The FTSE 350 and their pension disclosures

An Annual Report from JLT Pension Capital Strategies
May 2012

Strategies to Solutions

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JLT PENSION CAPITAL STRATEGIES

FTSE 350

In association with J.P.Morgan CAZENOVE

Executive Summary

- The total deficit in FTSE 350 pension schemes at 31 December 2011 is estimated to be £67 billion.
- Over the last 3 years, FTSE 350 pension schemes have gone from a total surplus of £13 billion to an overall deficit of £67 billion despite FTSE 350 companies paying £31 billion of deficit funding into their pension schemes. Ten FTSE 350 companies (Royal Dutch Shell, HSBC, Lloyds Banking Group, Unilever, BT, BAE Systems, GlaxoSmithKline, National Grid, Barclays and Aviva) have each paid more than £1 billion of deficit funding into their pension schemes over the last three years.
- The average pension scheme asset allocation to bonds has increased from 33% to 50% in the last five years, although the pace at which companies and trustees are switching pension assets out of equities into bonds would appear to have slowed. Over the past three years, 20 FTSE 350 companies have switched more than a quarter of their assets from equities into bonds. Aegis has seen the greatest switch, moving from 24% of assets in bonds in 2008 to 95% of assets in bonds in 2011. .
- The total disclosed pension liabilities of the FTSE 350 companies have increased to £513 billion in 2011 from £432 billion in 2008. 14 companies have disclosed pension liabilities of more than £10 billion, whilst 121 FTSE 350 companies have no defined benefit pension scheme at all.
- If pension liabilities were to be measured on a risk-free basis rather than using a AA bond discount rate, we estimate that it would increase the total disclosed pension liabilities of the FTSE 350 from £513 billion to around £730 billion and the total deficit at 31 December 2011 would be almost £160 billion.
- 34 FTSE 350 companies have disclosed pension liabilities greater than the total equity value of the company, and 11 FTSE 350 companies now have disclosed pension liabilities valued at over double the company equity value.
- Companies are reacting to the combination of difficult economic conditions, rising pension costs and increasingly aggressive pension regulations by closing pension schemes to future and even current employees. Already, more than a third of all FTSE 350 companies do not have a DB pension scheme. The decline in DB pension provision is reflected in the total service cost in the latest FTSE 350 accounts of £7.5 billion, which compares to £8.5 billion in 2008. PCS believes that the majority of FTSE 350 companies will cease DB pension provision to all employees within the next two years

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Funding Position

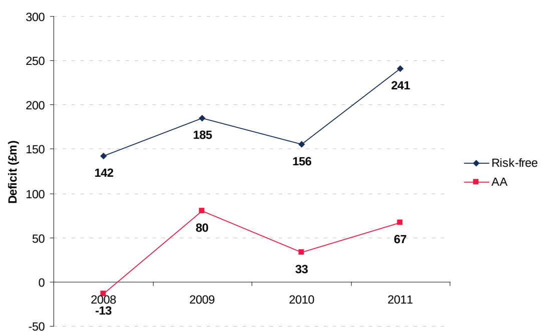
The overall funding position of pension schemes of FTSE 350 companies has seen some major swings over the past three years.

Including all pension arrangements, both UK and overseas, whether funded or unfunded, the FTSE 350 companies with the largest pension scheme surpluses over the past three years were as follows:

2009			2010			2011		
Name	Surplus/ (Deficit) £m	Funding Level	Name	Surplus/ (Deficit) £m	Funding Level	Name	Surplus/ (Deficit) £m	Funding Level
Rolls-Royce	900	114%	Prudential	338	107%	Prudential	312	105%
Prudential	644	114%	Old Mutual	138	117%	Standard Life	216	111%
RSA	530	112%	Henderson	90	129%	Marks & Spencer	182	103%
AMEC	156	115%	Resolution	59	106%	Old Mutual	142	115%
Henderson	153	161%	Gartmore Group	51	159%	Rolls-Royce	115	101%
Rentokil Initial	135	115%	WH Smith	25	103%	Henderson	113	133%
Standard Life	116	108%	Provident Financial	20	104%	WH Smith	69	110%
Provident Financial	51	114%	Ladbrokes	15	107%	Resolution	66	106%
Babcock International	51	103%	Dignity	9	113%	Phoenix Group	56	102%
Old Mutual	50	106%	Hunting	8	104%	Next	56	112%
Inchcape	50	107%	Man Group	5	102%	3i	44	107%
Punch Taverns	34	110%	London Stock Exchange	5	102%	Experian	42	108%
United Business Media	31	108%	British Land	3	103%	Provident Financial	41	109%
WH Smith	26	104%	Investec	1	101%	Morrison Supermarkets	38	102%
Schroders	22	104%	Derwent London	1	108%	London Stock Exchange	38	115%

The FTSE 350 companies with the largest pension scheme deficits over the past three years were as follows:

2009			2010			2011		
Name	Surplus/ (Deficit) £m	Funding Level	Name	Surplus/ (Deficit) £m	Funding Level	Name	Surplus/ (Deficit) £m	Funding Level
Barclays	(1,119)	93%	Aviva	(1,707)	86%	Imperial Tobacco	(754)	79%
Diageo	(1,197)	79%	Unilever	(1,723)	88%	TUI Travel	(795)	61%
National Grid	(1,203)	92%	GlaxoSmithKline	(1,744)	86%	British Airways	(826)	95%
Lloyds Banking Group	(1,392)	94%	Tesco	(1,840)	72%	Unilever	(1,219)	92%
Tesco	(1,494)	70%	AstraZeneca	(2,027)	68%	GlaxoSmithKline	(1,223)	91%
GlaxoSmithKline	(1,692)	85%	Royal Dutch Shell	(2,068)	95%	Tesco	(1,356)	81%
AstraZeneca	(1,760)	69%	British Airways	(2,070)	88%	AstraZeneca	(1,582)	75%
Rio Tinto	(1,826)	78%	Rio Tinto	(2,348)	77%	Royal Dutch Shell	(1,680)	96%
Royal Bank of Scotland	(1,996)	93%	Royal Bank of Scotland	(2,905)	91%	BT	(1,830)	95%
HSBC	(2,164)	87%	BP	(3,539)	85%	HSBC	(1,834)	91%
Unilever	(2,590)	82%	Lloyds Banking Group	(3,555)	87%	Rio Tinto	(2,095)	80%
BP	(3,941)	82%	HSBC	(3,763)	80%	Royal Bank of Scotland	(2,183)	91%
BT	(3,973)	88%	Barclays	(3,786)	82%	Barclays	(2,738)	87%
BAE Systems	(4,155)	76%	BAE Systems	(5,346)	74%	BP	(2,944)	88%
Royal Dutch Shell	(5,763)	84%	BT	(7,864)	82%	BAE Systems	(3,821)	82%



Commentary

Adjusting all these figures to 31 December in each year, we estimate that the total pension deficit in the FTSE 350 as at 31 December 2011 was £67 billion. This compares to an estimated deficit of £33 billion at 31 December 2010, a deficit of £80 billion at 31 December 2009 and a surplus of £13 billion at 31 December 2008.

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Investment Mismatching

Legislation over a number of years has clarified that pension liabilities are a form of corporate debt. Inevitably, analysis of mismatching is limited to the information disclosed in the annual report and accounts. Given the bond-like nature of pension liabilities, the allocation of pension assets to bonds gives an indication of the level of investment mismatching that exists.

The FTSE 350 companies with the highest allocation to bonds over the past three years were:

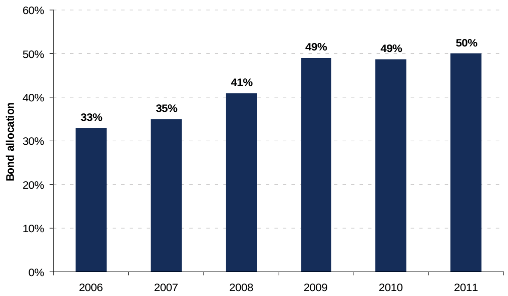
2009		2010		2011	
Name	**% Assets in bonds**	**Name**	**% Assets in bonds**	**Name**	**% Assets in bonds**
Hunting	97%	Gartmore Group	100%	Hunting	100%
WH Smith	94%	Hansen Transmissions	100%	WH Smith	96%
Fresnillo	91%	Hunting	98%	Aegis	95%
Misys	88%	WH Smith	96%	Cape	90%
ICAP	88%	Misys	89%	Phoenix Group	85%
London Stock Exchange	86%	Fresnillo	88%	BTG	83%
Rolls-Royce	83%	Capital Shopping Centres	87%	Resolution	83%
Logica	83%	Resolution	83%	Rolls-Royce	82%
Sage Group	78%	Phoenix Group	83%	Prudential	82%
Weir Group	78%	Rentokil Initial	83%	Rentokil Initial	81%

The FTSE 350 companies with the lowest allocation to bonds over the past three years were:

2009		2010		2011	
Name	**% Assets in bonds**	**Name**	**% Assets in bonds**	**Name**	**% Assets in bonds**
International Power	16%	Wood Group (John)	14%	Inmarsat	18%
Tullett Prebon	14%	Derwent London	13%	Wood Group (John)	16%
Inmarsat	12%	International Power	13%	BG	14%
Northumbrian Water	11%	Tullett Prebon	10%	Evraz	14%
BSS Group	9%	Inmarsat	10%	International Power	13%
St. Modwen Properties	7%	RIT Capital Partners	7%	Tullett Prebon	10%
RIT Capital Partners	4%	St. Modwen Properties	6%	Homeserve	8%
Renishaw	2%	Homeserve	5%	RIT Capital Partners	8%
Homeserve	0%	Renishaw	2%	Renishaw	2%
Hammerson	0%	Hammerson	0%	Hammerson	0%

The FTSE 350 companies with the greatest three-year change in investment strategy were

	Assets in Bonds						
Name	**2006 bonds**	**2007 bonds**	**2008 bonds**	**2009 bonds**	**2010 bonds**	**2011 bonds**	**Switch to bonds**
Aegis	31%	28%	24%	46%	47%	95%	+64%
Premier Farnell	12%	13%	14%	42%	76%	75%	+63%
Standard Life	12%	27%	33%	49%	51%	69%	+57%
Misys	23%	19%	71%	88%	89%	80%	+57%
G4S	30%	30%	33%	43%	42%	81%	+51%
Rolls-Royce	32%	32%	74%	83%	82%	82%	+51%
Prudential	36%	57%	61%	75%	75%	82%	+47%
Dairy Crest	26%	36%	39%	43%	73%	71%	+45%
Galliford Try	30%	36%	49%	57%	65%	74%	+44%
Rentokil Initial	38%	77%	78%	62%	83%	81%	+43%
All companies	*33%*	*35%*	*41%*	*49%*	*49%*	*50%*	*+17%*



Commentary

The average pension scheme asset allocation to bonds has increased from 33% to 50% in just five years, although the pace at which companies and trustees are switching pension assets out of equities into bonds would appear to have slowed. Over the past three years, 20 FTSE 350 companies have switched more than a quarter of their assets from equities into bonds. Aegis has seen the greatest switch, moving from 24% of assets in bonds in 2008 to 95% of assets and bonds in 2011.

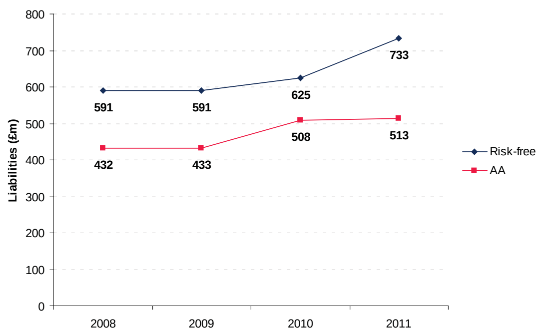
97 FTSE 350 companies now have more than 50% of assets in bonds. Moreover, company disclosures reveal little of the extensive activity there has been by a number of companies to reduce mismatching risk by LDI (liability-driven investment) strategies, which frequently make use of derivatives and other financial instruments.

Size of Pension Scheme

In recent years, pension schemes have grown significantly. Attempts by many companies to stem the growth of their pension liabilities by closing defined benefit pension schemes to new entrants have had little impact. Changes in economic conditions and increasing life expectancy have contributed to the spiralling growth in pension liabilities.

Not surprisingly, the table of the largest pension schemes in the FTSE 350 has remained fairly stable. The FTSE 350 companies with the largest pension scheme liabilities over the past three years are as follows:

2009		2010		2011	
Name	**Total pension liabilities £m**	**Name**	**Total pension liabilities £m**	**Name**	**Total pension liabilities £m**
Royal Dutch Shell	36,374	BT	43,293	Royal Dutch Shell	42,781
BT	33,326	Royal Dutch Shell	39,381	BT	39,052
Royal Bank of Scotland	27,752	Royal Bank of Scotland	30,830	Lloyds Banking Group	26,862
Lloyds Banking Group	22,326	Lloyds Banking Group	27,073	BP	25,179
BP	22,004	BP	23,281	Royal Bank of Scotland	24,999
BAE Systems	17,133	BAE Systems	20,488	Barclays	21,643
HSBC	16,494	Barclays	20,486	BAE Systems	21,158
National Grid	16,000	National Grid	19,598	HSBC	21,022
Barclays	15,615	HSBC	18,869	National Grid	19,480
Unilever	14,034	British Airways	16,826	British Airways	16,142
British Airways	12,806	Unilever	14,515	Unilever	14,983
GlaxoSmithKline	10,980	GlaxoSmithKline	12,438	GlaxoSmithKline	13,379
Aviva	9,951	Aviva	11,812	Aviva	11,419
Rio Tinto	8,288	Rio Tinto	10,006	Rio Tinto	10,575
Rolls-Royce	6,546	Rolls-Royce	7,537	Rolls-Royce	8,102
Diageo	5,789	Tesco	6,536	Tesco	6,964
AstraZeneca	5,674	AstraZeneca	6,364	Diageo	6,661
Tesco	4,914	Diageo	6,359	AstraZeneca	6,442
Invensys	4,814	Invensys	5,441	Prudential	5,692
British American Tobacco	4,752	British American Tobacco	5,370	British American Tobacco	5,512



Commentary

The total disclosed pension liabilities of the FTSE 350 companies has increased from £432 billion in 2008 to £513 billion in 2011. 14 companies have disclosed pension liabilities of more than £10 billion, whilst 121 companies have no defined benefit pension scheme at all.

The possibility of measuring pension liabilities on a risk-free basis (i.e. using gilt-based discount rates rather than AA bond discount rates) has been debated at length, including in the recent detailed discussion paper from the Accounting Standards Board. In the UK, a company can no longer default on its promises to pension scheme members unless it goes into liquidation (in which case it is likely there is no value left for shareholders). It is therefore difficult to see that shareholders get any value out of their limited ability to default on pension promises, and so applying a discount rate which allows for a probability of default is possibly illogical.

If pension liabilities were to be measured on a risk-free basis rather than using a AA bond discount rate, we estimate that it would increase the total disclosed pension liabilities of the FTSE 350 from £513 billion to around £630 billion and the total deficit at 31 December 2011 would be over £240 billion.

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Significance of the Pension Scheme in the Boardroom

The impact of the pension liabilities on corporate decision-making and its importance in the boardroom depends on the relative size of the pension scheme. In the analysis below, the pension scheme liabilities are expressed as a percentage of the equity market value (as at 31 December) of the company.

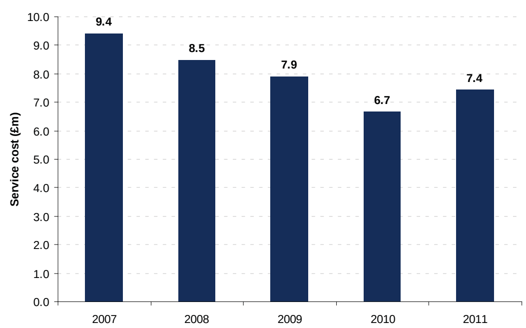
The FTSE 350 companies with the most significant pension scheme liabilities over the past three years are as follows:

2009			2010			2011		
Name	**Liabilities £m**	**Liabilities as a % of EMV***	**Name**	**Liabilities £m**	**Liabilities as a % of EMV***	**Name**	**Liabilities £m**	**Liabilities as a % of EMV***
British Airways	12,806	596%	Premier Foods	2,959	640%	British Airways	16,142	590%
Trinity Mirror	1,379	353%	British Airways	16,826	537%	Cable & Wireless Worldwide	1,470	338%
BT	33,326	319%	BT	43,293	310%	Phoenix Group	2,995	333%
Premier Foods	2,540	297%	Phoenix Group	2,935	291%	Invensys	5,452	320%
Northern Foods	705	225%	Go-Ahead	1,375	244%	Dixons Retail	950	267%
Interserve	534	221%	Invensys	5,441	190%	Go-Ahead	1,568	266%
Invensys	4,814	202%	Atkins (WS)	1,323	188%	BT	39,052	265%
Go-Ahead	1,142	201%	BAE Systems	20,488	182%	BAE Systems	21,158	220%
Kier	729	192%	Taylor Wimpey	1,819	181%	FirstGroup	3,450	212%
Royal Bank of Scotland	27,752	168%	FirstGroup	3,458	180%	Royal Bank of Scotland	24,999	209%

** equity market value as at as at 31 December*

A further sign of the significance of pensions in the boardroom is the extent of continuing DB provision to employees. This can be measured by looking at the ongoing spend on DB pensions (the service cost) before any allowance for deficit spending. The FTSE 350 companies with the highest ongoing spending over the past three years are as follows:

2009		2010		2011	
Name	**Service cost £m**	**Name**	**Service cost £m**	**Name**	**Service cost £m**
Royal Bank of Scotland	705	Royal Dutch Shell	619	Royal Dutch Shell	738
Royal Dutch Shell	655	Royal Bank of Scotland	583	Royal Bank of Scotland	499
Lloyds Banking Group	469	BP	430	Tesco	499
BT	459	Lloyds Banking Group	395	BP	488
BP	442	Tesco	391	Lloyds Banking Group	384
Tesco	428	HSBC	381	HSBC	358
HSBC	405	Barclays	281	Barclays	343
Barclays	299	GlaxoSmithKline	251	BT	297
GlaxoSmithKline	246	BT	206	GlaxoSmithKline	268
Unilever	214	Unilever	203	Unilever	224



Commentary

34 FTSE 350 companies have disclosed pension liabilities greater than the total equity value of the company, and 11 FTSE 350 companies now have disclosed pension liabilities valued at over double the company equity value.

Companies are reacting to the combination of difficult economic conditions, rising pension costs and increasingly aggressive pension regulations by closing pension schemes to future and even current employees. Already, more than a third of all FTSE 350 companies do not have a DB pension scheme. The decline in DB pension provision is reflected in the total service cost in the latest FTSE 350 accounts of £7.4 billion, which compares to £9.4 billion in 2007. PCS believes that the majority of FTSE 350 companies will cease DB pension provision to all employees within the next two years.

Contributions Paid Into Pension Schemes

This analysis compares the pension scheme contributions actually paid by companies with the cost of pension benefits accrued during the year. Pension contributions paid in excess of the cost of benefits will reduce pension scheme deficits. But where the contributions paid are less than the cost of benefits, this will increase pension scheme deficits (or reduce pension scheme surpluses).

The large increases in the contributions seen in the last couple of years have slowed, with the amount contributed in the most recent accounting year being £0.5 billion lower than the amount contributed the previous year.

Only contributions actually paid in the relevant accounting year are included in the analysis below.

The FTSE 350 companies who have made the largest surplus contributions to their pension schemes over the past three years were as follows:

	Pension Contributions			Cost of Benefits			
Name	**2009 £m**	**2010 £m**	**2011 £m**	**2009 £m**	**2010 £m**	**2011 £m**	**Surplus contributions £m**
Royal Dutch Shell	891	3,345	1,334	655	619	738	3,559
HSBC	381	617	2,146	410	394	378	1,963
Lloyds Banking Group	762	1,859	648	504	462	430	1,873
Unilever	594	1,071	574	195	159	172	1,713
BT	441	916	1,313	459	206	297	1,708
BAE Systems	486	864	791	167	183	251	1,540
GlaxoSmithKline	443	894	814	258	245	268	1,380
National Grid	799	572	408	136	112	165	1,366
Barclays	407	601	721	312	282	105	1,030
Aviva	620	294	579	163	156	170	1,004
Royal Bank of Scotland	810	1,153	832	733	598	566	898
Rio Tinto	231	370	670	147	130	156	838
Centrica	240	403	441	103	70	115	796
British Airways	331	364	268	154	123	137	549
AstraZeneca	207	365	296	185	181	80	423
Rolls-Royce	279	288	282	162	129	153	405
GKN	37	51	388	38	30	35	373
BP	271	646	835	487	431	489	346
British American Tobacco	145	214	218	79	82	76	340
Marks & Spencer	92	83	260	72	56	59	247

Commentary

In total, the amount contributed to FTSE 350 company pension schemes was £19.6 billion in the latest accounting year (cf. £7.1 billion cost of benefits), down from £20.0 billion in the previous accounting year (cf. £6.8 billion cost of benefits), and £13.5 billion the year before that (cf. £8.1 billion cost of benefits). Over the last three years a total of £31 billion has been paid into the pension schemes of FTSE 350 companies. Ten FTSE 350 companies have each paid more than £1 billion of deficit funding into their pension schemes. Despite this additional funding FTSE 350 pension schemes have gone from an estimated total surplus of £13 billion at 31 December 2008 to an estimated deficit of £67 billion at 31 December 2011.

Widening deficits, and perhaps weaker perceived sponsor covenants, will inevitably lead to trustees requesting larger deficit-correcting contributions from sponsoring employers. This year we expect to see a trend towards companies looking at alternative sources to fund their pension schemes. We are starting to see some companies make use of property partnership deals to help tackle their pension deficits. For example, Marks & Spencer, Sainsbury and Whitbread have used a total of £2.5billion worth of property assets in such deals

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Notes

All of the analysis contained in this report is based on the IAS19 numbers disclosed in companies' annual report and accounts.

No adjustment is made for the fact that companies have applied different interpretations of IAS19 and have used different actuarial assumptions (for example, different mortality assumptions can make a significant difference to a company's pension liabilities).

No adjustment is made in the individual analysis for the fact that companies have different year-ends. Inevitably, different market conditions applying at different year-ends will affect the comparisons.

The assets and liabilities shown are the total global pension assets and liabilities, not just the UK figures.

The figures shown in this report are before adjustment for IFRIC14 (and before adjustment for any other unrecognised pension surpluses).

For full details of all the FTSE 350 companies and their relevant pension disclosures please see the corresponding PCS reports "The FTSE 100 and their pension disclosures" and "The FTSE 250 and their pension disclosures."

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