Media Release

01 November 2011

For immediate release

Fears over underpriced inflation as UK corporate pension deficits teeter

Based on assumptions as at the end of October 2011, the Xafinity Corporate UK Pension Scheme model shows that the aggregate deficit has increased to £327 billion. Rising stock market values have propelled aggregate asset values back above the £1 trillion mark, but falling corporate bond yields have wiped out any gains on corporate balance sheets:

£ billion	October 2011	September	A year ago
Scheme Liabilities	1,355	1,280	1,361
Scheme Assets	1,028	975	1,006
Deficit	**327**	**305**	**355**

Hugh Creasy, director at Xafinity Corporate Solutions said: "*The fact that scheme asset values now exceed £1 trillion may seem comforting. It is of course helpful that the equity market is back at the levels of 12 months ago and we should not be churlish. However, the real drivers behind quoted pension costs are the financial parameters. Corporate bond yields had stood firm even as government bond yields performed their nose dive over the last four months. One small slip in the corporate yield during October, though, and we see £75 billion additional deficit landing on the corporate balance sheet.*"

Balance sheet deficits depend principally on the yield on corporate bonds and on the outlook for price inflation.

Hugh continued: "*For as long as the quoted outlook for price inflation remains depressed, we see the benefit through lower liability values. The effect is massive as a return to the stable picture we saw up until August 2011 would restore £200 billion onto the reported deficit. So, with just two months to run, can we count on auditors signing off on such low assumptions?*

"It is worth understanding a little more about this particular assumption. The figure comes from a comparison of yields on fixed interest government bonds and real yields on index-linked government bonds. In an undistorted world, the mathematical difference creates a

market driven assumption for inflation. But of course this world does have its distortions. In an environment where fixed interest yields have been driven down so sharply, we have seen the mathematical formula produce lower and lower inflation. No model should be used without question, and this is no exception.

"Questioning low inflation assumptions may not be the message corporate sponsors would welcome, but it would be poor quality advice if we simply presented the ideas people wanted to hear. At the very least, corporate sponsors should be prepared to deal with a rapid unwinding of the assumption and the damage it could do to next year's budgets.

"Now, more than ever, may be the time to de-risk those inflation linked liabilities before reality is restored in the pricing of inflation risk."

The Xafinity Consulting model draws on the Pensions Regulator's latest edition of the Purple Book, which was published in November 2010. The model covers 99% of the UK's PPF-eligible DB schemes and some 12 million members, making it the most comprehensive and accurate appraisal of pension scheme funding in the UK.

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Note to editors:

You can visit the Xafinity's Corporate Solution's website 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.

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About Xafinity Consulting:

Xafinity Consulting is one of the UK's leading specialists in pensions and employee benefits. Our expertise addresses the needs of both trustees and companies in pensions and actuarial services, flexible benefits, healthcare and training. We are committed to working in partnership with our clients, providing tailored solutions to maximise the returns of their benefit strategies.
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