LCP INSIGHT CLARITY ADVICE

LCP ACCOUNTING FOR PENSIONS 2013

This is our 20th annual survey of FTSE 100 companies' pensions disclosures. Much has changed over 20 years yet, perhaps surprisingly, much has stayed the same.

In this report we look back over 20 years' statistics as well as highlighting current facts, figures and trends.

Main findings

Accounting for Pensions - 20 years on

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Bob Scott
Partner
LCP

Faced with the costs of auto-enrolment and deficits that have remained stubbornly high, a growing number of FTSE 100 companies have closed their defined benefit pension schemes to future accrual.

Introduction

Welcome to our 20th annual survey of FTSE 100 companies' pensions disclosures.

Pension planning continues to be blighted by seemingly constant regulatory and legislative change. In the past 12 months alone we have seen the re-introduction of automatic enrolment; the announcement of a flat-rate State pension and the end of contracting out; and further changes to the IAS19 accounting standard. Is it any wonder that the past 20 years have seen traditional "final salary" pension schemes phased out to be replaced largely by defined contribution schemes?

Nevertheless, FTSE 100 companies remain responsible for pension liabilities worth nearly £0.5 trillion – a responsibility that presents a greater challenge now that pension scheme assets cover only 91% of the liability value than seemed to be the case in 1994. Back then companies reported an average funding level of 120%.

Many companies have taken further steps to reduce their exposure to pension risks: the most striking change in the past 20 years has been the reduction in the proportion of assets held in equities. Although market movements have meant a small increase in the proportion this year, FTSE 100 pension schemes now only hold 36.5% of their assets in equities compared to almost 70% in 2001.

We hope that you enjoy our analysis of recent accounts and of the past 20 years' developments and that the next 20 years is a happier period for pension provision than the past two decades.

Click here to view a welcome by Bob Scott.

Bob Scott
Partner
LCP

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1.1 Deficits persist

- We estimate that at the end of June 2013 the total IAS19 pension deficit for FTSE 100 companies was £43 billion, compared to £42 billion a year earlier.
- This reflects total assets of £447 billion, which represent approximately 91% of liabilities valued at £490 billion. The lowest level of cover was around 45%.
- *Our first survey, in 1994, showed that assets were sufficient to cover 120% of pension liabilities with the worst funded scheme being 88% funded.*

1.2 Low bond yields make funding negotiations difficult

- Economic conditions have been difficult, particularly for companies with pension schemes that have funding valuations due in 2012 or 2013. Low bond yields mean higher funding targets and bigger deficits for companies to fill.
- This led to calls for "smoothing" of asset and liability figures in 2012 – a concept that was rejected by the DWP. Instead, The Pensions Regulator was given a new statutory objective – to minimise any adverse impact on the sustainable growth plans of sponsoring employers.
- *Smoothing of asset values was standard practice when we carried out our first survey, in 1994. Indeed, we drew attention then to the opaque way in which companies calculated smoothed asset values and the impact that could have on their accounting figures.*
- A return to smoothing would, in our view, have been a retrograde step.

1.3 Company contributions continue to rise

- 2012 saw another increase in pension contributions with FTSE 100 companies paying £21.9 billion into their schemes, compared to £21.4 billion in 2011. This included a one-off contribution of £2 billion by **BT Group**.
- Contributions to defined contribution schemes increased again as companies closed their defined benefit schemes. As more FTSE 100 companies comply with auto-enrolment legislation, we expect to see the amounts paid to defined contribution schemes increase further.
- *This contrasts with the position in 1994 when many FTSE 100 companies still enjoyed contribution "holidays" and a number showed negative pension costs and balance sheet assets in their accounts.*

£21.9bn
of pension contributions in 2012. Many companies paid no pension contributions in 1994.

1.4 Allocation to equities increases

- At the end of 2012, FTSE 100 pension schemes held 36.5% of their assets in equities, compared to 34.8% at the end of 2011.
- This marks a – possibly temporary – cessation of a trend that has seen companies and pension scheme trustees systematically switch assets out of equities and into bonds.
- *When companies were first required to disclose this information, in 2001, FTSE 100 pension schemes held nearly 70% of their assets in equities.*
- Some companies disclosed significant changes in their investment mix over the past year. For example, **Bunzl** reduced its pension scheme's allocation to equities by 10% and **Meggitt** moved 16% of its UK pension scheme's assets from equities to bonds.
- On the other hand, **Croda** made one of the biggest switches into equities, with its pension scheme increasing its allocation by 9%.

1.5 More pension schemes close

- *In 1994 when we carried out our first survey, all FTSE 100 companies ran a defined benefit scheme and, as far as we were aware, all of these were open to new employees as well.*
- In 2012, with virtually all defined benefit schemes already closed to new employees, many FTSE 100 companies have taken steps to close their schemes to future benefit accrual for existing employees.
- During 2012, a further seven of the FTSE 100, including **HSBC**, **Kingfisher** and **Sainsbury's** either closed their defined benefit pension scheme to future accrual or announced proposals to do so. This leaves only 61 companies with defined benefit schemes open to future accrual.
- Accordingly, 39 FTSE 100 companies now provide only defined contribution pensions for their employees.
- *This contrasts with the position in 1996 when, for the first time, two FTSE 100 companies (BSkyB and Foreign & Colonial) offered only defined contribution pensions to their employees.*
- This trend is likely to accelerate further as companies face potentially higher National Insurance contributions from 2016 when contracting out ceases.

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FTSE 100 companies only provide defined contribution pensions compared to two in 1996.

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With more and more defined benefit schemes becoming purely legacy issues, we expect to see an increase in the number of companies looking to transfer their pension schemes to an insurance company.

- **Tate & Lyle** was one of the blue chip companies that completed a buy-in transaction during 2012.

1.6 Accounting standards set to change

- FTSE 100 companies will be required to comply with revised accounting standards from 2013. The changes will reduce companies' flexibility and will push up pension costs in most cases.
- Companies will have to show the full pensions deficit on the balance sheet – the option of spreading outside a corridor is being withdrawn. **Royal Dutch Shell** stated in its 2012 accounts that, had the revised standard applied at the end of 2012, its total equity would have been lower by around $14 billion.
- Companies will also no longer be able to calculate an "expected return on assets" based on their assumptions for asset returns. In many cases this will reduce companies' disclosed profits. **GlaxoSmithKline** states that the new standards would have reduced core operating profit for 2012 by £92 million and **Diageo** states its profits would have been £65 million lower.
- Companies will need to prepare for wide ranging changes to disclosure requirements. There are fewer prescriptive rules and a greater emphasis on broad principles, which in theory should mean that pension disclosures are more appropriate given the size of the company and pension scheme.
- *Since 1994, our surveys have called for clearer and more informative disclosure of companies' pensions obligations. The position has improved considerably over the last 20 years although there are still shortcomings in the information that companies are required to disclose.*
- *In particular, although the accounting figures are calculated objectively by reference to IAS19, they bear no relation to the actual funding position of the pension scheme as they effectively assume 100% investment in corporate bonds.*

1.7 Legislation brings major changes to the UK pension system

- The past 12 months have seen significant legislative and regulatory developments that affect UK pension provision.
- From October 2012 the UK's largest companies were required to automatically enrol qualifying employees into a suitable pension scheme.
- From April 2016, the State Pension will become flat rate, and "contracting out" of the State Second Pension will no longer be possible.
- Tax allowances for pensions savings are set to reduce again as the government struggles to balance its books.
- One positive development is that the threat of "Solvency II" style funding for pension schemes has receded. We previously estimated that this could have increased funding requirements for FTSE 100 companies by £200 billion. However, the European Union is still to announce its proposals on changes to transparency and governance and, therefore, any respite may only be temporary.

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Bob Scott
Partner
LCP

*Employees automatically join a pension scheme?
Actuarial valuations use smoothed asset values?
And the Chancellor raising revenue from pension funds?*

Plus ça change plus c'est la même chose.

This year sees the 20th LCP Accounting for Pensions survey. In this section we look at some of the developments and changes over the past 20 years and consider what they have meant for the typical FTSE 100 company.

2.1 We've been here before

Looking back to our first survey in 1994 and beyond, it is apparent that many of the pensions issues that were of concern to companies in previous decades remain relevant today.

Auto-enrolment

Prior to 1988, many companies automatically enrolled their employees in a pension scheme when they joined. However, in 1988 "personal pensions" were launched as a new savings vehicle and individuals were given the right, if they wished, to opt out of company pension provision.

25 years later, automatic pension membership is back again.

Sharks in the pool

When compulsory membership ceased in 1988, aggressive insurance salesmen were able to persuade a large number of people that they would be better off in a personal pension than in their employer's scheme.

The response of the regulators led to billions of pounds being spent on reviewing advice given to individuals, paying compensation and reinstating past pension benefits.

Today, aggressive salesmen continue to target individuals with pensions savings, offering them the prospect of early access to their pension funds (known as pension "liberation"). These schemes are often based on misleading information and result in individuals being charged high levels of commission and facing hefty tax bills from HMRC. The Pensions Regulator is currently taking action to clamp down on such practices.

Smoothing

Twenty years ago most pension scheme valuations used a "smoothed" asset value, calculated by reference to government bond yields, equity dividends and an assumption about future dividend growth. The method was opaque and not well understood and fell away once accounting standards moved to a "mark to market" approach, with the introduction of FRS17 in 2001.

However, in 2012, as government bond yields reached new lows, and as pension deficits climbed, there were calls from a number of sources for a return to

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"smoothing" in pension fund valuations. Although the DWP issued a call for evidence for this in early 2013, the reintroduction of smoothing was ultimately rejected.

As we highlighted in 1994, smoothing of asset values could lead to two companies with similar pension schemes showing very different figures just by changing the assumption about future dividend growth. In our view, a return to smoothing would be a retrograde step.

Where to invest?

In 1975, inflation reached a peak of 26.9% pa, well above the yield available on government bonds. Companies seeking a real return turned to a range of esoteric investments - most notably the British Rail pension fund, which invested in a portfolio of fine art which, its trustees reckoned, would hold its value in real terms.

In 2000, Boots challenged the received wisdom at that time and decided that government and corporate bonds were such an attractive investment that it invested 100% of its pension scheme assets in bonds, selling out of a falling equity market. No other company took such an extreme position in 2000, although most pension schemes have since sought to move at least some of their equity assets into bonds.

In 2013, with real yields on government bonds negative again, companies and trustees are again seeking investments that are likely to generate real returns. For the first time, the trend towards greater investment in bonds has paused and pension schemes are looking to investments such as infrastructure. **BAE Systems**, **BT Group**, **International Airlines Group** and **Lloyds Banking Group** are amongst those signing up to the government's Pensions Infrastructure Platform.

Taxation

Pensions strategy has always been heavily influenced by tax considerations. In the 1970s and early 1980s, companies paid money to their pension schemes to avoid high corporate tax rates and to provide benefits to their employees without falling foul of the government's incomes policy, which limited pay rises to no more than 5%.

These contributions, allied with strong investment returns over the following years were two of the factors that led to substantial surpluses in pension funds – and, in 1986, to legislation under which such surpluses were taxed. Later, both Norman Lamont

and Gordon Brown saw pension funds as a ready source of income as they first reduced, then removed altogether, the concession that had enabled pension funds to receive equity dividends free of UK tax.

Today, constant changes to the tax laws and ever more restrictive and complex provisions discourage pensions savings, with the result that employers are reluctant to provide good pensions and individuals are wary of them.

Contracting out

In 1978, the State Earnings Related Pension Scheme (SERPS) was established. Employers were able to "contract out" of SERPS and pay lower National Insurance contributions as a result, so long as their pension scheme provided at least a similar level of pension to their employees.

SERPS has undergone myriad changes over the past 35 years and is now known as the State Second Pension. However, from 2016, we will have a flat rate state pension, the State Second Pension will be no more and contracting out will cease.

This will result in an increase in National Insurance contributions for many employers and could significantly accelerate the closure of remaining defined benefit schemes to future accrual.

2.2 What has changed in 20 years?

Although some issues are unchanged, there have certainly been plenty of changes to the pensions landscape over the last 20 years.

Funding levels

Our 1994 survey showed that 88% of FTSE 100 schemes were in surplus at their accounting dates with funding levels ranging from 88% to 183% and the average funding level was 120%. By 2001, as companies began to report results under the updated accounting standard, FRS17, the average funding level was down to 100% with just under half the schemes in surplus.

This year, our survey shows an average funding level of just 87%, with levels ranging from 45% to 117% and only 14 of the FTSE 100 declaring a pension surplus at their 2012 balance sheet date.

The fall in funding levels comes despite a decade of rising contributions and continued reductions in the level of benefits being provided to employees. It is primarily due to a marked fall in corporate bond yields, used to value pension liabilities for accounting purposes, and revisions to companies' assessments of how long their employees will live.

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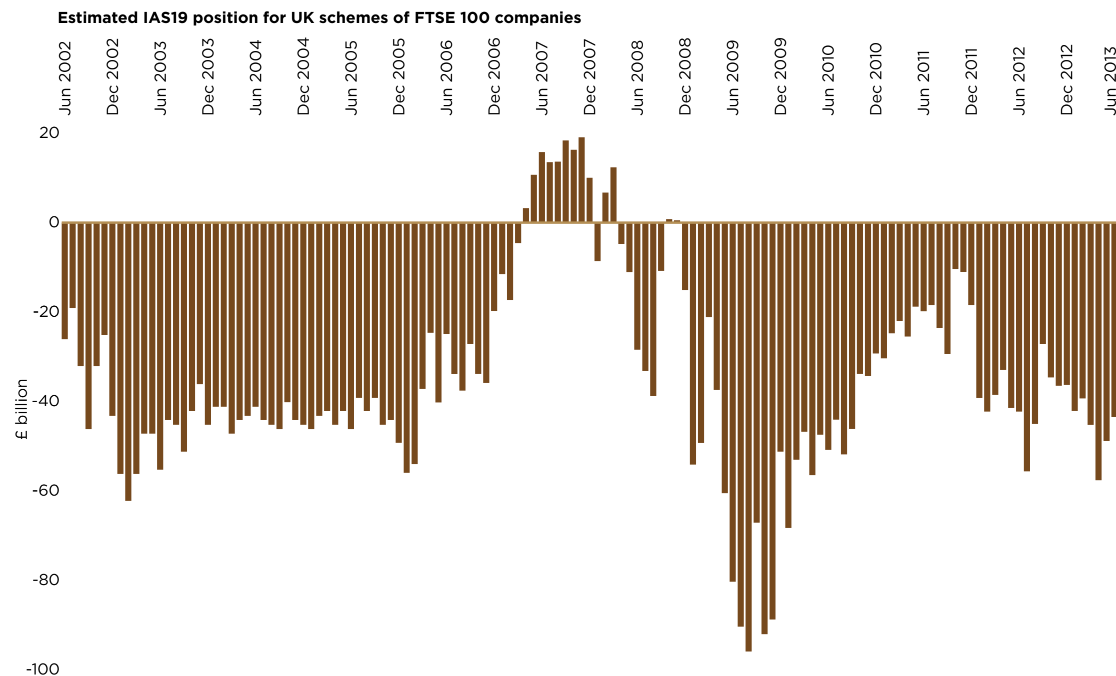
The estimated total deficit for FTSE 100 companies since 2002 is shown in the chart opposite. This shows that there have only been a few relatively short periods for which there has been an overall surplus, and illustrates the significant volatility in the position – particularly since 2006 – that companies have had to contend with.

Disclosure of information

Since 1994, our annual survey has consistently called for improvements in the level and quality of information that companies disclose in their accounts.

Although complying with the letter of the law, many of the disclosures in 1994 left the reader with no real idea of the significance of a company's pension arrangements and the risks that the company was running as a result.

Changes in accounting standards, combined with greater realisation of the significance of pension liabilities – and the influence of our survey – have led to far more detailed and informative disclosures. We welcome this development.



Final salary provision

In 1994, all FTSE 100 companies provided final salary pensions to their employees.

The first signs of a move away from final salary schemes came in our 1996 survey when two new entrants to the FTSE 100 (BSkyB and Foreign & Colonial) offered only defined contribution (or money purchase) pensions to their employees.

At the time, we made the general comment that "employees should understand that low-cost money purchase schemes will not provide an adequate income in retirement".

The trend accelerated following the 1997 tax changes (see section 3) as well as the significant pensions legislation introduced in the Pensions Act 1995 in response to the Maxwell scandal.

Still, by 2001, 75 of the FTSE 100 companies continued to offer defined benefit pensions to new and existing employees.

In December 2005 Rentokil announced that it would close its final salary scheme to future accrual – the first FTSE 100 company to take this step. Finally, the weight of pensions regulation combined with unfavourable investment conditions had led to companies seeking to manage their pension liabilities more proactively.

By the time we completed our 2007 survey, the government had announced plans for auto-enrolment to take effect from 2012. At that time we predicted that no FTSE 100 company would offer final salary pensions to new employees by 2012.

This year we have seen one new entrant to the FTSE 100 (**Croda**) which offers a final salary scheme to its new employees but, otherwise, final salary pensions are a thing of the past for new employees.

Impact on corporate activity

The 1980s and early 1990s saw considerable amounts of corporate activity. Companies with surpluses in their pension schemes could become takeover targets with the predator looking to realise the benefit of that surplus.

Successive pieces of legislation, combined with the general decline in funding levels meant that, by 2003, the picture was very different.

Most schemes had funding deficits by then and a company that sponsored a pension scheme was liable to fund the scheme up to the level required to buy out the benefits with an insurance company.

The Pensions Act 2004 gave even greater powers to trustees who used those powers notably to thwart potential takeovers (for example, WH Smith – where the pension scheme trustees demanded that any buyer of the business would need to make a large cash injection to the scheme), to impose their own terms, or just to extract additional funding from their sponsors.

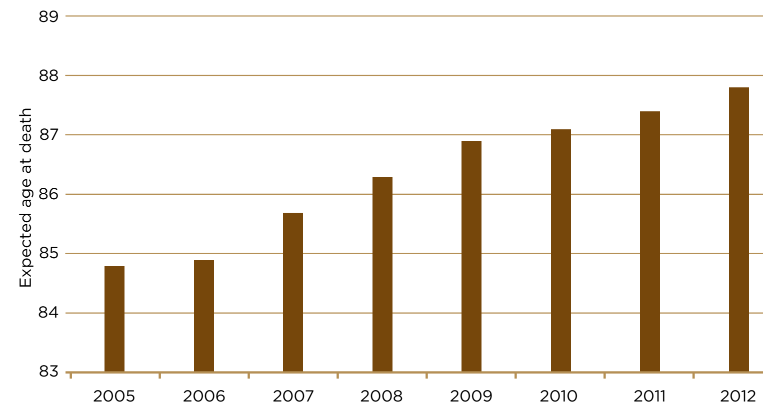
Today, some would say that companies with a large defined benefit scheme are almost immune from takeover – certainly they are not as highly sought after as in 1994.

Life expectancy

Over the last decade various surveys have revealed continuing increases in life expectancy. Whilst this is good news for us all, the longer period for which pensions are now expected to be paid has meant increased costs for companies.

Prior to the introduction of IAS19 in 2005, very little disclosure on mortality assumptions was made available in company accounts, with much more focus on the financial assumptions used to value pension promises.

However, even looking over the last eight years, the allowance made for life expectancy has increased materially. In 2005 the average assumption was that a male retiring at age 65 would live a further 19.8 years, until just before his 85th birthday. However, the equivalent assumption in 2012 was that a male age 65 would live for 22.8 years – an increase in life expectancy of 3 years. This is illustrated in the following chart.



Looked at differently, this means that companies' assumptions on how long their former employees will live has, on average, increased by over five months every year between 2005 and 2012. Over this period this will have served to increase accounting liabilities by around 8%, or a combined £40 billion for the FTSE 100.

£40bn
Provision for increased life expectancy since 2005.

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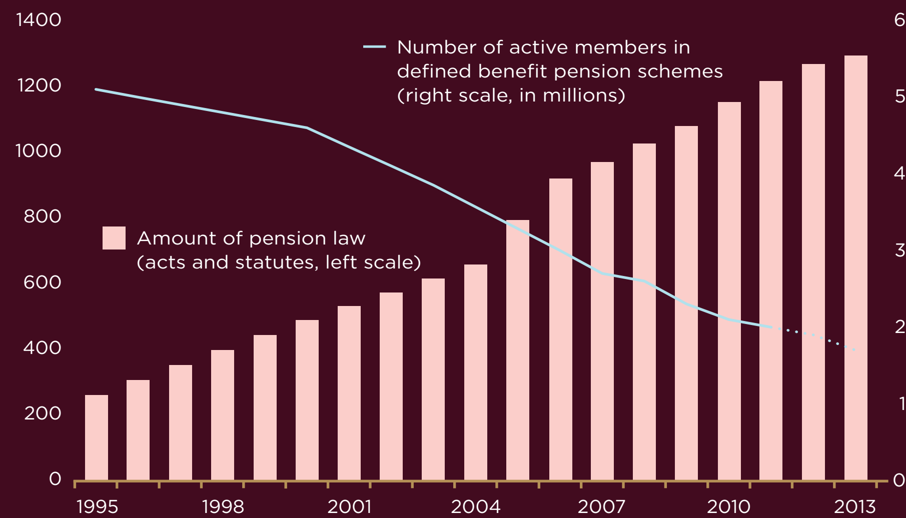
Pension regulation



Source: ONS

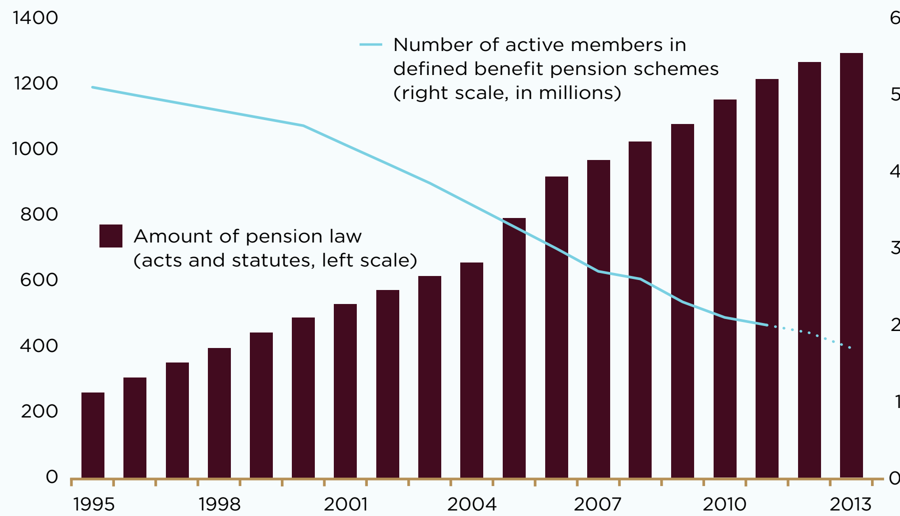
Nick Bunch
Partner
LCP

Successive governments have increased the regulatory burden on companies sponsoring pension schemes, to the extent that quality final salary pensions are now largely a thing of the past.

1970s

1980s | 1990s | 2000s | 2010s

Date	Change	Comment
Apr 1975	Preservation of benefits on leaving service introduced.	
Apr 1978	The State Earnings Related Pension Scheme commences, with the option for occupational schemes to "contract out" of this.	



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1970s | 1980s | 1990s | 2000s | 2010s

1980s

Date	Change	Comment
Jan 1986	Statutory increases on some leaver benefits prior to retirement introduced.	
Apr 1986	Nigel Lawson introduces taxation on pension scheme surpluses.	
Jul 1988	Personal pensions introduced.	With individuals given a choice of company or personal pension, compulsory enrolment ceases.
Jun 1989	Earnings cap introduced.	The earnings cap possibly marks the start of the decline of defined benefit pensions, with senior decision makers no longer fully benefiting from their company's pension scheme.
	SSAP24 accounting standard comes into force.	The first time that UK companies have had to disclose anything other than the amount of contributions paid into their pension schemes. In practice a lack of disclosure makes reliable pension comparison all but impossible.

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1970s | 1980s | **1990s** | 2000s | 2010s

Date	Change	Comment
May 1990	Barber ruling requires future pension benefits to be the same for men and women.	The impact of this ruling continues to be felt, with some pension schemes still finding that they have not "equalised" benefits correctly, and the question of how to equalise "guaranteed minimum pensions" – accrued by members in contracted out pension schemes – still unanswered.
Jan 1991	Full statutory increases to leaver benefits prior to retirement.	
Nov 1991	Robert Maxwell dies – and it emerges that he has been using money from his companies' pension funds to prop up Mirror Group.	The subsequent public outcry acts as the driver for the protections in the Pensions Act 1995, which come into force from April 1997.
Apr 1993	Norman Lamont reduces the level of tax relief on dividend payments available to pension schemes.	100 Companies disclose increased pension costs as a result of lower future expected investment returns. British Telecom (now **BT Group**) pays substantial extra contributions to its pension scheme as a result.
Apr 1997	The provisions in the Pensions Act 1995 come into force:	98
	• The Minimum Funding Requirement (MFR) sets a minimum level that all pension schemes should be funded to.	Over time the MFR proves woefully inadequate due to outdated mortality assumptions and optimistic views of future investment returns.
	• The Occupational Pensions Regulatory Authority (ORPA)is set up.	
	• Guaranteed pension increases in payment of RPI inflation up to 5% pa.	Substantially increases the cost of providing future pensions.
Jul 1997	Gordon Brown scraps tax relief on divided payments for pension schemes.	A further increase in pension cost with the income available on equities slashed by 20%.

100 These figures indicate the number of FTSE 100 companies with a final salary pension scheme open to new employees.

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1970s | 1980s | 1990s | **2000s** | 2010s

Date	Change	Comment	
Apr 2001	Stakeholder pensions introduced.	Hailed as the pension savings vehicle for those on low to moderate earnings. But in practice take up is limited.	
Jun 2001	FRS17 accounting standard first applies to UK companies.	The introduction of a market related accounting standard means significant volatility in companies' disclosed pension costs.	75
Jun 2003	Legislation is introduced to prevent companies abandoning their pension schemes without first ensuring these are funded to a level where they could be transferred to an insurance company.	This legislation has had a huge impact – overnight pensions were changed from aspirational promises to cast iron commitments with significant consequences for risk management in particular.	47
Jan 2005	IAS19 accounting standard first applies for listed UK companies.		
Apr 2005	Scheme specific funding regime introduced.		39
	Pension Protection Fund set up.	To date the Pension Protection Fund has been a huge success. But it remains to be seen how it will cope in the event of a number of companies with multi-billion pound pension scheme liabilities becoming insolvent.	
	The Pensions Regulator is formed out of the remnants of OPRA.	Intended to be a proactive, risk based, regulator of occupational pensions.	
	Pension sharing on divorce introduced.		
Apr 2006	A major change in pensions taxation comes into effect from 6 April 2006 ("A Day"). The existing Inland Revenue limits are replaced with a Lifetime Allowance and an Annual Allowance.	These changes were rolled out as "tax simplification" – in practice they have been anything but this.	28
	Level of guaranteed increases in payment reduced to RPI upto a maximum of 2.5% pa.	A welcome reduction in pension costs for employers – but too little too late, as this only applies to future benefit accrual and the decline of defined benefit pensions has gathered significant momentum.	
Apr 2009	Level of guaranteed increases after leaving service reduced from RPI up to a maximum of 5% pa to RPI up to 2.5% pa.	A further reduction in pension costs– again, only in respect of future pension accrual.	7

100 These figures indicate the number of FTSE 100 companies with a final salary pension scheme open to new employees.

1970s | 1980s | 1990s | 2000s | 2010s

Date	Change	Comment	
Jul 2010	Government announces that the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) will be used as the inflation measure in public sector pension schemes and for statutory minimum pension increases in private sector schemes.	As CPI is generally expected to be lower than RPI, this results in a third reduction in employer pension costs – but this time it's a "small print lottery" with the impact depending on the precise wording of each pension scheme's rules.	4
Apr 2011	Annual Allowance slashed from £255,000 to £50,000.	Acts as a disincentive for pensions saving. Also adds significant administrative costs, with individuals on moderate earnings potentially caught.	2
Apr 2012	Lifetime Allowance reduced from £1.8 million to £1.5 million.		
Oct 2012	Auto-enrolment commences (again).	So far, so good – opt out rates are low, but will this latest initiative provide meaningful pensions?	1

100 These figures indicate the number of FTSE 100 companies with a final salary pension scheme open to new employees.

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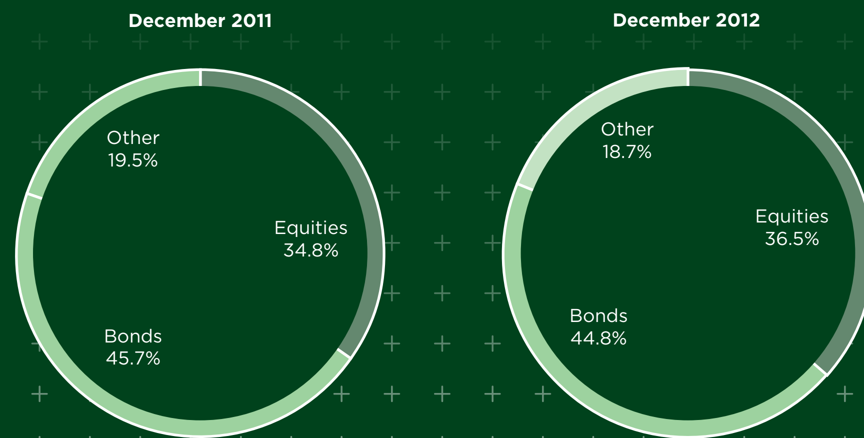
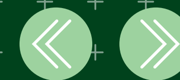


Bob Scott
Partner
LCP

For the first time since our survey began, the proportion of assets invested in equities has risen - showing that pension scheme trustees will not continue to buy bonds at any price.



4.1 Introduction

This section provides an insight into the disclosure of pension scheme costs in companies' 2012 accounts, comparing the different practices adopted by the largest UK companies and highlighting the financial implications.

By analysing their pension disclosures we aim to measure the exposure that companies have to their pension liabilities and deficits, particularly in the context of their market capitalisations, and we identify the steps that companies are taking to address their pensions issues.

FTSE 100 companies scrutinised

This report covers 86 of the FTSE 100 companies, analysing annual reports based on FTSE 100 constituents as at 31 December 2012. 14 companies have been excluded as they do not sponsor a material funded defined benefit pension scheme. A full list and summary details of the 86 companies' key pension disclosures are set out in appendix 1.

All of the companies analysed have reported under international accounting standards (IAS19 for pension costs) as required under EU regulations.

The information and conclusions of this report are based solely on detailed analysis of the information that companies have disclosed in their annual report and accounts and other publicly available information. We do not approach companies or their advisers for additional information or explanation.

4.2 Major changes to the UK pension system

The past 12 months have seen significant legislative and regulatory developments that affect UK pension provision. These include:

- The introduction, from October 2012, of a requirement for companies to automatically enrol their employees into a suitable pension scheme.
- The announcement of the flat rate State Pension and cessation of "contracting out" from April 2016.
- The suspension (for now) of European proposals which could have crippled some UK companies that sponsor defined benefit pension schemes.

We have also seen continued (and unwelcome) meddling with the pensions tax system – and the threat of further changes in future as the government struggles to balance its books.

We have commented further on the impact of these changes in section 4.8.

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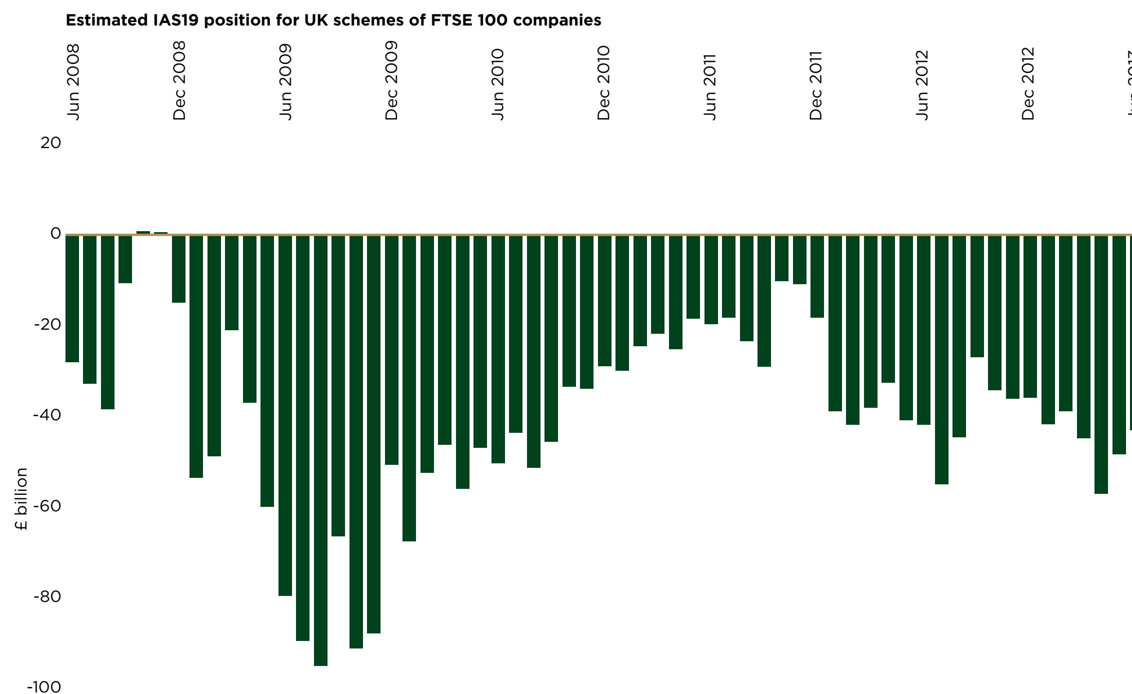
4.3 FTSE 100 pension liabilities approach half a trillion

We estimate that the combined FTSE 100 pension deficit in respect of UK liabilities was £43 billion at the end of June 2013, reflecting total IAS19 liabilities of £490 billion against assets of £447 billion.

Although the deficit is only marginally higher than the corresponding deficit of £42 billion at the end of June 2012 both asset and liability values have increased sharply over the year. In particular, asset values have been boosted by returns from equity markets which were up by around 18% over the year to 30 June 2013.

The chart below shows how the accounting deficit has developed over the past five years. Our figures include unfunded pension promises but exclude, where possible, the overseas pension schemes sponsored by FTSE 100 companies and any employee benefits other than pensions.



4.4 Pension scheme funding

Over the last year FTSE 100 companies have increased their total pension contributions, from £21.4 billion in 2011 to £21.9 billion in 2012.

Contributions to defined benefit schemes totalled £16.8 billion, of which we estimate the majority - £10.1 billion - went towards removing deficits rather than towards the cost of additional benefit accrual for current employees.

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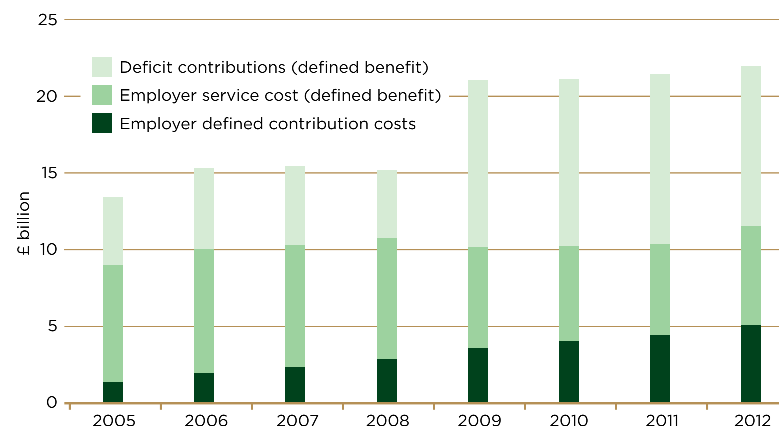
The highest level of defined benefit contributions during the year was £2.2 billion paid by **BT Group**. This included a lump sum payment of £2 billion agreed as part of the recovery plan to remove the deficit disclosed at the 30 June 2011 valuation of the company's main UK pension scheme.

Two other companies paid more than £1 billion into their defined benefit pension schemes during 2012. These were **Royal Dutch Shell** (£1.5 billion) and **BAE Systems** (£1.3 billion).

Eight companies – **BAE Systems**, **BT Group**, **Babcock**, **International Airlines Group**, **ITV**, **Lloyds Banking Group**, **Royal Bank of Scotland** and **Serco** – all paid more to their pension schemes than they paid in dividends to shareholders.

The following chart shows how company payments into pension schemes have changed since 2005.



We expect to see overall contributions (and payments to defined contribution pension schemes in particular) increase further in coming years as more FTSE 100 companies fall into the auto-enrolment regime and as the minimum required contributions are increased over the period to 2018.

The new statutory objective for The Pensions Regulator to "minimise any adverse impact on the sustainable growth of an employer" when considering scheme funding plans could lead to some moderation in the increase of deficit contributions to defined benefit schemes. However, we are unlikely to see any reduction in such contributions in the short term.

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Alternatives to cash funding

As well as paying large contributions into their pension schemes, FTSE 100 companies continue to make use of alternate forms of funding.

BAT, **Experian**, **Legal & General**, **Melrose**, **Reckitt Benckiser**, **Rio Tinto**, **Scottish & Southern Energy**, **Smith & Nephew**, **Smiths** and **Standard Life** all disclosed having company guarantees in place for some or all of their defined benefit schemes. Where suitably structured, cross-company guarantees can also help to reduce the annual levy payable by the pension scheme to the Pension Protection Fund (PPF). In some cases these levies can be significant – **International Airlines Group** disclosed that costs in relation to PPF levies were €7 million during 2012.

AstraZeneca, **BAE Systems**, **Diageo**, **National Grid**, **Rexam** and **Smiths** all disclosed having paid additional contributions to an escrow account or separate trust, that would become payable to the pension scheme on the occurrence of certain events, such as insolvency of one or more of the participating employers, or if the company and trustees agree a change to the scheme's long-term investment strategy.

Other companies have provided similar security by granting their pension scheme a charge over certain assets:

- **Centrica** disclosed that the Humber power station has been pledged as security for pension liabilities up to a value of £400 million.
- **InterContinental Hotels Group** has provided a charge over one hotel, valued at $89 million, to its pension schemes.
- **International Airlines Group** disclosed that its pension schemes have access to letters of credit totalling €283 million which are secured on aircraft.
- The **Rexam** pension scheme has a charge over canning facilities and machinery, enforceable up to 31 December 2017 in the event of a default on contributions to the scheme or a material decline in the strength of the employer's covenant.
- **Vodafone** has provided a charge in favour of the trustee of its pension scheme over UK index-linked government bonds held by the company. The amount of the charge increased in December 2011 due to an increase in the scheme's deficit.

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Another way of providing security to a pension scheme is through offering "negative pledges". As an example, **BT Group** has said that, so long as its funding deficit remains above £2 billion, future creditors will not be granted security superior to the pension schemes in excess of a £1.5 billion threshold.

United Utilities has entered into an inflation mechanism with its pension scheme in order to facilitate a move to a lower risk investment strategy. Under this mechanism, additional contributions will be paid in periods where inflation exceeds 2.75% pa. This appears particularly appropriate given that the company has a natural hedge against inflation through its regulated pricing structure.

We have also seen companies agreeing to pay additional pension contributions that are dependent on the performance or activities of the business:

- **BT Group** has agreed that one third of any net proceeds from disposals and acquisitions in excess of £1 billion during any year to 30 June will be paid into its pension scheme. In addition, it has promised that contributions to the pension scheme will be at least as large as payments made to shareholders over the period from 1 March 2012 to 30 June 2015.
- **ITV** has stated that, subject to an annual cap, it will pay additional contributions of 10% of EBITA over a threshold level, between 2015 and 2020.
- **National Grid** has agreed to make payments of up to £220 million to one of its pension schemes should certain triggers be breached, primarily relating to a loss of licence or its credit rating falling below agreed levels.
- **Whitbread** has promised that the pension scheme will participate in any increases in ordinary dividends in excess of RPI and will have the right to consultation before any special distribution is made.

In previous years we have reported on the partnership arrangements that some companies have set up with their pension scheme trustees. Typically, these work as follows:

1. Assets of the company are transferred into a newly created partnership. Usually property is transferred, although **Diageo** transferred stocks of whisky into a partnership with its pension scheme trustees and **TUI Travel** used its brands.
2. The company makes a one-off contribution to the pension scheme, which is then invested in the partnership in return for the pension scheme

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having the right to income generated by the partnership assets. In some cases, the right to receive this income may be contingent on other events – for example, the level of dividends paid by the company.

3. The partnership is structured so that its assets would transfer into the pension scheme on the sponsoring employer's insolvency.
4. After a specified period the assets in the partnership revert to the company, possibly with a further contingent payment from the partnership to the pension scheme to ensure that the scheme is fully funded on an agreed basis.

For the pension scheme this arrangement provides a regular income and additional security against the sponsoring employer's insolvency. For the employer, this type of arrangement has even more advantages:

- There is no requirement for an up-front cash contribution to the pension scheme, yet the trustees can place a value on the future income stream generated by the partnership assets.
- In the past it has been possible to receive accelerated tax relief on the expected future payments to the pension scheme from the partnership.
- The period over which the scheme's deficit is removed can be longer than would normally be acceptable for direct cash contributions.
- The arrangement can be structured to avoid the risk of a "trapped surplus" in the pension scheme.
- It may be possible to secure a reduction in the scheme's PPF levy.

In March 2012 HMRC introduced legislation to limit the circumstances in which up-front tax relief can be given to the companies which fund these partnership arrangements. However, this does not appear to have put companies off these arrangements, with **Centrica** setting up a new partnership arrangement at the end of 2012 and **Morrisons** transferring property into a partnership arrangement with its pension scheme in early 2013.

The use of partnership arrangements is now widespread throughout the FTSE 100. In addition to the companies mentioned above, **GKN**, **IMI**, **ITV**, **Kingfisher**, **Lloyds Banking Group**, **Marks & Spencer**, **Sainsbury's** and **Whitbread** all disclosed having previously set up partnership arrangements with their pension scheme trustees.

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4.5 The decline of defined benefit pensions continues

In recent years there has been a movement toward closing defined benefit pension schemes and last year we reported that there were no remaining FTSE 100 companies that offered a final salary pension scheme to new employees.

The trend has reversed slightly, with **Croda**, which entered the FTSE 100 for the first time in March 2012, still providing new employees with a final salary pension. A small number of other FTSE 100 companies still provide defined benefit pensions on a less generous basis to new employees – for example **Morrisons** offers a cash balance scheme as its auto-enrolment vehicle. **Amec** runs a career average revalued earnings (CARE) scheme but closed this to new entrants in October 2012. **Johnson Matthey** also closed its CARE scheme to new entrants during 2012 and has set up a replacement cash balance scheme for new employees.

Recently we have seen a new wave of companies closing their pension schemes to future benefit accrual for existing employees.

- **InterContinental Hotels Group** will be closing its pension scheme to future accrual from 1 July 2013.
- **Kingfisher** closed its UK final salary scheme to future benefit accrual with effect from 30 June 2012, resulting in a gain of £11 million after allowing for transitional payments to active members.
- **Resolution** closed its pension scheme to accrual from the end of 2012 and as a result disclosed a gain of £22 million.
- **Severn Trent** has decided to close its defined benefit pension schemes to all benefit accrual with effect from March 2015 and has recognised a £23.1 million gain due to this in its 2012 accounts.
- **BG Group** is consulting employees about a proposal to close its main pension scheme to future accrual of benefits on 30 November 2013.
- **HSBC** has announced proposals to close to accrual from 30 June 2014, which would result in a reduction in the accounting deficit of around $0.3 billion.
- **Sainsbury's** has entered into a consultation regarding the proposed cessation of future benefit accrual within its defined benefit pension scheme.

If all of the proposals described above proceed then less than half of the FTSE 100 companies will continue to provide a final salary pension to any of their employees.

Several companies continue to provide existing members of their pension scheme with a final salary benefit but with a limit on the level of increases in salary that are treated as being pensionable.

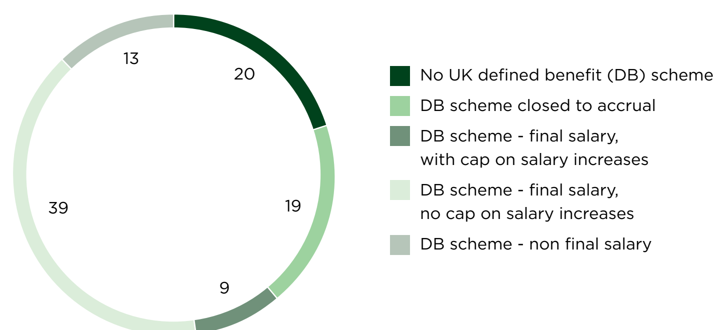
During 2012 **Centrica** capped increases in pensionable pay at 2% pa in the final salary sections of its two main pension schemes. Similarly, **GlaxoSmithKline** has chosen to limit increases in pensionable earnings to 2% pa from 2013. In combination with a change to using CPI inflation rather than RPI inflation when granting discretionary increases this has enabled it to disclose a £395 million gain in its accounts. **Lloyds Banking Group** has also changed its policy for discretionary increases so that these will in future be based on CPI inflation, resulting in a £258 million saving.

Companies have also made other changes to reduce the cost of pension benefits being built up by employees. With effect from October 2012 **Royal Bank of Scotland** has given its pension scheme members the option of an increase in retirement age from 60 to 65 or an increase in member contributions.

Tesco has implemented a two year increase in the age at which a full pension is payable, from 60 to 62, with further changes possible depending on changes in life expectancy. In addition, from July 2012 onwards, increases to pensions will be based on CPI rather than RPI inflation.

The chart below shows the proportion of FTSE 100 companies providing different types of pension benefit for existing employees.

Type of pension benefit provided for existing employees of FTSE 100 companies



4.6 More confusion over inflation measures

Since the measure of inflation applying for statutory increases to pensions was changed from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) in 2010 many companies have benefited from a reduction in pension liabilities, as over the long-term CPI inflation is expected to be lower than RPI inflation.

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After a period of uncertainty as lawyers analysed pension scheme rules to ascertain which inflation measure to use, most companies seemed to have resolved the issue.

However, in October 2012, in response to concerns over the material difference between RPI and CPI, the Office for National Statistics (ONS) launched a public consultation covering four options for "improving" the RPI, ranging from no change to a realignment of the formulae used in its construction to be consistent with the formulae used to construct the CPI.

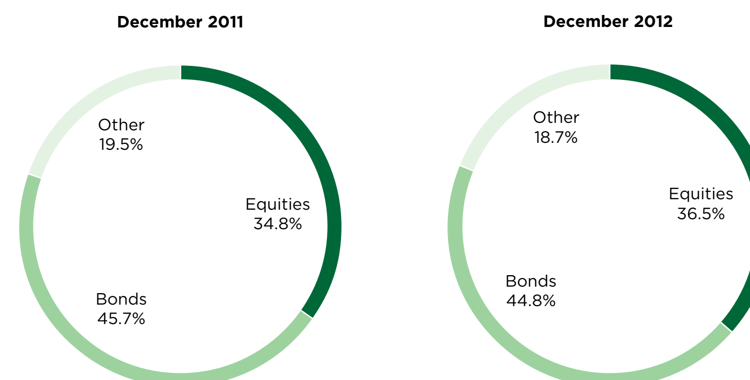
It was widely expected that this consultation would lead to a closer alignment of RPI and CPI and so it was a surprise to many when, in January 2013, the National Statistician announced that there would be no change to the RPI. This was despite admitting that the method for calculating the RPI was flawed and that RPI could no longer be considered a "national statistic".

Instead, a new inflation measure - RPIJ - has been introduced on an experimental basis. The construction of this index will be based on formulae more similar to those used in CPI and so RPIJ inflation will be systematically lower than RPI and can be expected, generally, to fall somewhere between CPI and RPI inflation.

This means that pension schemes potentially have a third inflationary index available for use when increasing benefits. It remains to be seen how widely this index will be used. In part, this may depend on whether the debt management office issues any CPI or RPIJ linked government bonds in which pension schemes can invest – at present no plans to do this have been announced.

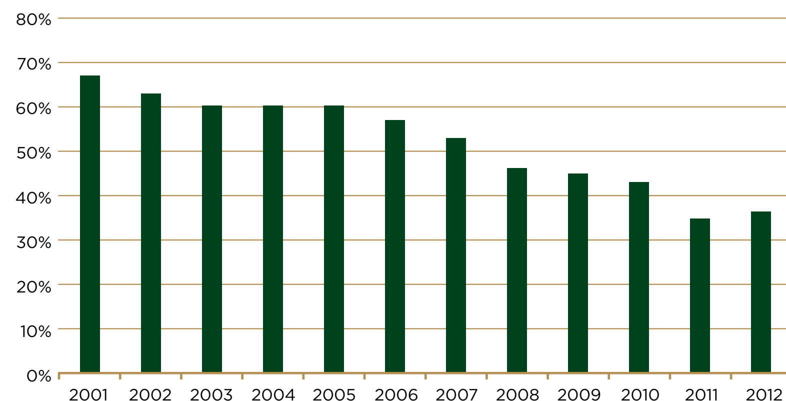
4.7 Equity allocation increases

In recent years we have seen a continued shift of pension scheme assets out of equities and into bonds as pension scheme trustees look to remove risk and invest in assets that more closely match changes in liability values.



However, during 2012 we saw a cessation of the trend as the proportion of assets that schemes held in equities increased. Although this largely reflects market movements during the year – as equities outperformed bonds – this is the first time since our survey began that the proportion of equities held by FTSE 100 pension schemes has gone up.

Percentage of assets held in equities



With pension schemes continuing to mature it is likely that this will only be a temporary pause in the long-term trend. We suspect that a number of companies and pension scheme trustees have put their de-risking plans on hold until bonds become less expensive.

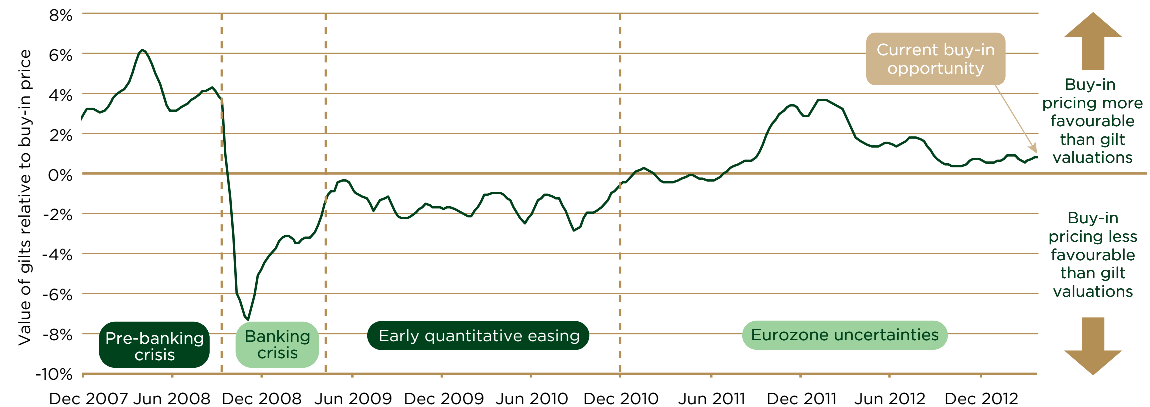
Nevertheless, some schemes did materially de-risk their investment strategy during the year – for example **Bunzl** reduced its pension schemes' allocation to equities by 10% and **Meggitt** moved 16% of its UK pension scheme's assets from equities to bonds. On the other hand, **Croda** made one of the biggest switches into equities, with its pension scheme increasing the allocation to equities by 9%.

Whilst moving assets from equities to bonds reduces investment risk, companies can still be left with other significant risks in their pension scheme. Most notable is longevity – the risk that pension scheme members live longer than expected and the cost of providing their pensions increases. During 2012 **BAE Systems** took out a "longevity swap" covering £2.7 billion of liabilities. Under this arrangement, the counterparty will provide additional payments to the pension scheme if members live longer than assumed.

In order to remove or hedge pension risk it is possible to purchase a bulk annuity policy with an insurance company (a "buy-out" or "buy-in") – something that a number of FTSE 100 companies have done in recent years. **Legal & General**, **Next** and **Tate & Lyle** all purchased annuity contracts in 2012.

The graph opposite tracks insurance company pricing for pensioner liabilities since the buy-out/ buy-in market expanded in 2007. At the current time pricing is particularly attractive, with pension schemes that hold government bonds being able to swap these for an insurance policy at a profit.

Given the general desire to remove risk from company balance sheets, we expect to see many more buy-in transactions for FTSE 100 companies in the coming months and years.



Source: LCP analysis of the relative value of gilts against pensioner buy-in prices based on middle-of-the-road longevity assumptions for a UK pension plan. Buy-in pricing depends on a range of factors such as transaction size, benefit structure, membership profile and insurer appetite.

4.8 Legislative and regulatory developments

Auto-enrolment

In October 2012 the UK's largest companies were for the first time required to automatically enrol qualifying employees into a pension scheme meeting certain minimum requirements. This requirement is being phased in over the period to February 2018 depending on the size of employer but, at the time of writing, the majority of the FTSE 100 will be complying with the new legislation.

Once the arrangements are fully in place, the broad requirement will be for contributions of at least 8% of qualifying earnings - including an employer contribution of at least 3% - to be paid into a pension scheme for all qualifying employees,

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unless they choose to actively opt out of the system. Alternatively, companies can automatically enrol employees into a suitable defined benefit or hybrid pension scheme.

Auto-enrolment is likely to result in a surge in the number of members of occupational pension schemes, with a corresponding increase in companies' pension costs. For example, **Morrisons** states that employee participation trebled within one month of its cash balance plan being launched and new employees being auto-enrolled. Reported rates of opt-out have been surprisingly low. **Sainsbury's** – one of the first companies to auto-enrol employees into a pension scheme – reports an opt-out rate of only 6%.

Whilst low opt-out rates can be interpreted as a sign that the policy has been a "success", there is a long way to go before auto-enrolment provides any individuals with meaningful retirement benefits.

For this to happen, minimum contribution levels would need to rise significantly – perhaps following the experience in Australia where compulsory employer superannuation contributions commenced at 3% of relevant earnings, but are now set to rise from 9% to 12% by 2019.

In order for benefits to be provided efficiently, the number of defined contribution schemes needs to be reduced dramatically so that the remaining schemes can benefit from efficiencies and economies of scale. Some commentators have suggested that, rather than 50,000 schemes, we should aim to have just five.

The requirement to purchase an annuity also means that people on relatively low incomes – even if they save for many years – may only end up with a relatively small pension. It would be preferable if individuals with small retirement pots could use them to purchase temporary annuities – perhaps to bridge the gap between retirement and State Pension Age – rather than being forced to buy a lifetime annuity.

State pension changes

In March 2013 the government announced that the current combination of State Basic Pension, State Second Pension and complex income guarantees would be replaced with a flat rate pension of around £7,500 pa (in 2012/13 terms), from April 2016. Whilst the simplification of what is a hugely complex system is long overdue, the change does result in one significant issue for companies providing defined benefit pension schemes.

At present most defined benefit schemes are "contracted out" of the State Second Pension which means that employers and members pay lower National Insurance contributions with the pension scheme replacing some of the member's State Second Pension. However, from 2016, companies (and members) will be faced with an increase in National Insurance contributions. Faced with this increase companies can either accept the extra cost and make no changes to the company's pension provision, or seek to mitigate the cost by reducing the level of pension provided.

In practice we expect that very few companies will take the first option and rather than modifying their defined benefit scheme, many companies may simply use the end of contracting out as a catalyst to close their pension scheme to future accrual and move all employees over to a lower quality defined contribution scheme.

Europe backtracks on new pension directive

In May the EU announced that it had decided not to introduce Solvency II style rules – as will soon apply to insurance companies – for funding defined benefit pension schemes. As proposed, those rules could have resulted in FTSE 100 companies being required to pay an additional £200 billion into their pension schemes.

However, the EU is still pressing ahead with proposals for a directive focusing on governance, transparency and reporting to be put forward this autumn. Therefore, companies might still be required to assess and disclose pensions risk in a similar way to insurance companies, even though they will not, for now, be required to fund their schemes on that basis.

Taxation changes act as a disincentive to pension savings

In December 2012 the Chancellor announced a further reduction in the tax relief available on pension savings, with the following changes from April 2014:

- the maximum value of pension savings that an individual can build up without incurring an additional tax charge – known as the Lifetime Allowance – will reduce from £1.5 million to £1.25 million; and
- the maximum amount of pension savings that can be made in any year – known as the Annual Allowance – will reduce from £50,000 to £40,000.

We can expect further changes – for example, the Labour party has suggested that the Annual

Allowance should be reduced to just £26,000 to reflect the level of the national average wage.

Such reductions in tax incentives – and the uncertainty that comes with such frequent changes to the rules – make it less likely that individuals will save in a pension plan.

There is also a significant disparity between the maximum benefits that can be provided through a defined benefit scheme compared to a defined contribution scheme.

Defined benefit pensions are assessed against the Lifetime Allowance using a factor of £20 for each £1 pa of pension – so an individual with a pension of £62,500 pa would be assessed to have pension savings of £1,250,000 and pay no additional tax. However, defined contribution pensions are generally assessed against the value of the pension pot – the maximum amount an individual can build up at retirement before any additional tax is due will be £1,250,000. However, given current annuity rates this might only secure a pension of around £33,000 pa.

Furthermore, many individuals in defined benefit schemes have protected entitlements to benefits significantly in excess of £62,500 pa.

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Nick Bunch
Partner
LCP

Changes to IAS19 will mean that many companies report lower profits in 2013 - and some may see their balance sheets hit too.

5. Accounting standards for pensions

This year it's all change for pensions accounting. Companies will be reporting 2013 figures under a revised version of the international pensions accounting standard IAS19, which will lead to reduced profits for many companies.

UK companies will see a further wave of change in 2015, when the UK pensions accounting standard FRS17 is replaced by new rules modelled on the revised IAS19, as part of the comprehensive overhaul of UK GAAP. These changes won't affect the headline results for listed companies, which already report under international rather than UK standards. Nevertheless, the changes to the UK rules may have wide ranging effects on debt covenants, remuneration, and dividend distributions for subsidiaries of listed companies, as well as for all unlisted companies.

5.1 Revised international standard

The new version of the international pensions standard IAS19 applies for accounting years beginning on or after 1 January 2013, so it will be used by companies for 31 December 2013 accounts. Along with those 2013 figures, companies will also be required to recalculate the 2012 comparator figures under the new standard, allowing a direct "like for like" comparison of the two sets of numbers. We estimate that those figures will reveal:

- Total 2012 profits of FTSE 100 companies will be some £2 billion lower when recalculated under the new version of IAS19, because interest on pension scheme assets will be calculated using a "discount rate" based on corporate bonds, rather than an "expected return" based on the actual assets held. The impact will be felt unevenly by different companies – while **BP** will report a £0.5 billion reduction in profits, other companies such as **Aviva** will report a small increase in profit under the new standard.
- The total 2012 year-end balance sheet liabilities of FTSE 100 companies will be some £20 billion higher, because of the abolition of complex "corridor" rules which used to allow companies to smooth the effect of market movements on their balance sheets. **Royal Dutch Shell** alone will see a pre-tax increase in liability of £11.6 billion.

£20bn
increase in balance sheet liabilities.

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As companies prepare their figures under the new rules, management and investors should be alert to the details which can be significant in some cases.

- Under the new rules, we expect most companies will charge the running costs of their pension schemes – such as administration fees – directly to operating profit. This is a change to current practice for many companies which currently charge an estimate of their costs to finance income. For example, **ITV** states that its operating costs will increase by £4.5m as a result.
- Although companies have not yet implemented the new accounting standard, already the standard setters are proposing changes. An amendment published in March 2013 proposes changes to the way that employee contributions are taken into account in actuarial valuations. Whilst this is not expected to mean any change to current practice for the majority of UK pension schemes, companies should monitor the position.
- Companies will need to prepare for wide ranging changes to disclosure requirements. There are fewer prescriptive rules and a greater emphasis on broad principles, which in theory should mean that pension disclosures are more appropriate given the size of the company and pension scheme.

5.2 UK GAAP overhauled

In March 2013 the new reporting regime for UK companies was published. All UK GAAP standards, including the pensions accounting standard FRS17, will be replaced by the new rules. The new pensions rules are based on a cut-down version of the new, revised version of IAS19, and will apply for accounting years beginning on or after 1 January 2015, with early adoption permitted.

Like the new version of IAS19, the new UK GAAP does away with the "expected return on assets", replacing it with interest based on the discount rate. This will change the calculation of profit, in many cases reducing it.

The principles for calculating the balance sheet items under FRS17 and the new UK GAAP rules are similar, and many companies will see no change to their balance sheet. This doesn't always apply though – some companies will be caught by rule changes that will mean huge changes to balance sheets, with knock on effects on debt covenants, distributable reserves and remuneration.

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Examples of the change are:

- Companies that contribute to multi-employer schemes, where a single pension scheme covers many companies or subsidiaries, could face having to recognise a pension scheme deficit on the balance sheet for the first time.
- All companies could be affected by rules determining the pension asset or liability on the balance sheet, which can be very different between the old and new rules, particularly where the scheme is in surplus.

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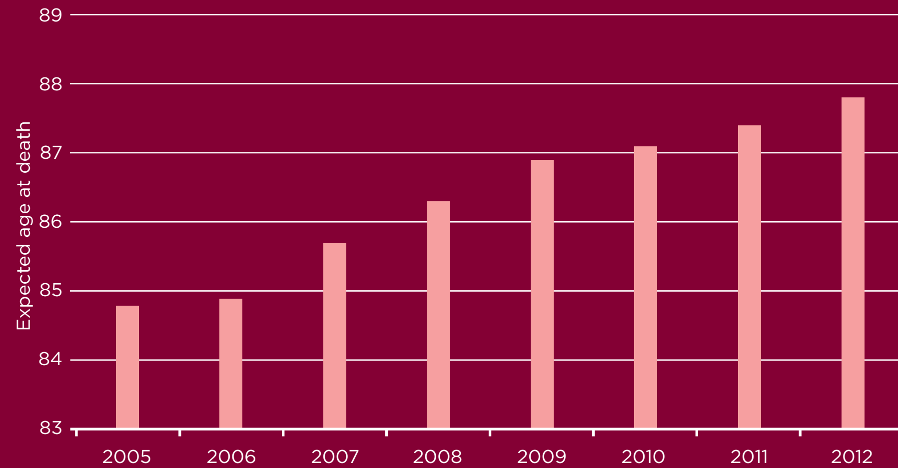
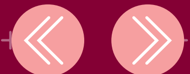
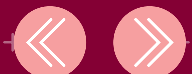




Nick Bunch Scott
Partner
LCP

Over the last eight years, allowance for improvements in life expectancy has added £40 billion to the disclosed cost of FTSE 100 pension liabilities.



6.1 Introduction

In this section, we have analysed 86 FTSE 100 companies reporting in 2012. 14 companies were excluded as they do not sponsor a material defined benefit pension scheme.

We have concentrated on the financial position of the defined benefit schemes in which the companies' employees and former employees participate. Some companies offer post-retirement healthcare, which we have excluded from our analysis, where possible. Overseas pension arrangements have been included, except where otherwise indicated.

The disclosures

The average pensions note runs to nearly five pages, with most companies also having several paragraphs of pension commentary in the main body of their reports. The longest disclosure was by **HSBC**, which dedicated 14 pages of its 2012 report to pensions.

For many FTSE 100 companies, pensions are financially significant and the volume of information disclosed in the accounts reflects this. However, for those companies whose pension arrangements are not so material, even the minimum disclosure requirements under IAS19 can be quite onerous.

6.2 Analysis of results

Funding levels

IAS19 takes a snapshot of the accounting surplus or deficit at the company's financial year-end and this is generally the number that appears on the balance sheet.

We have set out a full list of the disclosed accounting surpluses and deficits of the FTSE 100 companies in appendix 1.

14 of the 86 FTSE 100 companies disclosed assets equal to or in excess of accounting liabilities, compared to 17 of these companies last year.

This general deterioration was largely due to the fall in corporate bond yields over 2012 offset to some extent by lower expectations of future inflation and strong investment returns.

Prudential disclosed the highest funding level - 117% as at 31 December 2012. 50 companies reported being less than 90% funded on an accounting basis at their 2012 year-end, compared with 47 companies in 2011.

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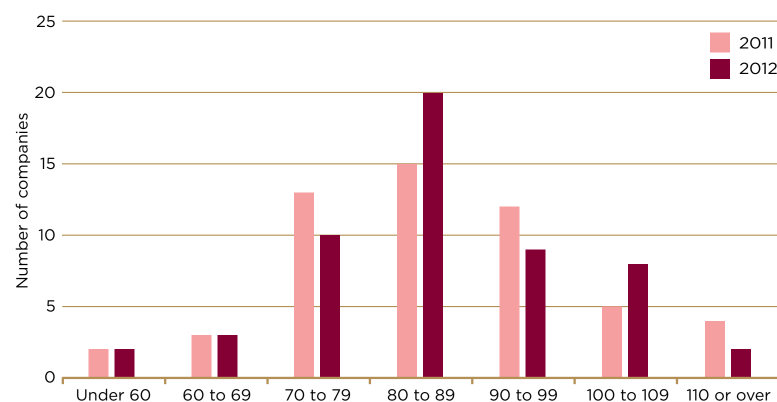
Changes over 2012

The chart below shows how worldwide funding levels have changed over the year for the 54 FTSE 100 companies in our report which have December 2012 year-ends.

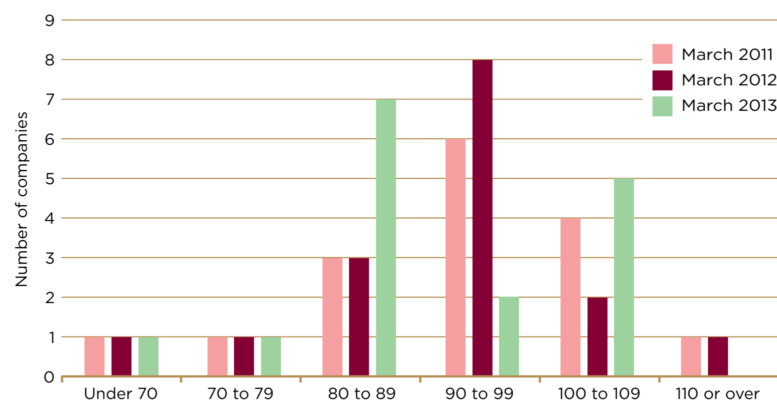
Ratio of assets to IAS19 liabilities at end of December (%)



The average reported IAS19 funding level for companies with December year-ends was 87% in 2012, compared to 88% in 2011.

We have shown a similar chart for those companies with March year-ends opposite – the overall trend is that funding levels have improved between March 2012 and March 2013.

Ratio of assets to IAS19 liabilities at end of March (%)



The average reported IAS19 funding level for these companies was 92% at March 2013 compared with 90% in 2012 and 92% in 2011.

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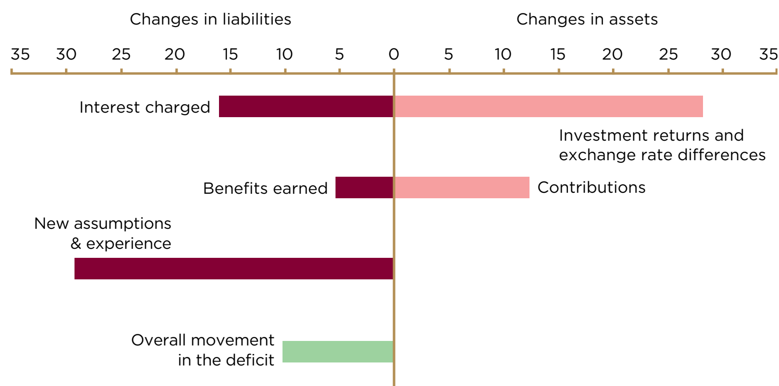
Sources of deficits and surpluses

For the 54 companies with December year-ends, worldwide deficits increased by £10.1 billion over 2012. This is illustrated in the chart below.

IAS19 sources of deficits and surpluses for companies with December year-ends (£ billion)



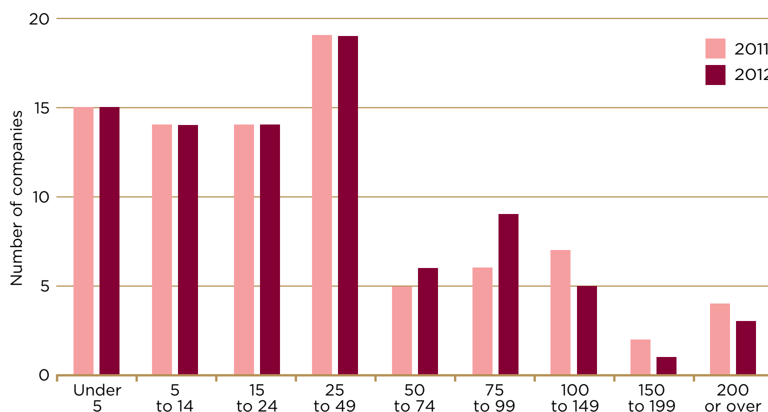
Our analysis shows that investment returns (£28.2 billion) comfortably covered "interest" charges (£16.0 billion) and contributions paid (£12.3 billion) were well above the net IAS19 value of benefits earned over the year (£5.4 billion). All other things being equal, the aggregate deficit would have been much lower as a result.

However, changes in IAS19 liability values (£29.2 billion), primarily as a result of lower discount rates due to lower corporate bond yields, offset those positive effects, leading to an overall increase in deficits of £10.1 billion for these companies.

Pension schemes in relation to their sponsoring companies

The following chart shows the size of accounting liabilities relative to companies' market capitalisations. The average FTSE 100 pension liability was 45% of market capitalisation in 2012, compared to 51% in 2011. This reduction was largely due to increases in equity markets which increased the market capitalisation of many companies. However, pension schemes still pose a very significant risk for certain companies. For example, **International Airlines Group**'s accounting liabilities were over five times the size of its market capitalisation.

Accounting liabilities as a proportion of market capitalisation (%)



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For some companies, even the size of the IAS19 pension scheme deficit is significant compared to the value of the company itself. For example, **BAE Systems**' accounting deficit was over 50% of the value of its market capitalisation at its 2012 accounting year-end.

On average, pension scheme deficits were 5% of market capitalisation, the same as in 2011.

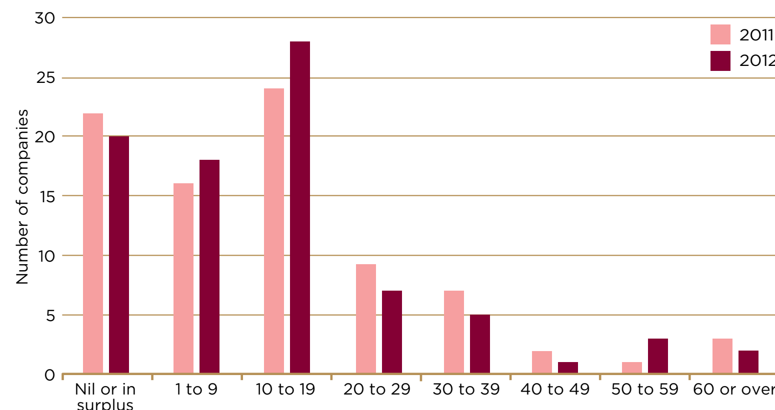
What have companies done to tackle their deficits?
FTSE 100 companies paid contributions totalling £16.8 billion to their defined benefit schemes in 2012. This follows £16.9 billion of contributions paid in 2011, £17 billion paid in 2010 and the record level of £17.5 billion paid in 2009. Over half of companies paid higher contributions over 2012 than over 2011, although a few, for example **Barclays**, paid significantly less as a result of having paid large contributions in the previous year.

The six companies that paid the highest contributions are shown in appendix 2. **BT Group**, **Royal Dutch Shell** and **BAE Systems** all paid more than £1 billion into their defined benefit pension schemes over their 2012 accounting years. **BT Group** paid over £2 billion, an increase of nearly £1 billion from the previous year, following the triennial valuation of its main pension fund as at 30 June 2011.

Most companies pay contributions at a rate greater than the IAS19 value of benefits earned over the year; if the IAS19 assumptions were borne out in reality, this excess would reduce the IAS19 deficit.

However, ten companies paid contributions lower than or equal to the IAS19 value of benefits promised over the year. These were **British Land Company**, **Carnival**, **Fresnillo**, **Glencore**, **Intertek**, **Next**, **SABMiller**, **Sage**, **Standard Life** and **Tesco**.

The chart below shows the "excess" contributions that companies paid during the year (ie contributions over and above the IAS19 value of the benefits earned during the year) as a proportion of the deficit that would have been disclosed at the end of the year had these contributions not been paid.



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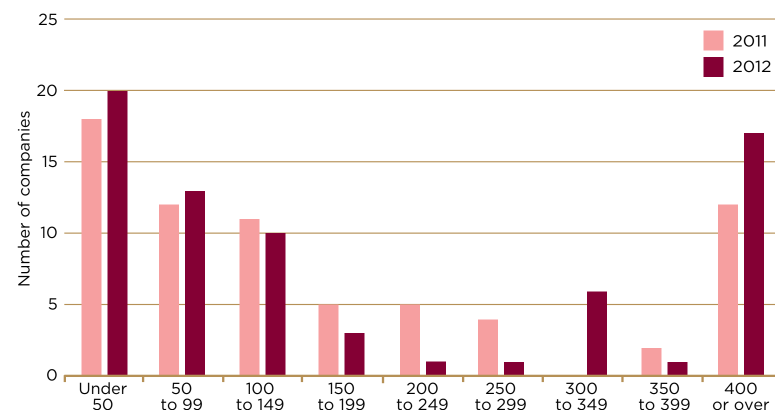
The highest proportion of deficit paid off was by **Tate & Lyle** which reduced its 2012 year-end deficit by 68%.

Pension schemes versus shareholders

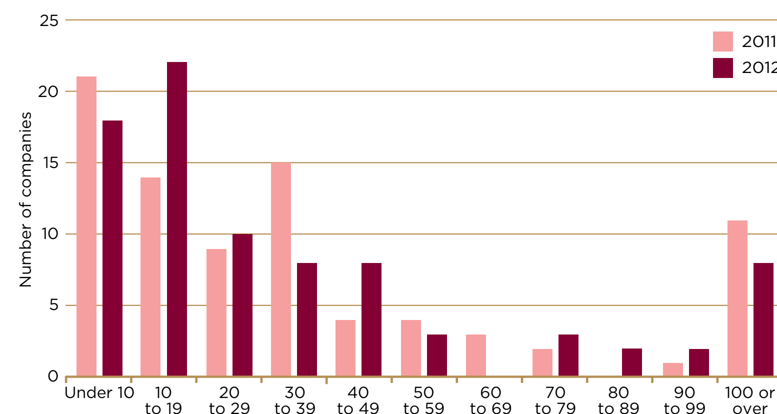
The chart below shows how pension deficits compare to dividends paid. Of the 72 FTSE 100 companies that disclosed a pension deficit in 2012, 33 disclosed a deficit that was greater than or equal to the dividends paid to their shareholders in 2012. However, in 26 cases, the 2012 dividend was more than double the deficit at the 2012 financial year-end, suggesting that these companies could pay off their pension scheme deficits relatively easily if they wanted to.

Percentage of deficit that could be paid off with one year's declared dividends (%)



The chart below shows the company contributions paid over the 2012 and 2011 accounting years as a percentage of dividends distributed over these periods and therefore illustrates the amount of cash paid to the pension scheme in preference to the shareholders. In 2012, eight companies paid more contributions into their pension schemes than they distributed in dividends during their accounting year, compared to eleven companies in 2011.

Contributions paid as a proportion of dividends paid (%)



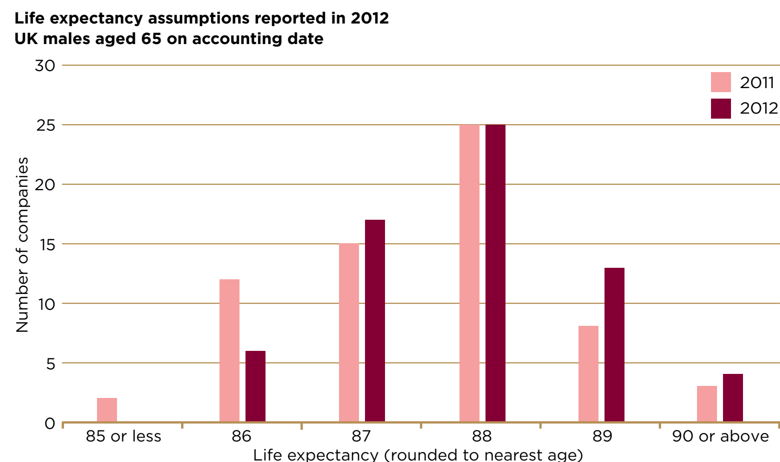
6.3 Key assumptions

We consider below the various assumptions used to place an IAS19 value on pension benefits. Where a company operates pension schemes in more than one country, we have considered the assumptions used for the UK if separately given. Where a company has disclosed a range of assumptions, we have taken the mid-point.

Life expectancy

Under the IAS19 standard, companies are required to disclose any "material actuarial assumptions". Whilst no specific mention is made of life expectancy in the standard, all of the companies in our survey apart from **Evraz** (where the defined benefit pension scheme is very small in the context of the business) have disclosed some detail on the assumption. 65 of the 86 companies with material defined benefit pension schemes have provided sufficient information in their 2012 accounts for us to derive basic mortality statistics.

The following chart shows the range of life expectancies assumed under IAS19 by FTSE 100 companies for UK males aged 65 on the balance sheet date.



The average assumed life expectancy was 87.8 years – up from 87.4 years in the same companies' 2011 accounts.

Last year we noted that the rate of increase in assumed life expectancy appeared to be slowing and this trend has continued in 2012. Although 49 companies disclosed higher life expectancy assumptions in 2012, adding 0.5 years on average, five companies disclosed lower life expectancy assumptions for some or all of their membership. For example, **Meggitt** reduced its average assumed life expectancy for a 65 year old male by 0.7 years, from 88.3 to 87.6 following analysis carried out for the 2012 funding valuation of its UK pension scheme.

Standard Life has adopted the strongest mortality assumption, stating in its 2012 accounts that male pensioners currently aged 60 will live on average to age 91.

Research has shown that two of the main factors influencing life expectancies are socio-economic group and income. In this respect it is interesting to analyse the FTSE 100 companies' assumed life expectancies by the sector in which the company operates.

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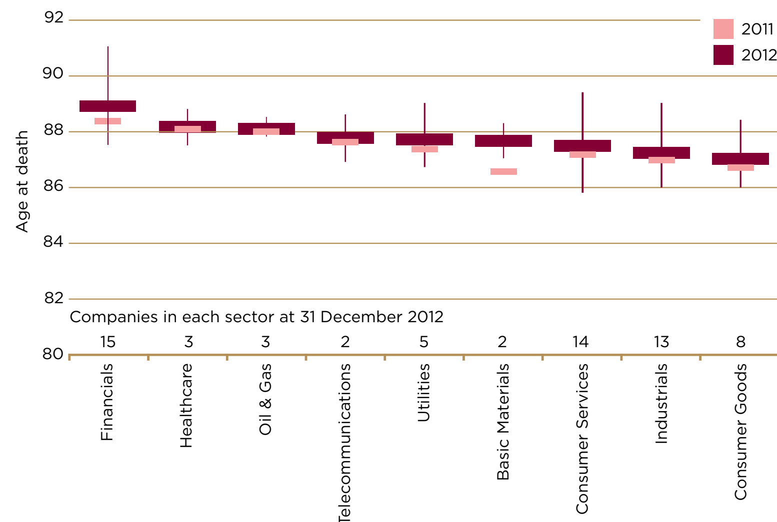
In the chart below the horizontal bars show the average life expectancy for a male aged 65 in the UK for each sector, for which we have followed the Industry Classification benchmark as published by FTSE. The vertical lines show the extent of the variation within each sector, which in most cases increases the greater the number of companies within the sector.

Life expectancy assumptions reported in 2012 split by sector
UK males aged 65 on accounting date



This chart shows that the highest average assumed life expectancies are found in the financials and healthcare sectors, as last year. The lowest average assumed life expectancies are found in the industrials and consumer goods sectors.

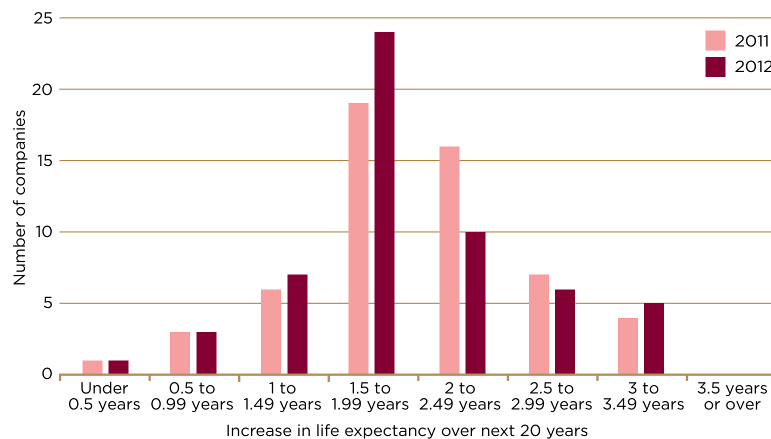
The biggest change was in basic materials where the average increased from 86.6 to 87.7.

Future improvements in mortality

As well as setting assumptions to estimate how long current pensioners will live on average, companies must also decide how life expectancies for future pensioners will change as a result of improvements in mortality. Allowing for future improvements can result in a significant increase in the IAS19 value of pension scheme liabilities, and hence deficits.

56 companies disclosed enough information in their accounts to analyse how their allowance for future improvements in mortality has changed compared to 2012. The chart below shows the allowance that these companies have made for increases to longevity over a period of 20 years.

Additional life expectancy improvements reported in 2012
Improvements for UK male members aged 65 now versus aged 65 in 2032



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On average, these companies assumed that UK pensioners retiring at age 65 in 20 years' time will live for 1.9 years longer than a pensioner retiring today. This compares to 2.0 years in 2011.

Overall these companies increased their average assumption for the life expectancy of a 65 year old in 2032 by 0.3 years, from 89.4 years in their 2011 accounts to 89.7 years in 2012.

Discount rates and inflation

The discount rate is used to calculate a present value of the projected pension benefits. A lower discount rate means a higher IAS19 value of pension liabilities and vice versa.

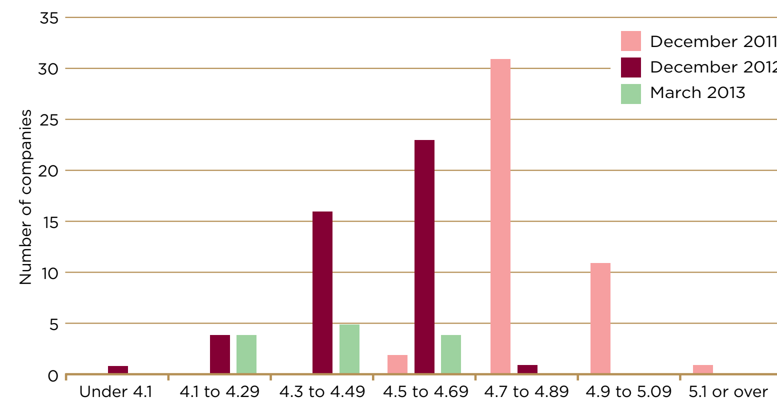
The typical FTSE 100 company has pension liabilities that are linked to price inflation. A decrease in the price inflation assumption will lead to a lower level of projected benefit payments, and hence a lower IAS19 value being placed on those benefits, all other things being equal.

We have analysed the discount rates used by 45 companies and the RPI inflation assumption of 41 companies with a December year-end, together with the assumption for CPI inflation disclosed by 13 of these companies. Similarly, we have analysed the discount rates used by 13 companies and the RPI inflation assumption of 12 companies with a March 2013 year-end, together with the assumption for CPI inflation disclosed by 6 of these companies. The results are summarised in the charts below.

Discount rates

Under IAS19 the discount rate should be based on "high quality" corporate bonds and the duration of the corporate bonds should be consistent with the estimated duration of the pension obligations.

The yields on high quality corporate bonds, and hence the discount rates, will fluctuate from day to day in line with market conditions.



The average discount rate fell over the year to December 2012, from 4.8% pa in December 2011 to 4.4% pa in December 2012. This has had the effect

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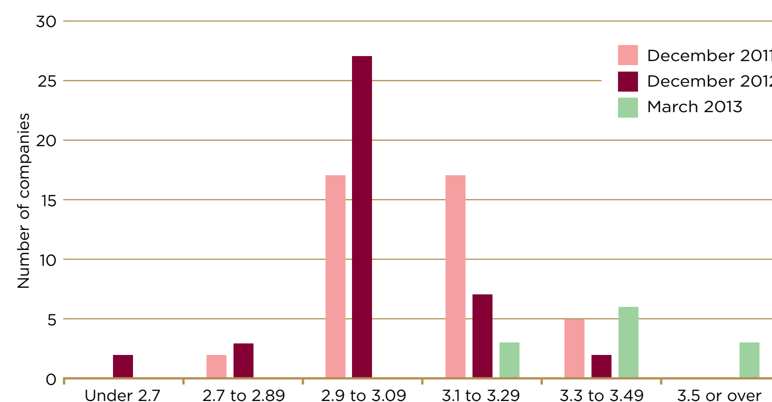
of increasing companies' reported pension liabilities. The average discount rate used by FTSE 100 companies with a March 2013 year-end was 4.3% pa. The spread of discount rates used by FTSE 100 companies with a December 2012 year-end has increased compared to December 2011.

As in 2011, **Centrica** disclosed the highest discount rate (4.8% pa in 2012 compared to 5.4% pa in 2011) for a FTSE 100 company in its December 2012 accounts. **British American Tobacco** adopted the lowest discount rate of 4.1% pa.

Inflation (RPI assumptions)

The chart below shows the difference between average long-term inflation assumptions as measured by the Retail Prices Index (RPI). This shows that the average RPI assumption decreased slightly from 3.1% pa in December 2011 to 3.0% pa in December 2012. For companies with March 2013 year ends, the average was 3.4% pa.



For December 2012 year-ends, the highest RPI inflation assumption was 3.3% pa, adopted by **Aggreko** and **Schroders**. At the other extreme **RSA**, who reported at the same date, adopted an assumption of 2.5% pa. In general, the December 2012 RPI inflation assumptions were more spread out than the comparable assumptions made in December 2011 or March 2013. This may be due to uncertainty caused by the ONS' consultation in 2012 regarding possible changes to the calculation of RPI.

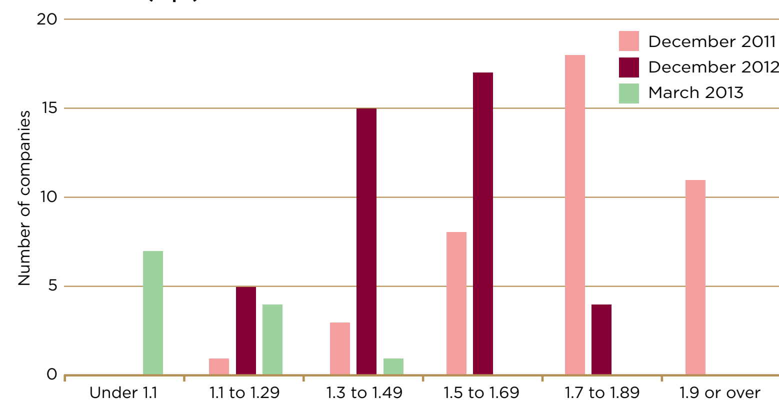
The Bank of England publishes statistics for future price inflation implied by gilt spot rates. These showed that long-term RPI inflation implied by 20-year gilt spot rates was around 3.1% pa at the end of December 2012. This suggests that, in order to justify an assumption much lower than this for future

RPI inflation, companies may be allowing for a significant "inflation risk premium". This represents the theoretical return that investors are willing to forgo when investing in index-linked gilts, in return for the inflation protection that these assets provide.

In practice, it is the discount rate net of assumed future price inflation which is the key assumption.

The chart below shows the difference between the discount rate and the assumption for RPI inflation (the net discount rate) for companies reporting as at 31 December 2011, 31 December 2012 and 31 March 2013. It shows that the net discount rate has reduced slightly since December 2011, from an average of 1.7% pa to 1.5% pa at 31 December 2012.

Discount rates in excess of RPI inflation used in December 2011, December 2012 and March 2013 (% pa)



Inflation (CPI) assumptions

Since 2010, the statutory minimum increases that pension schemes must provide have been linked to the Consumer Prices Index (CPI) rather than the RPI. Historically CPI has generally increased at a lower rate than RPI and is expected to do so in the future due to the different ways in which the two inflation indices are constructed.

In practice the inflation measure applying in a particular pension scheme depends on the wording of the scheme rules and their interaction with the relevant legislation setting out minimum increases. Many companies have determined that some or all of the benefits in their pension scheme should increase in line with CPI inflation and have therefore disclosed an assumption about future CPI inflation.

As there is currently no significant market in CPI-linked securities, market practice is to derive an assumption for future CPI inflation by deducting a margin from the assumed future level of RPI inflation. The chart below shows the range of margins used by companies in their December 2011, December 2012 and March 2013 year-end accounts, where such information was available.

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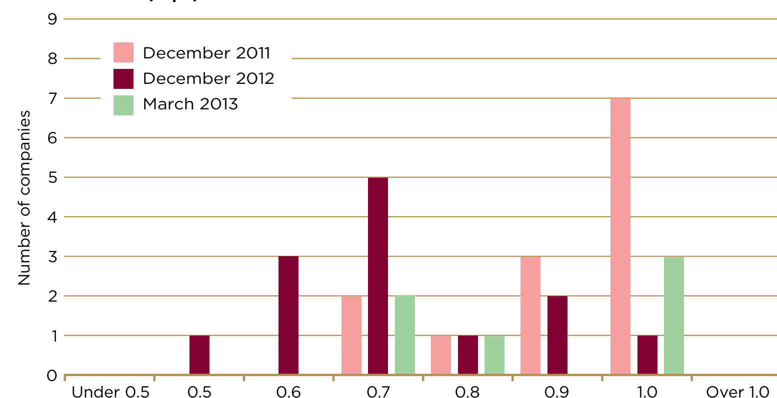
Difference in RPI and CPI inflation assumptions used in December 2011, December 2012 and March 2013 (% pa)



At 31 December 2012 the average margin was 0.7% pa compared to 0.9% pa at 31 December 2011. This reflects market expectations as at 31 December 2012 that the Office for National Statistics (ONS) would announce a change in the method of calculation of RPI which would have the effect of moving RPI closer to CPI.

However, the ONS announced in January 2013 that there would be no change in the calculation of RPI and, by March 2013, the average margin had increased back to 0.9% pa.

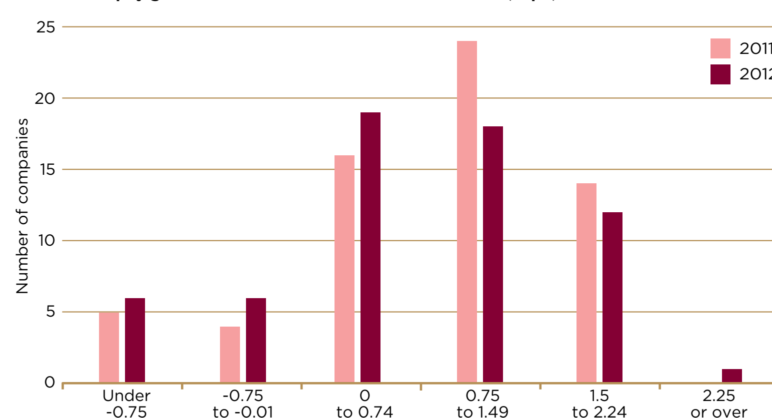
At 31 December 2012, **IMI** used a long-term CPI inflation assumption of 1% pa below its RPI inflation assumption, the largest margin at that accounting date.

Increases in pensionable pay

For schemes that still relate benefits to pay close to retirement, the assumed rate of growth in pensionable pay affects the disclosed IAS19 liability and the assessed cost of benefits being earned. A lower assumption produces a lower projected pension and hence lower pension liabilities as well as a lower charge to operating income.

The average assumption for increases in pensionable pay (in excess of RPI) fell from 0.6% pa in 2011 to 0.5% pa in 2012. In recent years a number of companies have introduced caps on, or even frozen, increases in pensionable salary and as a result assumed that average pensionable pay would increase by less than RPI.

Pensionable pay growth rates used in excess of RPI inflation (% pa)



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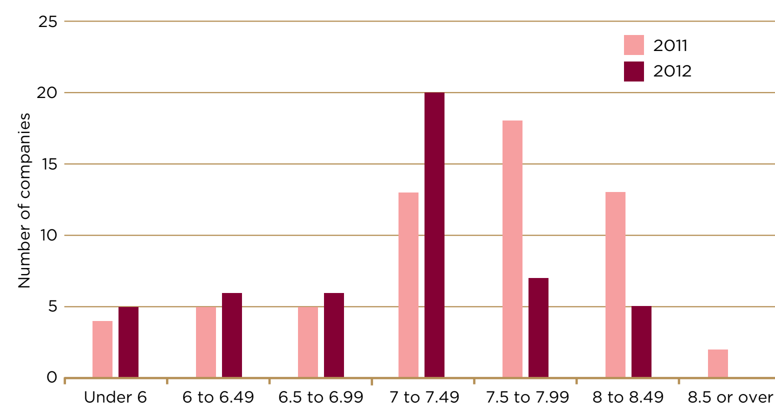
As the number of active members in final salary pension schemes has reduced, this assumption has become much less significant.

Expected return on equities

Under IAS19 companies are not required to provide a breakdown of their assumed asset returns on each asset class but can instead simply provide an overall expected return for the pension assets. For those companies where we could determine the assumption for future equity returns, there is a wide range of values, reflecting the subjectivity in setting this assumption.



The lowest equity return assumption was 5.0% pa, disclosed by **Resolution**, and the highest was 8.4% pa, adopted by **Babcock**.

The average expected rate of return on equities was 3.9% pa higher than the long-term yield available on gilts, measured by reference to the FTSE over 15 year gilt yield index at the balance sheet date.

This difference can be said to represent companies' views of the so-called "equity risk premium", which is the additional return expected from investing in equities, compared with low risk assets such as gilts, to compensate for the increase in risk. The average equity risk premium is unchanged from 2011.

For accounting years from 1 January 2013 onwards, companies will no longer be able to reflect this subjective assumption in their accounts.

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This table shows the key disclosures made by the companies in the FTSE 100 as at 31 December 2012 that reported IAS19 figures in their 2012 accounts. The source of the data is each company's annual report and accounts for the accounting period ending in 2012. The market value of assets and surplus/(deficit) figures relate to the worldwide position of each company, not just the UK schemes. Figures are shown before deferred tax and before any balance sheet asset limits have been applied. All figures are rounded to the nearest million pounds. The discount rate and price inflation assumptions refer to those disclosed for the companies' main UK schemes where available. "ND" means no UK specific figures were disclosed.

		2012	Surplus/(deficit)					2011	Surplus/(deficit)				
Company	Year-end	Market value of assets £m	Total £m	Funded schemes £m	Discount rate % pa	Inflation[1] % pa	Disclosed mortality?[2]	Market value of assets £m	Total £m	Funded schemes £m	Discount rate % pa	Inflation[1] % pa	Disclosed mortality?[2]
Aberdeen Asset Management	Sep	154	(15)	(15)	4.60	2.80	Y	130	(24)	(24)	5.10	3.20	Y
Aggreko	Dec	70	(4)	(4)	4.50	3.30	Y	59	(6)	(6)	4.80	3.40	Y
AMEC	Dec	1,645	(7)	(7)	4.50	2.90	Y	1,569	(49)	(49)	4.70	3.00	Y
Anglo American	Dec	3,303	(332)	(198)	ND	ND	N	1,679	(136)	(23)	ND	ND	N
Associated British Foods	Sep	3,003	(87)	(30)	4.60	3.10	Y	2,788	(36)	15	5.10	3.30	Y
AstraZeneca	Dec	6,180	(1,404)	(1,037)	4.50	3.10	Y	5,516	(1,735)	(1,416)	4.80	3.20	Y
Aviva	Dec	12,281	606	733	4.50	3.00	Y	11,791	1,264	1,380	4.90	3.10	Y
Babcock International Group	Mar	2,783	(257)	(257)	4.80	2.70	N	2,580	(215)	(215)	5.60	3.10	N
BAE Systems[3]	Dec	19,454	(4,555)	(4,360)	4.50	2.90	N	17,980	(4,201)	(4,006)	4.80	2.90	N
Barclays[4]	Dec	24,096	(1,146)	(985)	4.31	2.93	Y	22,748	(75)	88	4.74	3.04	Y
BG Group[4]	Dec	983	(177)	(134)	4.60	3.00	Y	829	(210)	(171)	5.00	3.10	Y
BHP Billiton	Jun	1,238	(179)	(108)	4.20	3.40	Y	1,157	(110)	(51)	5.40	3.50	Y
BP	Dec	23,972	(6,630)	(2,372)	4.40	3.10	Y	22,150	(5,814)	(2,033)	4.80	3.20	Y
British American Tobacco	Dec	5,547	(873)	(649)	4.10	2.90	Y	5,184	(665)	(468)	4.70	3.00	Y
British Land Company (The)	Mar	109	2	2	4.60	3.20	Y	110	11	11	5.50	3.70	Y
BT Group	Mar	38,541	(2,448)	(2,380)	4.95	3.05	Y	37,222	(1,830)	(1,760)	5.50	3.40	Y
Bunzl	Dec	304	(76)	(59)	ND	ND	N	272	(74)	(60)	ND	ND	N
Capita Group (The)	Dec	675	(108)	(108)	4.50	2.90	Y	578	(86)	(86)	4.90	3.00	Y
Carnival	Nov	283	(21)	(21)	4.40	3.00	Y	218	4	4	5.00	3.10	Y
Centrica	Dec	5,133	88	125	4.80	3.20	Y	4,670	330	364	5.40	3.30	Y
Compass Group	Sep	1,899	(362)	(168)	4.50	2.70	Y	1,773	(293)	(111)	5.10	3.00	Y
CRH	Dec	1,748	(537)	(499)	4.50	3.00	Y	1,569	(533)	(498)	4.70	3.00	Y
Croda International	Dec	712	(166)	(141)	4.50	3.10	N	648	(199)	(176)	4.80	3.30	N
Diageo	Jun	6,165	(1,084)	(881)	4.50	2.90	Y	6,035	(824)	(643)	5.60	3.60	Y
Evraz[4]	Dec	334	(358)	(358)	ND	ND	N	306	(337)	(337)	ND	ND	N
Experian	Mar	598	56	81	5.20	3.30	Y	571	42	66	5.60	3.50	Y

Company	Year-end	2012 Market value of assets £m	2012 Surplus/(deficit) Total £m	2012 Surplus/(deficit) Funded schemes £m	2012 Discount rate % pa	2012 Inflation[1] % pa	2012 Disclosed mortality?[2]	2011 Market value of assets £m	2011 Surplus/(deficit) Total £m	2011 Surplus/(deficit) Funded schemes £m	2011 Discount rate % pa	2011 Inflation[1] % pa	2011 Disclosed mortality?[2]
Fresnillo	Dec	13	(7)	(2)	ND	ND	N	19	(6)	(2)	ND	ND	N
G4S	Dec	1,589	(471)	(436)	4.50	3.00	Y	1,539	(335)	(286)	5.00	3.10	Y
GKN	Dec	2,759	(978)	(446)	4.05	2.85	Y	2,693	(868)	(465)	4.70	3.00	Y
GlaxoSmithKline	Dec	13,879	(1,312)	(910)	4.40	3.00	Y	12,858	(1,476)	(1,098)	4.80	3.00	Y
Glencore International[4]	Dec	213	(166)	(166)	ND	ND	N	183	(148)	(148)	ND	ND	N
Hammerson	Dec	55	(31)	(18)	4.50	3.00	N	52	(31)	(19)	4.70	3.20	N
HSBC Holdings	Dec	23,588	20	418	4.50	3.10	Y	22,504	(136)	255	4.80	3.20	Y
IMI	Dec	1,211	(219)	(147)	4.25	3.00	Y	1,196	(189)	(125)	4.80	3.10	Y
Imperial Tobacco Group	Sep	3,099	(1,046)	(262)	4.30	2.80	Y	2,876	(754)	(67)	5.40	3.20	Y
InterContinental Hotels Group	Dec	523	17	89	4.50	3.00	Y	445	(48)	21	4.70	3.10	Y
International Airlines Group[4]	Dec	17,538	(985)	(753)	4.30	2.90	N	16,263	(360)	(163)	4.85	2.95	N
Intertek Group	Dec	105	(17)	(17)	4.50	ND	Y	97	(11)	(11)	4.90	ND	Y
ITV	Dec	2,693	(551)	(510)	4.20	2.90	Y	2,646	(390)	(351)	4.70	3.00	Y
Johnson Matthey	Mar	1,226	(129)	(115)	5.10	3.40	Y	1,137	(93)	(81)	5.50	3.50	Y
Kingfisher	Jan	1,947	(15)	(15)	4.50	3.00	Y	1,645	(58)	(58)	5.60	3.50	Y
Land Securities Group	Mar	162	(2)	(2)	4.80	3.50	Y	151	9	9	5.70	3.70	Y
Legal & General Group[5]	Dec	1,557	(333)	(333)	4.40	2.80	Y	1,407	(288)	(288)	4.70	2.80	Y
Lloyds Banking Group[4]	Dec	30,367	(957)	(957)	4.60	2.90	Y	28,828	592	592	5.00	3.00	Y
Marks & Spencer Group	Mar	6,186	91	91	4.60	3.10	Y	5,398	182	183	5.50	3.40	Y
Meggitt	Dec	635	(241)	(169)	4.50	3.00	Y	585	(265)	(198)	4.70	3.00	Y
Melrose Industries	Dec	1,043	(261)	(143)	4.50	3.00	Y	959	(118)	(107)	4.90	3.10	Y
Morrison (Wm) Supermarkets	Jan	2,589	(11)	(11)	4.75	3.30	Y	2,304	38	38	5.60	3.80	Y
National Grid	Mar	19,957	(1,429)	(1,186)	4.80	3.20	Y	18,903	(577)	(352)	5.50	3.50	Y
Next	Jan	540	35	45	5.00	3.10	Y	507	56	63	5.70	3.60	Y
Old Mutual[4]	Dec	606	39	39	4.40	3.20	N	594	48	48	4.70	3.30	N
Pearson	Dec	2,327	(74)	(50)	4.40	3.00	Y	2,157	(23)	1	4.90	3.00	Y
Prudential[5]	Dec	7,074	1,015	1,015	4.40	2.70	Y	7,051	1,431	1,431	4.70	2.90	Y

Company	Year-end	2012 Market value of assets £m	2012 Surplus/(deficit) Total £m	2012 Surplus/(deficit) Funded schemes £m	2012 Discount rate % pa	2012 Inflation[1] % pa	2012 Disclosed mortality?[2]	2011 Market value of assets £m	2011 Surplus/(deficit) Total £m	2011 Surplus/(deficit) Funded schemes £m	2011 Discount rate % pa	2011 Inflation[1] % pa	2011 Disclosed mortality?[2]
Reckitt Benckiser Group	Dec	1,281	(271)	(157)	4.30	3.00	Y	1,112	(337)	(233)	4.80	3.10	Y
Reed Elsevier	Dec	3,806	(466)	(306)	ND	ND	N	3,634	(242)	(87)	ND	ND	N
Resolution Limited	Dec	1,344	62	62	4.48	ND	Y	1,294	52	52	4.90	ND	Y
Rexam	Dec	2,941	(393)	(301)	4.40	3.10	Y	2,811	(407)	(321)	4.70	3.10	Y
Rio Tinto	Dec	8,956	(2,943)	(2,295)	4.30	2.90	N	8,490	(3,023)	(2,417)	4.70	3.00	N
Rolls-Royce Group	Dec	10,328	563	1,131	4.40	3.00	N	10,016	1,251	1,746	4.70	3.10	N
Royal Bank Of Scotland Group (The)	Dec	26,370	(3,740)	(3,572)	4.50	2.90	Y	25,086	(2,051)	(1,888)	5.00	3.00	Y
Royal Dutch Shell[4]	Dec	45,220	(5,401)	(2,963)	ND	ND	N	41,364	(4,111)	(1,793)	ND	ND	N
RSA Insurance Group	Dec	6,218	(215)	(138)	4.30	2.50	Y	5,813	(135)	(67)	4.90	2.80	Y
SABMiller	Mar	270	(97)	17	ND	ND	N	239	(89)	28	ND	ND	N
Sage Group (The)	Sep	17	(14)	(14)	ND	ND	N	18	(12)	(12)	ND	ND	N
Sainsbury (J)	Mar	5,192	(471)	(462)	5.00	3.30	Y	4,614	(340)	(331)	5.50	3.30	Y
Schroders	Dec	777	67	67	4.60	3.30	Y	764	56	56	4.60	3.40	Y
Scottish & Southern Energy	Mar	2,695	(430)	(430)	4.60	3.20	Y	2,464	(294)	(294)	5.50	3.50	Y
Serco Group[6]	Dec	1,944	(425)	(424)	ND	ND	N	1,747	(290)	(242)	ND	ND	N
Severn Trent	Mar	1,557	(346)	(337)	4.90	3.10	Y	1,473	(292)	(284)	5.60	3.50	Y
Smith & Nephew	Dec	753	(132)	(110)	4.50	3.00	Y	686	(161)	(145)	4.90	3.10	Y
Smiths Group	Jul	3,348	(597)	(516)	4.10	2.80	Y	3,273	(175)	(107)	5.30	3.50	Y
Standard Chartered	Dec	1,523	(293)	(182)	4.50	3.00	Y	1,363	(301)	(205)	4.80	3.10	Y
Standard Life	Dec	2,891	391	468	4.50	3.00	Y	2,756	441	515	4.60	3.15	Y
Tate & Lyle	Mar	1,362	(36)	10	5.10	3.30	Y	1,245	(41)	1	5.50	3.60	Y
Tesco	Feb	6,169	(1,872)	(1,812)	ND	ND	Y	5,608	(1,356)	(1,291)	ND	ND	Y
TUI Travel	Sep	1,343	(648)	(462)	4.50	2.70	Y	1,222	(514)	(366)	5.30	3.20	Y
Unilever	Dec	14,309	(2,436)	(1,299)	4.30	2.60	Y	13,311	(2,119)	(1,050)	4.70	3.00	Y
United Utilities Group	Mar	2,113	(92)	(83)	5.00	3.25	Y	1,718	(195)	(187)	5.50	3.35	Y
Vedanta Resources	Mar	30	(37)	(37)	ND	ND	N	24	(35)	(35)	ND	ND	N
Vodafone Group	Mar	1,604	(306)	(248)	ND	ND	Y	1,558	10	70	ND	ND	Y

Company	Year-end	2012 Market value of assets £m	2012 Surplus/(deficit) Total £m	2012 Surplus/(deficit) Funded schemes £m	2012 Discount rate % pa	2012 Inflation[1] % pa	2012 Disclosed mortality?[2]	2011 Market value of assets £m	2011 Surplus/(deficit) Total £m	2011 Surplus/(deficit) Funded schemes £m	2011 Discount rate % pa	2011 Inflation[1] % pa	2011 Disclosed mortality?[2]
Weir Group (The)	Dec	650	(90)	(82)	4.30	2.90	Y	606	(85)	(76)	4.80	3.10	Y
Whitbread	Mar	1,341	(599)	(599)	4.65	3.15	Y	1,257	(488)	(488)	5.60	3.45	Y
Wolseley	Jul	961	(358)	(287)	4.60	2.90	Y	889	(360)	(283)	5.40	3.70	Y
Wood Group (John)	Dec	118	(34)	(34)	4.50	ND	N	104	(29)	(29)	4.80	ND	N
WPP	Dec	710	(334)	(176)	4.20	ND	Y	654	(281)	(133)	4.70	ND	Y
Xstrata	Dec	1,607	(433)	(427)	ND	ND	N	1,529	(445)	(440)	ND	ND	N

Notes:

1 We have listed RPI as the measure of inflation and excluded CPI where it could be identified in the accounts.

2 This column indicates companies that disclosed sufficient information to calculate their assumption for life expectancy for a male pensioner in the UK.

3 The figures for BAE Systems exclude £1,148m of its 2012 deficit (£965m in 2011) which is allocated to equity accounted investments and other participating employers and include £0m (£403m in 2011) of assets held in trust.

4 All of the companies above accounted using immediate recognition of gains and losses (through "Other Comprehensive Income"), with the exception of Barclays, BG Group, Evraz, Glencore International, International Airlines Group, Lloyds Banking Group, Old Mutual and Royal Dutch Shell, who opted to spread gains and losses under IAS19.

5 Legal & General and Prudential split their pension scheme surplus/(deficit) between shareholder and with-profit funds and hold group insurance policies in respect of some of their obligations. We have included the IAS19 value of these policies in the figures stated above, as follows: Legal & General: £636m (2011: £583m), Prudential: £169m (2011: £165m).

6 The figures quoted for Serco Group relate to the total across all defined benefit pension schemes. Some of the surplus/(deficit) relates to contracts under which the pension costs are due to be reimbursed.

The 2012 figures are as at the end of the accounting periods ending in 2012. The 2011 figures are as at the start of the accounting period. All figures shown above were taken from IAS19 disclosures. Figures have been converted to pounds sterling where a company has reported figures in its accounts in a different currency.

Traditionally, some companies with overseas pension plans do not fund them via an external scheme, instead backing the pension plan with company assets, which may result in a larger deficit being disclosed. Where disclosed, the surplus/(deficit) attributable to funded schemes is also shown above.

The discount rate and inflation assumption refer to those disclosed for the companies' main UK scheme(s). Where a company has disclosed a range of assumptions, we have taken the mid-point. Where a company operates pension schemes in more than one country, we have considered the assumptions used for the UK if separately given. "ND" means no UK figures were disclosed.

We have excluded from our survey the following 14 companies who had no evidence of significant defined benefit provision: Admiral Group, Antofagasta, ARM Holdings, British Sky Broadcasting, Burberry Group, Eurasian Natural Resources, Hargreaves Lansdown, Intu Properties, Kazakhmys, Petrofac, Polymetal International, Randgold Resources, Shire and Tullow Oil.

The following five companies have entered the FTSE 100 index since 31 December 2012 and hence are not included in our survey: Easyjet, London Stock Exchange Group, Persimmon, Travis Perkins and William Hill. The following five companies have exited the FTSE 100 index since 31 December 2012: Evraz, Intu Properties, Kazakhmys, Polymetal International and Xstrata.

These tables show the key results of analysis of the disclosures made by the companies in the FTSE 100 as at 31 December 2012 that were reported in their 2012 accounts.

The figures relate to the worldwide position of each company (not just the UK disclosure) but exclude healthcare and defined contribution pension arrangements where possible.

The source of the data is each company's annual report and accounts for the accounting period ending in 2012.

The surplus/(deficit) figures are before allowing for deferred tax and before any balance sheet asset limit has been applied.

Traditionally, some companies with overseas pension schemes do not fund them via an external scheme, instead backing the pension scheme with company assets, which may result in a larger deficit being disclosed.

The source of market capitalisation figures is the FTSE All-Share Index Series reports as at the companies' year-ends (where available).

All figures shown here have been calculated using unrounded numbers. Therefore, some metrics shown may differ to those calculated using the rounded figures.

Largest liabilities

Company	2012 Liabilities £m	2011 Liabilities £m
Royal Dutch Shell	50,621	45,475
BT Group	40,989	39,052
Lloyds Banking Group	31,324	28,236
BP	30,602	27,964
Royal Bank Of Scotland Group	30,110	27,137
Barclays	25,242	22,823

Largest deficits

Company	2012 Deficit £m	2011 Deficit £m
BP	6,630	5,814
Royal Dutch Shell	5,401	4,111
BAE Systems[1]	4,555	4,201
Royal Bank Of Scotland Group	3,740	2,051
Rio Tinto	2,943	3,023
BT Group	2,448	1,830

[1] The figures for BAE Systems exclude £1,148m of its 2012 deficit (£965m in 2011) allocated to equity accounted investments and other participating employers and include £0m (£403m in 2011) of assets held in trust.

Largest liabilities compared to market capitalisation				
			2012	2011
			Liabilities/	Liabilities/
Company	Liabilities £m	Market cap £m	Market cap %	Market cap %
International Airlines Group	18,524	3,428	540	608
BT Group	40,989	17,508	234	272
BAE Systems[2]	25,157	10,929	230	250
Royal Bank Of Scotland Group	30,110	19,524	154	227
RSA Insurance Group	6,433	4,514	143	160
Babcock International Group	3,040	2,860	106	127

[2] The figures for BAE Systems include all liabilities of the multi-employer plans that the group participates in.

Largest deficit compared to market capitalisation				
			2012	2011
			Deficit/	Deficit/
Company	Deficit £m	Market cap £m	Market cap %	Market cap %
BAE Systems[1]	4,555	10,929	42	45
International Airlines Group	985	3,428	29	13
TUI Travel	648	2,618	25	31
GKN	903	3,727	24	28
Whitbread	599	2,982	20	16
Royal Bank Of Scotland Group	3,740	19,524	19	17

Highest funding level				
Company	Assets £m	Liabilities £m	2012 Assets/ Liabilities %	2011 Assets/ Liabilities %
Prudential[3]	7,074	6,059	117	125
Standard Life	2,891	2,500	116	119
Experian	598	543	110	108
Schroders	777	710	109	108
Next	540	505	107	112
Old Mutual	606	567	107	109

[3] Prudential splits its pension scheme surplus/(deficit) between shareholder and with-profit funds and holds group insurance policies in respect of some of its obligations. We have included the IAS19 value of these policies in the asset and liability figures stated above, which was £169m for 2012 (2011: £165m).

Lowest funding level				
Company	Assets £m	Liabilities £m	2012 Assets/ Liabilities %	2011 Assets/ Liabilities %
Vedanta Resources	30	66	45	41
Evraz	334	691	48	48
Sage Group	17	31	54	60
Glencore International	213	379	56	55
Hammerson	55	86	64	63
Fresnillo	13	20	66	76

Largest service cost[4]		
	2012	2011
Company	Service cost £m	Service cost £m
Royal Dutch Shell	788	727
BP	622	612
Royal Bank Of Scotland Group[5]	506	483
Tesco	492	528
Lloyds Banking Group	376	400
HSBC Holdings	373	1

[4] The service cost (representing the value of benefits earned over the accounting period) includes the value of any past service benefits awarded to members during the year.

[5] Royal Bank of Scotland Group's service cost includes £51m of expenses (2011: £53m).

Largest employer contributions		
	2012	2011
Company	Contributions £m	Contributions £m
BT Group	2,179	1,313
Royal Dutch Shell	1,452	1,436
BAE Systems[6]	1,157	585
Royal Bank Of Scotland Group	977	1,059
Barclays	840	2,220
BP	803	886

[6] The figures for BAE Systems do not include contributions by the employer in respect of employee salary sacrifice arrangements.

Largest increase in employer contributions			
Company	2012 Employer contributions £m	2011 Employer contributions £m	Increase in employer contributions £m
BT Group	2,179	1,313	866
BAE Systems[6]	1,157	585	572
Unilever	490	402	88
Whitbread	87	2	85
Standard Chartered	127	47	80
AstraZeneca	534	458	76

Highest employer contributions compared to dividends paid[7]				
Company	Contributions £m	Dividends £m	2012 Contributions /Dividends %	2011 Contributions /Dividends %
Lloyds Banking Group	667	56	1,191	1,666
BT Group	2,179	590	369	242
Royal Bank Of Scotland Group	977	301	325	2,648
BAE Systems[6]	1,157	631	183	93
Serco Group	67	42	159	281
Babcock International Group	84	74	115	160

[7] International Airlines Group did not pay a dividend in 2011 or 2012 but contributed £450m and £503m to its pension scheme in each year respectively.

Largest employer contributions compared to service cost

Company	Contributions £m	Service cost £m	2012 Contributions less service cost £m	2011 Contributions less service cost £m
BT Group	2,179	267	1,912	1,016
BAE Systems[6]	1,157	249	908	328
GlaxoSmithKline	635	-124	759	570
Royal Dutch Shell	1,452	788	664	709
Barclays	840	348	492	1,849
Royal Bank Of Scotland Group	977	506	471	576

Highest equity allocation

Company	2012 Equity allocation %	2011 Equity allocation %
Wood Group (John)	83	83
BP	67	68
Wolseley	62	63
BG Group	61	60
Vodafone Group	60	62
Bunzl	55	65

Lowest equity allocation		
Company	2012 Equity allocation %	2011 Equity allocation %
Fresnillo	0	0
Prudential	3	5
IMI	8	8
Aviva	9	7
Rolls-Royce Group	12	11
Sage Group	14	16

Largest % increase in funding level				
Company	2012 Funding level %	2011 Funding level %	Increase in funding level %	Accounting date
InterContinental Hotels Group	103	90	13	Dec
Aberdeen Asset Management	91	84	7	Sep
United Utilities Group	96	90	6	Mar
Reckitt Benckiser Group	83	77	6	Dec
AstraZeneca	81	76	5	Dec
BG Group	85	80	5	Dec

Largest % decrease in funding level				
Company	2012 Funding level %	2011 Funding level %	Decrease in funding level %	Accounting date
Vodafone Group	84	101	-17	Mar
Smiths Group	85	95	-10	Jul
Fresnillo	66	76	-10	Dec
British Land Company	102	111	-9	Mar
Melrose	80	89	-9	Dec
Carnival	93	102	-9	Nov

Highest gain on assets[8]		
Company	2012 Gain %	2011 Gain %
BG Group	14	-6
Anglo American	14	6
Unilever	13	3
Royal Dutch Shell	13	3
Bunzl	12	2
Wood Group (John)	12	-2

[8] Figures calculated as a percentage of assets at the start of the accounting year (December year-ends only).

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LCP Accounting for Pensions 2013

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