assumption disclosed by FTSE 100 companies in various countries, with the UK being the highest.

Country	Average FTSE 100 life expectancy for a male age 60 on the accounting date
UK	86.1
Canada	84.2
USA	83.4
Netherlands	83.1
Germany	83.0

It is not clear that such different treatment is justified.

BP
 GlaxoSmithKline
 National Grid
 Royal Dutch Shell

British Airways
 Friends Provident
 Rio Tinto
 RSA Insurance
 Group

SABMiller

NON-UK FINDINGS

6.6 Post-retirement medical plans

Post-retirement medical arrangements are widespread in the USA due to the low levels of state-sponsored healthcare for US citizens, and employers have been encouraged to set up plans which provide healthcare benefits to former employees once they reach retirement. The liabilities for these arrangements can be significant with over £11 billion disclosed by FTSE 100 companies.

BP, GlaxoSmithKline, National Grid and Royal Dutch Shell all have post-retirement healthcare liabilities of more than £1 billion.

In recent years, spiralling healthcare costs have led to US companies reviewing their post-retirement healthcare arrangements. Many companies are likely to have changed the design to manage those costs, but few have disclosed details in their most recent accounts.

6.7 Multi-employer pension schemes

A handful of FTSE 100 companies, including *British Airways, Friends Provident, Rio Tinto* and *RSA Insurance Group* disclose that they participate in multi-employer pension schemes. Such schemes are widespread in countries like the USA, the Netherlands and Sweden.

Contributions to these schemes are usually determined by a scheme board or insurance company, and companies may not be able to influence the level of contributions, particularly when they leave the scheme and have to meet their share of underfunding.

None of the FTSE 100 companies in overseas multi-employer schemes disclose the level of underfunding it may be required to pay if it were to leave the scheme. However the risk is real, and *SABMiller* disclose it is required to make contributions of \$4 million pa until 2013 to a scheme it left in 1997.

VIEWPOINT

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Many FTSE 100 companies have significant overseas pension liabilities which potentially carry a significant amount of risk. These risks need to be managed appropriately at a local and group level.

Colin Haines
Partner, LCP

”

Lane
Clark &
Peacock

Actuaries & Consultants

Accounting For Pensions 2009

APPENDICES



Appendix 1 – FTSE 100 accounting disclosure listing

This table shows the key disclosures made by the companies in the FTSE 100 as at 31st December 2008 that disclosed significant funded defined benefit liabilities in their 2008 accounts. The source of the data is each company's annual report and accounts for the accounting period ending in 2008. 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 the discount rate and price inflation refer to those disclosed for the companies' main UK schemes where available. "ND" means no UK figures were disclosed.

Company	Year-end	2008						2007							
		Market value of assets £m	Total Surplus/(deficit) £m	Funded schemes £m	Discount rate %pa	Inflation %pa	Expected return on equities %pa	Disclosed Mortality? ¹	Market value of assets £m	Total Surplus/(deficit) £m	Funded schemes £m	Discount rate %pa	Inflation %pa	Expected return on equities %pa	Disclosed Mortality? ¹
3i Group	Mar	477	(38)	(38)	6.00	3.50	ND	479	(1)	(1)	5.00	3.00	3.00	ND	Y
Alliance Trust (The)	Jan	21	2	2	6.00	3.35	7.20	21	0	0	5.25	3.25	3.25	7.50	N
Amecc	Dec	1,221	156	156	6.00	2.80	7.30	1,328	237	237	5.70	3.20	3.20	8.10	N
Amlin	Dec	256	(4)	(4)	6.30	2.80	7.50	318	23	23	5.70	3.40	3.40	7.60	Y
Anglo American	Dec	1,430	(58)	17	ND	ND	ND	1,574	27	81	ND	ND	ND	ND	Y
Associated British Foods	Sep	2,424	96	126	6.00	3.70	7.70	2,474	310	341	5.80	3.30	3.30	7.30	Y
AstraZeneca	Dec	4,051	(1,920)	(1,511)	6.20	2.80	7.90	4,492	(1,022)	(789)	5.80	3.30	3.30	8.00	Y
Aviva ²	Dec	9,338	(613)	(509)	6.20	2.90	6.30	9,839	(178)	(71)	5.80	3.40	3.40	9.20	N
BAE Systems ³	Dec	12,978	(4,155)	(4,013)	6.30	2.90	8.25	15,110	(1,999)	(1,901)	5.80	3.30	3.30	8.00	N
Barclays ⁴	Dec	14,496	(1,119)	(990)	6.75	3.16	8.50	18,027	551	641	5.82	3.45	3.45	8.30	Y
BG Group ⁴	Dec	506	(191)	(164)	6.30	3.30	8.20	591	(163)	(136)	5.60	3.50	3.50	7.90	N
BHP Billiton	Jun	884	(61)	(27)	6.60	3.80	8.40	878	(16)	16	5.70	3.40	3.40	8.60	N
BP	Dec	17,959	(3,918)	(279)	6.30	3.00	8.00	21,418	1,429	4,272	5.70	3.20	3.20	8.00	Y
British Airways ⁴	Mar	14,272	722	729	6.80	3.50	ND	13,316	(1,294)	(1,287)	5.35	3.00	3.00	ND	N
British American Tobacco	Dec	4,169	(583)	(454)	6.00	2.90	6.90	4,209	(150)	(98)	5.80	3.40	3.40	7.50	Y
British Energy Group	Mar	2,710	(216)	(216)	6.00	3.30	8.00	2,671	(65)	(65)	5.40	3.00	3.00	8.30	Y
British Land Company ⁵	Mar	80	0	0	6.00	5.60	7.00	79	9	9	5.40	3.20	3.20	7.00	N
BT Group	Mar	37,448	2,779	2,779	6.85	3.50	8.50	38,390	(389)	(389)	5.35	3.00	3.00	7.40	Y
Bunzl	Dec	202	(51)	(37)	ND	ND	ND	230	(14)	(4)	ND	ND	ND	ND	N
Cable & Wireless	Mar	2,342	391	427	6.80	3.50	8.00	2,289	51	91	5.30	3.00	3.00	7.80	N
Cadbury	Dec	2,269	(225)	(144)	6.10	2.65	8.00	2,742	117	174	5.80	3.25	3.25	8.00	Y
Capita Group	Dec	427	(25)	(25)	6.20	2.70	6.65	488	4	4	5.90	3.20	3.20	7.60	Y
Carnival	Nov	123	4	4	6.50	3.00	ND	145	13	13	5.90	3.15	3.15	ND	Y
Centrica	Dec	2,642	(113)	(89)	6.70	3.30	8.50	3,327	97	128	5.80	3.40	3.40	8.10	Y
Cobham	Dec	407	(51)	(51)	6.30	3.00	ND	421	(37)	(37)	5.82	3.30	3.30	ND	Y
Compass Group	Sep	1,419	(133)	6	6.40	3.60	7.80	1,442	(70)	64	5.80	3.20	3.20	8.00	Y
Diageo	Jun	5,165	(394)	(252)	6.70	4.00	8.30	5,019	(402)	(272)	5.80	3.20	3.20	8.40	Y
Drax Group	Dec	94	(21)	(21)	6.10	3.00	ND	105	(14)	(14)	5.80	3.40	3.40	ND	Y
Experian	Mar	525	74	91	6.90	3.60	9.10	545	53	72	5.40	3.10	3.10	8.10	Y
FirstGroup	Mar	2,911	123	123	6.85	3.30	8.95	2,507	18	18	5.45	2.80	2.80	8.45	N

Appendix 1 – continued

Company	2008							2007							
	Year-end	Market value of assets £m	Total	Funded schemes	Discount rate	Inflation	Expected return on equities	Disclosed Mortality? ¹	Market value of assets £m	Total	Funded schemes	Discount rate	Inflation	Expected return on equities	Disclosed Mortality? ¹
			£m	£m	% pa	%pa	% pa		£m	£m	£m	% pa	%pa	% pa	
Friends Provident ⁶	Dec	1,171	91	93	5.98	See note 6	6.87	Y	1,126	(22)	(20)	5.51	3.53	7.16	Y
G4S	Dec	1,121	(328)	(286)	6.30	3.10	ND	Y	1,240	(167)	(136)	5.80	3.40	ND	N
GlaxoSmithKline	Dec	9,288	(1,692)	(1,374)	6.20	2.70	7.75	Y	10,182	(156)	103	5.75	3.25	8.00	N
Hammerston	Dec	42	(8)	2	6.50	2.80	ND	Y	47	(6)	1	5.90	3.20	ND	Y
HBOS ⁷	Dec	7,241	532	581	6.25	3.00	7.55	Y	7,329	(294)	(250)	5.70	3.40	ND	Y
Home Retail Group	Mar	647	84	94	6.10	3.50	8.10	Y	637	9	20	4.90	3.10	7.90	Y
HSBC Holdings	Dec	14,330	(2,164)	(1,810)	6.50	2.90	8.10	Y	15,175	(953)	(744)	5.80	3.30	8.30	Y
ICAP	Mar	6	(1)	(1)	ND	ND	ND	N	6	(1)	(1)	ND	ND	ND	N
Imperial Tobacco Group	Sep	2,769	(105)	437	7.30	3.40	8.20	Y	3,238	205	590	5.90	3.40	8.10	Y
Inmarsat	Dec	24	(8)	(5)	6.10	3.15	8.15	Y	26	(7)	(3)	5.80	3.45	7.75	Y
InterContinental Hotels Group	Dec	379	(82)	21	5.60	3.00	7.90	Y	378	(13)	33	5.50	3.40	7.90	Y
International Power ⁴	Dec	219	(82)	(82)	5.70	2.90	7.40	Y	264	(5)	(5)	5.80	3.40	8.00	Y
Invensys	Mar	4,722	(191)	(72)	6.10	3.70	8.30	Y	4,681	(489)	(370)	5.35	3.20	7.90	N
Johnson Matthey	Mar	915	46	54	6.50	3.50	8.00	Y	952	30	34	5.40	3.10	7.75	N
Kingfisher	Feb	1,472	77	85	6.20	3.30	8.10	Y	1,377	(55)	(39)	5.30	2.90	7.80	Y
Land Securities Group	Mar	139	15	15	6.90	3.60	7.50	Y	144	(6)	(6)	5.40	3.25	7.50	Y
Legal & General Group	Dec	1,047	(140)	(140)	6.50	2.70	7.00	Y	1,202	(182)	(182)	5.70	3.40	7.50	Y
Liberty International	Dec	50	(6)	(6)	5.70	2.70	ND	Y	59	(0)	(0)	5.60	3.20	ND	Y
Lloyds TSB Group ^{4,7}	Dec	13,693	(1,924)	(1,924)	6.30	3.00	8.20	Y	16,112	(683)	(683)	5.80	3.30	8.00	Y
London Stock Exchange Group	Mar	233	4	12	6.60	3.60	7.90	Y	225	(15)	(15)	5.30	3.10	7.60	Y
Man Group ⁴	Mar	172	(5)	(5)	6.90	3.80	8.30	Y	182	(25)	(25)	5.40	3.20	8.00	N
Marks & Spencer Group	Mar	5,046	502	503	6.80	3.50	8.30	Y	5,228	(261)	(260)	5.30	3.00	8.40	Y
Morrison (Wm) Supermarkets	Feb	1,939	(68)	(68)	5.75	3.75	7.00	Y	1,774	(198)	(198)	5.00	3.20	7.00	Y
National Grid	Mar	16,536	145	303	6.60	3.70	ND	Y	15,468	(659)	(576)	5.40	3.20	ND	Y
Next	Jan	383	(46)	(40)	6.15	3.50	7.30	Y	380	(47)	(41)	5.30	3.00	6.55	Y
Old Mutual ⁴	Dec	828	50	50	5.65	2.95	7.75	N	855	180	180	5.00	3.33	7.75	N
Pearson	Dec	1,578	(16)	0	6.40	2.80	ND	Y	1,853	42	54	5.80	3.30	ND	Y
Prudential ²	Dec	5,214	541	721	6.10	3.00	6.80	Y	5,322	307	496	5.90	3.30	7.50	Y
Reckitt Benckiser	Dec	710	(171)	(171)	6.50	2.60	7.70	Y	873	(60)	(60)	5.80	3.30	7.90	Y
Reed Elsevier	Dec	2,682	(369)	(241)	ND	ND	ND	N	3,018	50	141	ND	ND	ND	N
Rexam	Dec	2,505	(81)	(5)	6.00	2.80	7.47	Y	2,561	(63)	(3)	5.60	3.30	7.87	Y
Rio Tinto	Dec	7,295	(1,826)	(1,207)	6.30	2.80	7.70	Y	8,116	(1,287)	(237)	5.90	3.40	7.50	Y
Rolls-Royce Group	Dec	7,446	900	1,337	6.40	3.00	7.20	Y	6,903	(9)	275	5.80	3.50	7.80	N
Royal Bank Of Scotland Group	Dec	25,756	(1,996)	(1,795)	6.50	2.70	8.40	Y	27,662	115	327	6.00	3.20	8.10	Y
Royal Dutch Shell ⁴	Dec	29,679	(5,588)	(3,789)	ND	ND	ND	Y	37,692	6,764	8,004	ND	ND	ND	N
RSA Insurance Group	Dec	5,042	506	581	6.20	2.80	7.50	Y	5,244	158	232	5.60	3.20	7.50	N

Company	Year-end	2008						2007							
		Market value of assets £m	Total	Funded schemes	Discount rate	Inflation	Expected return on equities	Disclosed Mortality ¹	Market value of assets £m	Total	Funded schemes	Discount rate	Inflation	Expected return on equities	Disclosed Mortality ¹
		£m	£m	£m	% pa	% pa	% pa	£m	£m	£m	% pa	% pa	% pa	% pa	Y
SABMiller	Mar	681	(186)	(67)	ND	ND	ND	564	(160)	(65)	ND	ND	ND	ND	Y
Sage Group	Sep	16	(4)	(4)	ND	ND	ND	13	(5)	(5)	ND	ND	ND	ND	N
Sainsbury (J)	Mar	4,171	495	503	6.90	6.90	ND	4,298	(103)	(97)	5.30	ND	ND	ND	Y
Schroders	Dec	548	22	22	5.70	3.00	7.80	555	43	43	5.70	3.10	7.80	Y	
Scottish & Southern Energy	Mar	2,081	162	162	6.90	3.50	8.00	2,110	(92)	(92)	5.40	3.10	8.00	Y	
Serco Group	Dec	1,194	(149)	(98)	ND	ND	ND	1,343	(158)	(120)	ND	ND	ND	Y	
Severn Trent	Mar	1,332	(126)	(120)	6.40	3.40	8.00	1,365	(135)	(128)	5.40	3.00	8.25	Y	
Smith & Nephew	Dec	467	(224)	(210)	6.10	3.20	7.90	516	(77)	(66)	5.80	3.30	7.60	Y	
Smiths Group	Jul	2,960	49	103	6.60	3.60	8.20	3,319	248	300	5.80	3.10	8.20	N	
Standard Chartered	Dec	1,182	(289)	(184)	6.40	2.90	8.00	1,253	(152)	(23)	5.90	3.20	8.50	Y	
Standard Life	Dec	1,629	116	153	6.10	3.35	ND	1,384	(203)	(155)	5.75	3.45	ND	N	
Tate & Lyle	Mar	1,112	(16)	(16)	6.60	3.60	8.50	1,188	(52)	(52)	5.40	3.00	7.80	Y	
Tesco	Feb	4,089	(838)	(804)	6.40	3.50	8.90	4,007	(950)	(923)	5.20	3.00	8.10	Y	
Thomas Cook Group	Sep	582	(190)	(26)	ND	ND	ND	635	(175)	(13)	ND	ND	ND	N	
Thomson Reuters ⁴	Dec	2,503	(133)	24	ND	ND	ND	1,148	(12)	95	ND	ND	ND	N	
TUI Travel	Sep	924	(254)	(190)	6.90	3.60	8.20	995	(294)	(231)	5.60	3.40	7.90	Y	
Unilever	Dec	11,447	(2,591)	(1,340)	6.50	2.80	7.80	12,654	(225)	893	5.80	3.00	8.00	N	
United Utilities	Mar	1,863	(101)	(94)	5.95	3.40	ND	2,706	61	69	5.25	3.00	ND	Y	
Vedanta Resources	Mar	14	(21)	(21)	ND	ND	ND	9	(18)	(18)	ND	ND	ND	N	
Vodafone Group	Mar	1,271	(39)	54	ND	ND	ND	1,251	(41)	57	ND	ND	ND	Y	
Whitbread	Feb	1,372	(33)	(33)	6.20	3.40	8.30	1,366	(196)	(196)	5.20	3.00	8.00	N	
Wolseley	Jul	672	(236)	(173)	6.30	4.00	8.20	711	(107)	(53)	5.70	3.30	7.90	Y	
WPP	Dec	550	(269)	(129)	6.00	2.80	7.30	504	(134)	(40)	5.80	3.30	7.30	N	
Xstrata	Dec	1,146	(217)	(213)	ND	ND	ND	1,257	(114)	(111)	ND	ND	ND	N	

¹ This column indicates companies who disclosed sufficient information to calculate their assumption for life expectancy for a male pensioner aged 60 in the UK.

² Aviva, Legal & General and Prudential split their pension scheme surplus/(deficit) between shareholder and with-profit funds.

³ BAE Systems allocated £891m of its 2008 deficit (£450m in 2007) to equity accounted investments and other participating employers.

⁴ The 2008 figures are as at the end of the accounting periods ending in 2008. The 2007 figures are as at the start of the accounting period. All figures shown above were taken from IAS19 disclosures. All of the companies above accounted using immediate recognition of gains and losses (through the SORIE), with the exception of Barclays, BG Group, British Airways, International Power, Lloyds TSB Group, Man Group, Old Mutual, Royal Dutch Shell and Thomson Reuters who opted to spread gains and losses under IAS19.

⁵ Whilst British Land Company disclosed its inflation assumption and salary increase assumption at 31st March 2008 to be 5.6% pa and 3.4% pa respectively, we suspect this is a typographical error and the figures should be reversed.

⁶ Friends Provident did not disclose an inflation rate assumption as at 31st December 2008 only stating that it was based on the Citigroup Zero Coupon RPI swaps curve.

⁷ On 19th January 2009 Lloyds TSB Group was renamed Lloyds Banking Group, following the acquisition of HBOS.

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 schemes do not fund them via an external scheme, instead backing the pension scheme with company assets, which may result in a larger deficit being disclosed. Where disclosed, the surplus/(deficit) attributable to funded schemes is also shown above. All figures are rounded to the nearest million pounds. The figures have been converted to Sterling where a company has reported figures in a different currency.

The assumptions for discount rate and price inflation 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. "ND" means no UK figures were disclosed.

We have excluded from our survey the following ten companies who had no evidence of significant funded defined benefit provision: Antofagasta, Autonomy Corporation, Admiral Group, British Sky Broadcasting, Cairn Energy, Eurasian Natural Resources Corporation, Kazakhmys, Randgold Resources, Shire and Tullow Oil.

The following five companies have entered the FTSE 100 index since 31st December 2008 and hence are not included in our survey. Foreign & Col Invest Trust, Fresnillo, Intertek Group, Lonmin and Petrofac. The following five companies have exited the FTSE 100 index since 31st December 2008: Amlin, Drax Group, FirstGroup, Tate & Lyle and Whitbread.

Appendix 2 – FTSE 100 accounting risk measures

Largest liabilities

Name	2008 Liabilities £m	2007 Liabilities £m
Royal Dutch Shell	35,267	30,927
BT Group	34,669	38,779
Royal Bank Of Scotland Group	27,752	27,547
BP	21,877	19,989
BAE Systems ¹	17,133	17,109
HSBC Holdings	16,494	16,128

These tables show the key results of analysis of the disclosures made by the companies in the FTSE 100 as at 31st December 2008 that were reported in their 2008 accounts. The figures relate to the worldwide position of each company (not just the UK disclosure) but excludes healthcare and defined contribution pension arrangements where possible.

The source of the data is each company's annual report and accounts for the accounting period ending in 2008.

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

Largest deficits

Name	2008 Deficit £m	2007 Deficit £m
Royal Dutch Shell	5,588	-6,764
BAE Systems ¹	4,155	1,999
BP	3,918	-1,429
Unilever	2,591	225
HSBC Holdings	2,164	953
Royal Bank Of Scotland Group	1,996	-115

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

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

All figures shown here have been calculated using unrounded numbers. Therefore, some metrics shown may differ to those calculated using the rounded figures.

Largest liabilities compared to market capitalisation

Name	Liabilities £m	Market Cap £m	2008 Liabilities / Market Cap %	2007 Liabilities / Market Cap %
British Airways	13,550	2,694	503	261
Invensys	4,913	1,791	274	229
Lloyds TSB Group	15,617	7,526	208	63
BT Group	34,669	17,091	203	153
HBOS	6,709	3,716	181	28
Royal Bank Of Scotland Group	27,752	19,602	142	31

¹BAE Systems allocated £891 million of its 2008 deficit (£450 million in 2007) to equity accounted investments and other participating employers.

Largest deficit compared to market capitalisation

Name	Deficit £m	Market Cap £m	2008 Deficit / Market Cap %	2007 Deficit / Market Cap %
BAE Systems ¹	4,155	13,285	31	11
Lloyds TSB Group	1,924	7,526	26	3
G4S	328	2,887	11	5
Invensys	191	1,791	11	22
TUI Travel	254	2,410	11	10
Wolseley	236	2,246	11	2

Highest funding level

Name	Assets £m	Liabilities £m	2008 Assets / Liabilities %	2007 Assets / Liabilities %
Cable & Wireless	2,342	1,951	120	102
Experian	525	451	116	111
Home Retail Group	647	563	115	101
Amec	1,221	1,065	115	122
Rolls-Royce Group	7,446	6,546	114	100
Sainsbury (J)	4,171	3,676	113	98

Lowest funding level

Name	Assets £m	Liabilities £m	2008 Assets / Liabilities %	2007 Assets / Liabilities %
WPP	550	819	67	79
Smith & Nephew	467	690	68	87
AstraZeneca	4,051	5,971	68	81
BG Group	506	697	73	78
International Power	219	301	73	98
Wolseley	672	908	74	87

Appendix 2 – continued

Largest employer contributions

Name	2008 Contribut'ns £m	2007 Contribut'ns £m
British Airways	944	543
Royal Dutch Shell	888	628
Royal Bank Of Scotland Group	810	599
BT Group	708	926
BAE Systems	598	594
Unilever	594	790

Largest service cost²

Name	2008 Service Cost £m	2007 Service Cost £m
Royal Bank Of Scotland Group	733	706
Royal Dutch Shell	612	545
BT Group	576	600
BP	483	433
Tesco	461	208
HSBC Holdings	416	404

Largest employer contributions compared to service cost²

Name	Contributions £m	Service Cost £m	2008 Contributions / Service Cost %	2007 Contributions / Service Cost %
British Airways	944	199	474	163
Legal & General Group	58	13	446	229
Morrisons	193	44	439	177
Invensys	116	27	430	98
National Grid	465	127	366	240
Kingfisher	103	29	355	305

²The service cost (representing the value of benefits earned over the accounting period) includes the value of any past service benefits awarded to members during the year.

Largest employer contributions compared to dividends paid

Name	Contributions £m	Dividends £m	2008 Contributions / Dividends %	2007 Contributions / Dividends %
Invensys	116	1	11,600	6
Serco Group	61	22	284	18
Morrisons	193	108	179	104
BAE Systems	598	489	122	67
TUI Travel	70	70	100	47
FirstGroup	75	81	94	72

Largest dividends paid compared to deficits

Name	Dividends £m	Deficit £m	2008 Dividends / Deficit %	2007 Dividends / Deficit %
Vodafone Group	3,771	39	9,669	8,754
ICAP	96	1	9,590	4,964
Man Group	288	5	6,343	636
Sage Group	106	4	2,723	925
Anglo American	1,267	58	2,186	N/A
Liberty International	123	6	2,016	61,050

Smallest dividends paid compared to deficits

Name	Dividends £m	Deficit £m	2008 Dividends / Deficit %	2007 Dividends / Deficit %
Invensys	1	191	1	1
BAE Systems ¹	489	4,155	12	20
Serco Group	22	149	14	12
Smith & Nephew	59	224	26	68
G4S	87	328	27	38
TUI Travel	70	254	28	5

Largest Equity Allocation

Name	2008 Equity Allocation %	2007 Equity Allocation %
Inmarsat	84	84
Centrica	71	75
BP	71	75
Vodafone Group	69	72
Home Retail Group	68	70
Experian	66	69

Smallest Equity Allocation

Name	2008 Equity Allocation %	2007 Equity Allocation %
Hammerson	0	0
Sage Group	9	12
Invensys	13	23
London Stock Exchange Group	14	16
Prudential	17	25
Rolls-Royce Group	17	26

Appendix 2 – continued

Largest % increase in funding level

Name	2008 Funding level %	2007 <i>Funding level</i> %	Increase in Funding level %
Standard Life	108	87	21
Cable & Wireless	120	102	18
Land Securities Group	112	96	16
Sainsbury (J)	113	98	15
Marks & Spencer Group	111	95	16
British Airways	105	91	14

Largest % decrease in funding level

Name	2008 Funding level %	2007 <i>Funding level</i> %	Decrease in Funding level %
Royal Dutch Shell	84	122	38
International Power	73	98	25
BP	82	107	25
Old Mutual	106	127	21
Smith & Nephew	68	87	19
Unilever	82	98	16

Largest gain on assets³

Name	2008 Gain %	2007 <i>Gain</i> %
Standard Life	14	5
Rolls-Royce Group	8	9
Friends Provident	3	7
Schroders	-1	7
HBOS	-2	8
Old Mutual	-2	10

Largest loss on assets³

Name	2008 Loss %	2007 <i>Loss</i> %
Royal Dutch Shell	29	-9
Centrica	26	-6
Legal & General Group	22	-2
Inmarsat	21	-8
BG Group	21	-11
International Power	20	-9

³ Figures calculated as a percentage of assets at the start of the accounting year.

Notes

Notes



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