

Media Release

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For immediate release

£689 billion pensions black-hole by the end of year predicts Xafinity

UK companies providing defined benefit (DB) pensions could face a twelve-fold increase in pension deficit by the end of 2009, taking the total to a staggering £689 bn**, warns Xafinity Corporate Solutions.

The conclusions are drawn from Xafinity Corporate Solutions' latest interactive model, Corporate UK Pensions Scheme; a predictive tool available on the company's website (www.xafinity.com/modelsolutions) that covers some 93% of the UK's PPF-eligible DB schemes and some 12.4 million members.

Commenting on the £689 bn pension deficit projection, Xafinity Corporate Solutions director, Pat Wynne explained:

"The potential outlook for defined benefit pension scheme funding is exceptionally bleak. To put it into context, a £689 bn deficit is the equivalent to nearly 40% of the UK's GDP.

"At present, the difference between gilts and corporate bond yields, around 2.5%, is the highest we've seen since The Great Depression. Should corporate bond spreads revert to historic norms, then the yield would fall below 4.75%. Any significant downward movement in corporate bond yields will greatly affect the funding and accounting of DB pension schemes and as a result companies should not be lulled into a false sense of security at this time with high returns on corporate bonds keeping their liabilities down.

Even if the FTSE recovered to 5000 the Corporate UK Pensions Scheme model predicts that the combined UK pension scheme deficit would still be around £583 bn."

Xafinity urged UK companies to get a true hold on their current position. The modelling tools developed by Xafinity Corporate Solutions enable companies to accurately model the impact of future changes in the factors that influence assets and liabilities and the overall funding of their pension scheme, thus assisting decision-making on the viability of their pension scheme arrangements going forward.

Whilst the model is currently unlikely to give any good news to schemes, it can help company executives and finance professionals plan their own scheme future, whether it's ongoing funding, FRS17 or buy-outs.

Wynne continued:

“These are by no means "worst case" scenarios as our analysis of the average longevity assumptions underpinning the Purple Book figures suggests that further improvements in longevity will need to be built into future valuations. Indeed using a "best estimate" from our longevity experts coupled with the lower quartile assumption on equity performance over the year the gearing effect of these changes creates a staggering deficit in excess of £1,000 billion!”

Companies are invited to run their own scenarios for the future of Corporate UK Pensions Scheme on the Xafinity Corporate Solutions model at www.xafinity.com/modelsolutions

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**The underlying assumptions are based on research with leading investment managers who anticipate the FTSE will finish 2009 at around 4000 points, corporate bond yields could fall to 4.75%.

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Background information and more detail for Editors:

- Supporting article below
- Corporate UK Pensions Scheme Q&A document is available to download at <http://www.xafinity.com/Media-Centre/Xafinity-Press-Releases.aspx>

By using the unique power of Xafinity's Model Solutions technology, Xafinity Corporate Solutions '**Corporate UK Pensions Scheme**' model can project future funding positions. It accurately models the impact that future changes in the factors that influence assets and liabilities will have on the overall funding

of UK pension schemes, whether measured on an ongoing funding, FRS17 or even buy-out basis.

To date most of the surveys covering the funding positions of UK final salary arrangements have focused on the pension schemes of only the very largest companies - often the FTSE100 - and have primarily aggregated their historic or current funding positions. Whilst sizeable in liability value, in number these schemes represent less than 1.5% of UK final salary schemes and thus cannot show a representative picture of the true funding plight of UK defined benefit arrangements.

Recognising this deficiency, Xafinity Corporate Solutions has, utilising its powerful Model Solutions valuation tool, created the **Corporate UK Pensions Scheme** model. Using as a base the dataset from the PPF's and the Pensions Regulator's "Purple Book", the model covers over 93% of the UK's PPF-eligible DB schemes and some 12.4 million members thus providing the most comprehensive and accurate appraisal of funding in the UK.

At 1st January 2009 the **Corporate UK Pensions Scheme** had liabilities of £823 billion but assets of only £765 billion producing a funding deficit of **£58** billion. In January the FTSE 100 index (this index being used as a measure of the value of all equity holdings) was around 4,400, gilt yields stood at around 3.75% but driven by the supply/demand equation and the concern over corporate debt, the "credit risk premium" within corporate bonds was at a near all time high, producing yields on AA bonds of some 6.25%

Since that date, global equity investment markets have been highly volatile, falling to a nadir of 3,400 and, after a recent sustained rally, returning to the January 2009 levels. Predicting where the equity markets will be at the year end is, at best, fraught with difficulty and, at worst, a near impossible task. To supplement our own views, in March this year, we surveyed the leading investment managers for their views on market outturns. The mean of the responses indicated the FTSE may finish 2009 around 4000 and, whilst this may now appear unduly pessimistic, it is a further indication of the economic uncertainties that exist within equity markets.

However, of much greater significance to the funding and accounting of DB pensions will be the movement in corporate bond yields. All investment manager responses predicted sharp falls in yields, although the pace of decline varied. Historically, the credit risk spread on AA corporates has yielded an additional 1% above gilts. Should, as is predicted, yields return to these historic norms then, in today's terms, AA bond yields would fall to 4.75% (3.75% gilts plus 1%).

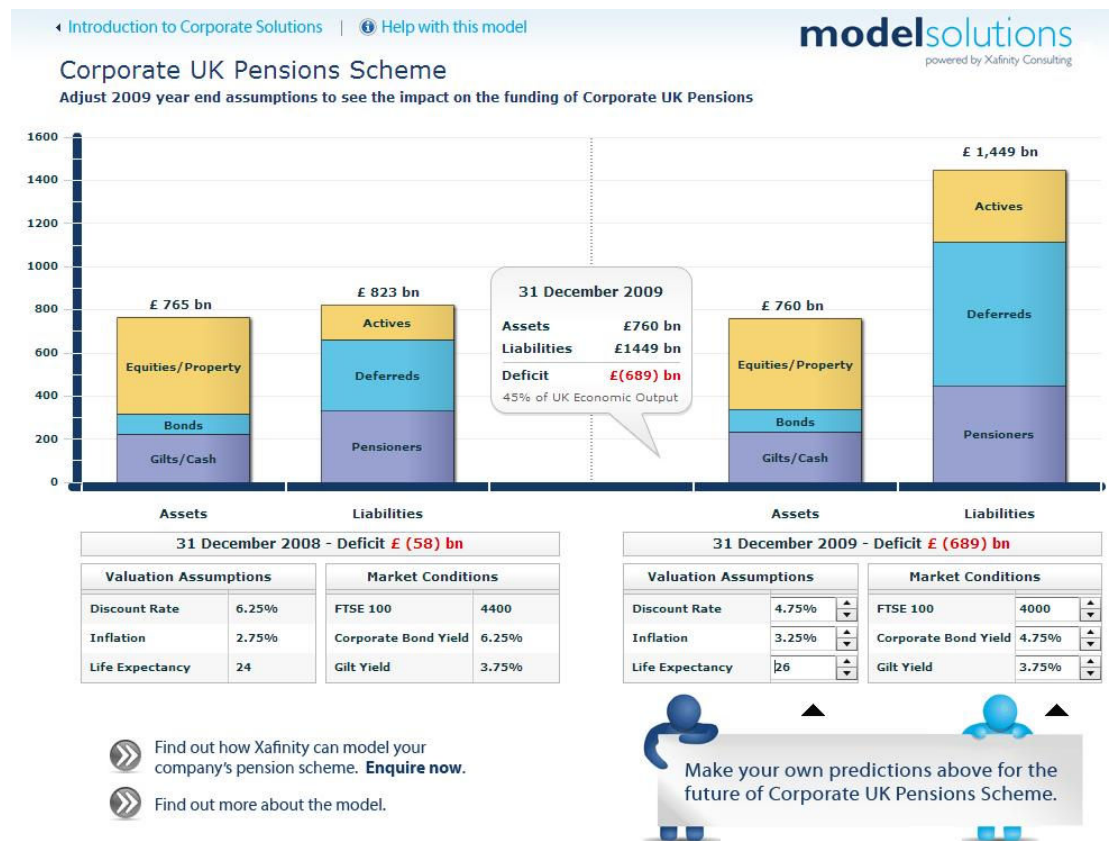
The corporate bond yield is of particular significance to pension scheme accounting. Building in a yield of 4.75%, using a FTSE year end figure of 4000 and typical assumptions for inflation and longevity we estimate that liabilities would grow to £1,449 billion, assets would hardly move at £760 billion, producing an overall deficit of **£689** billion a 12-fold increase from the 2009 starting position. A rally in the FTSE to the 5000 level would still only

bring this deficit down to £583 billion.

These are by no means "worst case" scenarios as our analysis of the average longevity assumptions underpinning the "Purple Book" figures suggests that further improvements in longevity will need to be built into future valuations. Indeed using a "realistic estimate" from our longevity experts coupled with the lower quartile assumption on equity performance over the year the gearing effect of these changes creates a staggering deficit in excess of £1,000 billion!

You can visit the Xafinity's Corporate Solution's web site at www.xafinity.com/modelsolutions and use the interactive tool to see how the year end funding position of **Corporate UK Pensions Scheme** varies under your own economic predictions.

Make your own predictions for Corporate UK Pensions Scheme:
www.xafinity.com/modelsolutions



Xafinity is one of the UK's leading specialist providers of pensions, employee benefits and payments expertise, with 170 years' experience and handling £2 trillion annually.

The Group provides consulting, software, resourcing, training and business process outsourcing services that enable public and private sector organisations to deliver employee benefits more efficiently.

In 2009, Xafinity was voted best Third Party Administration provider at the Pension and Investment Provider Awards. In 2008, Xafinity was voted Pensions Administration System Provider of the Year and won the Pensions Administration Software Award, as well as winning Best Pensions Software provider in 2007. Xafinity is the accredited software supplier to the UK Principal Civil Service Pension Scheme.

With 1,400 people nationwide, Xafinity has operational and relationship management centres across the UK, in Bath, Cardiff, Crawley, Fleetwood, Leeds, London, Reading, Stafford, Stirling and Waterlooville.

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Xafinity Consulting is one of the UK's leading specialists in employee benefit innovation and optimisation. Our expertise covers pensions and actuarial services, corporate solutions, flexible benefits, healthcare, trusteeship and training. We are committed to working in partnership with our clients, providing a service to maximise the returns of their benefit strategies.

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