

Xafinity Corporate Solutions

UK Corporate Pensions Scheme Model – Q & A

Website address: www.xafinity.com/modelsolutions

1. How was the £689 billion calculated?

Xafinity surveyed leading investment managers for their views on the market. The mean of the responses indicated the FTSE may finish 2009 around 4000. In addition, all investment manager responses predicted sharp falls in corporate bond yields. Historically, the credit risk spread on AA corporate's 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 could fall to 4.75% (3.75% gilts plus 1%).

Using the Model Solutions valuation tool and building in a yield of 4.75%, using a FTSE year end figure of 4000 and typical assumptions for inflation and longevity, liabilities are estimated to grow to £1,449 billion, assets would hardly move at £760 billion, producing an overall deficit of **£689** billion

2. What is the typical allocation within a DB pension – specifically what percentage is equity based and what percentage is bonds

Equities, both overseas and UK, make up some 54% of invested assets. Bonds (including Government issued gilts) make up 33%. Cash represents 6% with property and other assets the other 7%

3. Is £689 billion the worst case scenario?

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. 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 deficit in excess of £1,000 billion.

4. What was the starting deficit? (1 Jan 2009)

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

5. What sample data was used for the model?

By using the unique power of Xafinity's Model Solutions technology, Xafinity Corporate Solutions 'Corporate UK Pensions Scheme' model uses as its base, the dataset from the PPF and the Pensions Regulator's "Purple Book". The model covers over 93% of the UK's PPF-eligible defined benefit schemes

and some 12.4 million members thus providing the most comprehensive and accurate appraisal of funding in the UK.

The “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.

6. What are the potential implications for companies?

There are many implications for companies:

- Firstly under existing FRS17 rules the pension scheme surplus (to the extent it can be recovered) or deficit is recognised in full on the balance sheet
- Secondly for any potential buyouts as employers find the additional funding required excessive
- Thirdly for any M&A activity as, at worst. pension deficits potentially swamp the value of the sponsoring employer, or at best introduce an unacceptable level of ‘unknown’ into financing arrangements
- Finally for the future of any defined benefit schemes as a whole as cost become too high and unpredictable for employers to bear

7. What can / should companies be doing to help improve the situation?

Companies will need to carefully consider the risk profile of their pensions arrangements and how this dovetails with the company risk profile. Volatility in the pension funding position will have a direct effect on shareholder value.

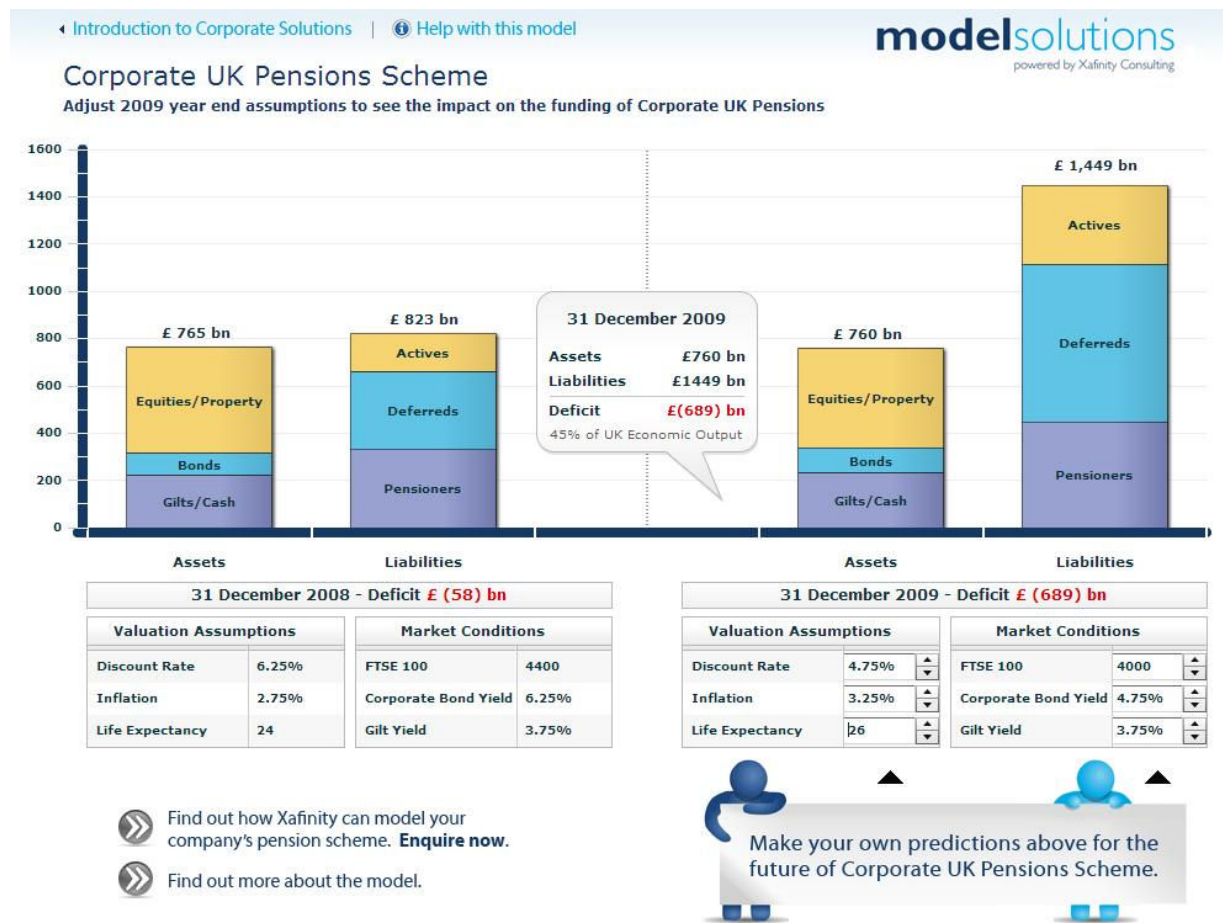
There are a myriad of ways to reduce the pension scheme risks. However the investment held can also be considered as an extension of the shareholders holdings , In some cases a reduction in risk bearing assets may be the answer, however in others the level of risk may be totally acceptable, given the financial significance of the pension scheme.

Trustees will of course be concerned with the security of the benefits for members, but this of course relates back to the overall strength of the sponsoring employer.

8. Is this the death of Defined Benefit pension schemes?

The truth is that Defined benefit pension schemes are already on the endangered species list. Recent changes in legislation and economic outlook only serve to accelerate the extinction process.

Screen Shot:



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