

Media Release

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For immediate release

Xafinity: UK Corporate Pension Deficits – a review of 2011

Based on assumptions as at the end of November 2011, the Xafinity Corporate UK Pension Scheme model shows that corporate deficits have now driven through £400 bn to reach an eight month high. While the outlook for price inflation remains suppressed, corporate bond yields have started to slide and this will be harming corporate balance sheets.

£ billion	November 2011	Last month	Last year
Scheme Liabilities	1,435	1,355	1,361
Scheme Assets	1,016	1,028	986
Deficit	419	327	375

Hugh Creasy, director at Xafinity Corporate Solutions said: *“This will make depressing reading for finance directors. In the face of global turmoil, both on the streets and within financial markets, corporate pension scheme deficits had remained relatively benign. As we started this final quarter of 2011, the aggregate deficit stood only a shade above the £300 bn mark. Yet, as we close in on 31 December – the key date for corporate balance sheets – the deficit has roared ahead.”*

Hugh continued, *“Commentators have highlighted the malaise in gilt yields over recent months. This will have increased pressure in negotiations with trustees on long term cash requirements. However, quite whether the dramatic falls in gilt yields are a rational guide for long term funding is a question in itself, one which does challenge the relevance of those headline figures.”*

Accounting rules mean that corporate pension deficits must be quoted using a mechanistic process. This contrasts with long term cash funding deficits, where judgement plays an important role in applying financial market data.

“Finance directors will now be watching the path corporate bond yields follow into the year end. If the recent falls in gilt yields do suck that AA yield down even further, we face the prospect of remarkably large deficits within corporate balance sheets, regardless of any judgement calls over short term distortions in bond markets. History shows us that corporate auditors leave little room for manoeuvre.

“So, as we head on into Christmas, what has 2011 shown us?”

“First up, over the year as a whole, market pricing need not be as volatile as global news suggests. This year has seen such momentous events in North Africa along with the dominance of finance in decision-making, and even replacement of governments, within Europe. Yet, the first six months of 2011 showed barely a murmur in key financial indicators such as stock market values, bond yields and inflation expectations. Rarely have the Doldrums seemed so attractive.

“Lesson number two: while there is such apparent stability in financing corporate pension schemes, the day to day picture is so different. The Emperor’s New Clothes were spotted on 12 October with a devastating impact over the following week. In just 4 days, corporate bond yields fell from a seemingly impregnable 5¼% to 5%. A small change perhaps? It may seem so at first sight, but this creates £80 bn of liability on corporate balance sheets.

“2011 has also burst the bubble on the idea that August is that quiet time when everyone just packs up and lies low for a month. Whether your interest is in equity prices, bond yields, or even the social state of the country, August was an interesting time for us all.

“Another lesson from 2011 has been the difference between corporate accounting for pension costs and cash funding deficits. The year closes with question marks over any mechanistic approach for cash funding. The last four months have also reminded us that a trustee’s funding nightmare may be a finance director’s dream. Perhaps 2012 will tell us the opposite, for that is certainly equally possible.

“Finally, and positively, 2011 has been a year when the de-risking of investment risk has borne fruit. A growing number of pension schemes have now taken major steps both to reduce exposure to equity markets and to dampen the impact of bond yields and inflation on their deficits. Much as the close of the year looks to present disappointing news, we should not forget that the grass could have been so much less green.”

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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