

European companies with UK defined benefit schemes



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Our report analyses the contributions paid, levels of deficit and levels of risk within the schemes.

Introduction

This survey relates to constituent companies of the Dutch AEX, French CAC40, German DAX, Spanish IBEX, Italian FTSE MIB and Scandinavian OMX share indices that have UK subsidiary companies with defined benefit (DB) pension schemes. The survey covers 79 European companies with around £107bn of UK pension liabilities between them.

Our report analyses the contributions paid, levels of deficit and levels of risk within the schemes. Data has been taken from the latest available financial statements of the UK subsidiary companies, which are as at 31 December 2014 in most cases. Although the companies are not named directly within this survey, they are represented by the same number in each chart throughout.

The costs and risks associated with DB pension schemes are well known within the industry. In most cases the parent companies in our survey are leading players in their industries and are able to absorb reasonably substantial pension costs. However, the impact upon performance and return on investments of the UK subsidiary companies can be more pronounced. Comparisons of these subsidiaries against other UK companies without legacy DB pension liabilities, especially on a cash basis, could be heavily influenced by the pension related costs and cash contributions.

There are also some surprising results, for example that although the average funding level of these schemes is slightly higher than the FTSE350 average, the total contributions paid last year (for past service deficit and current service) represented 14.1% of total staff costs, versus a corresponding figure of just 6% for the FTSE350.

I hope you will find our report both interesting and useful as a benchmark of your UK pension exposure against other European-owned companies.



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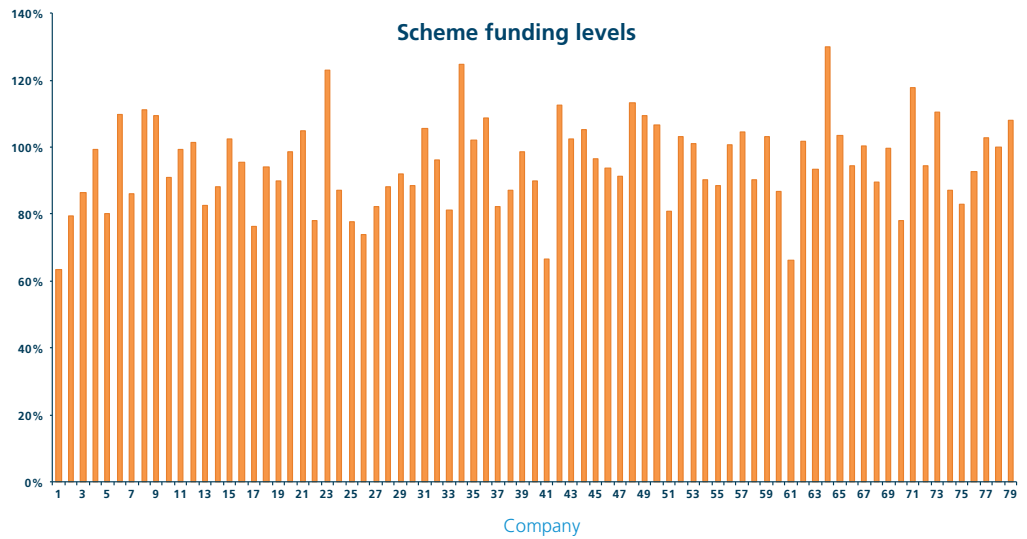
Note: Where figures are not available from a particular company's accounts, we have estimated them based on other information, if possible, or excluded them from the relevant section of analysis.

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The average funding level is 95%, which is higher than the average funding level of FTSE350 companies' DB schemes at the same date of 93%.

Funding levels on the company accounting basis

The funding levels (as measured under IFRS) of these companies' schemes are similar to those seen across UK DB schemes as a whole. The average funding level is 95%, which is slightly higher than the average funding level of FTSE350 companies' DB schemes at the same date of 93%. There were 30 companies with funding surpluses, which are a rare sight within the FTSE350. The least well-funded scheme had a funding level of 64%.

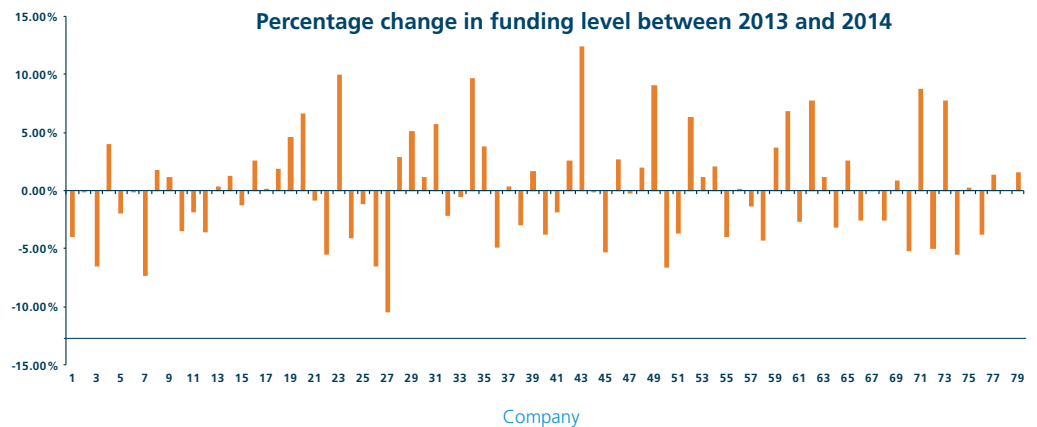


Source: financial statements as at 31 December 2014

The funding level of course depends on the actuarial assumptions used to calculate scheme liabilities. The strength of assumptions adopted will vary from one employer to another, and from one year to the next but should comply with the international accounting standards at the relevant date.

Changes in funding level

The following chart shows the percentage change in the funding levels between 2013 and 2014. The funding level increased by only 0.2% on average between year-end 2013 and year-end 2014, although there are some marked variations across different schemes.



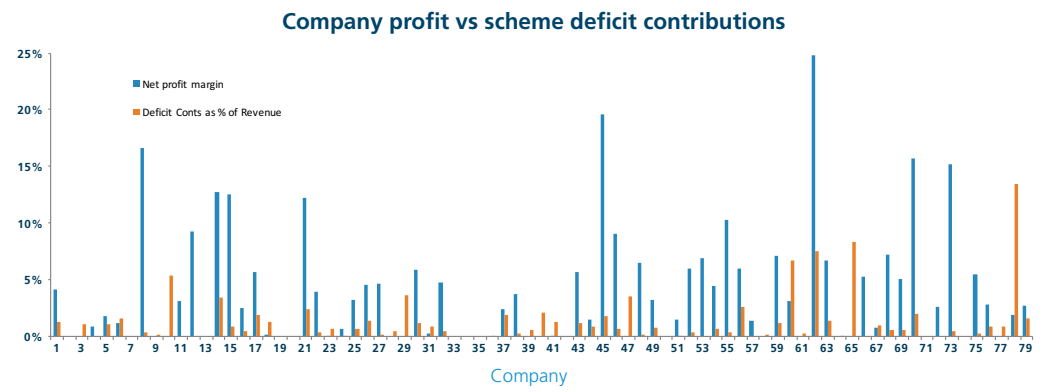
Source: financial statements as at 31 December 2014

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At current contribution rates it will take an average of 4.2 years for the employers with scheme deficits to clear these, assuming that further deficits do not arise in the meantime.

Pension related cost and impact on financial performance

The following chart shows deficit contributions paid as a percentage of company revenues, against companies' net profit (losses are shown as zero). Companies 19, 20, 33, 35, 42, 50 and 74 are not included due to insufficient data and Companies 2, 7, 13, 34 and 71 have been removed as they disclosed net profit margins that were deemed to be outliers.



Source: financial statements as at 31 December 2014

For the purpose of this survey, deficit contributions have been derived as total DB contributions paid by the employer less the disclosed 'current service cost' for DB accrual. Where this figure is negative we have assumed that no deficit contributions are being paid.

The aggregate contribution paid into these DB schemes in 2014 was approximately £2.3bn, with contributions relating to UK past service deficits amounting to £1.6bn. This represents 1.6% of total UK revenues, which is greater than the 0.4% of total revenue contributed by FTSE350 companies on average for the same period.

In most cases, the contribution requirements of the schemes are reasonably affordable for the employer and/or parent company, as they generate sufficient levels of profits. However, it would appear that some will struggle to meet contribution requirements over the longer term without making changes to their funding strategy. For example, the use of formal guarantees to improve covenant and thereby enable a lower assessment of technical provisions; or asset backed contributions to bolster the assessed value of assets without immediate cash injections.

At a simpler level, the recovery plan could be extended in order to reduce the annual contribution requirement, although this will also depend upon the trustees' view of the company covenant.

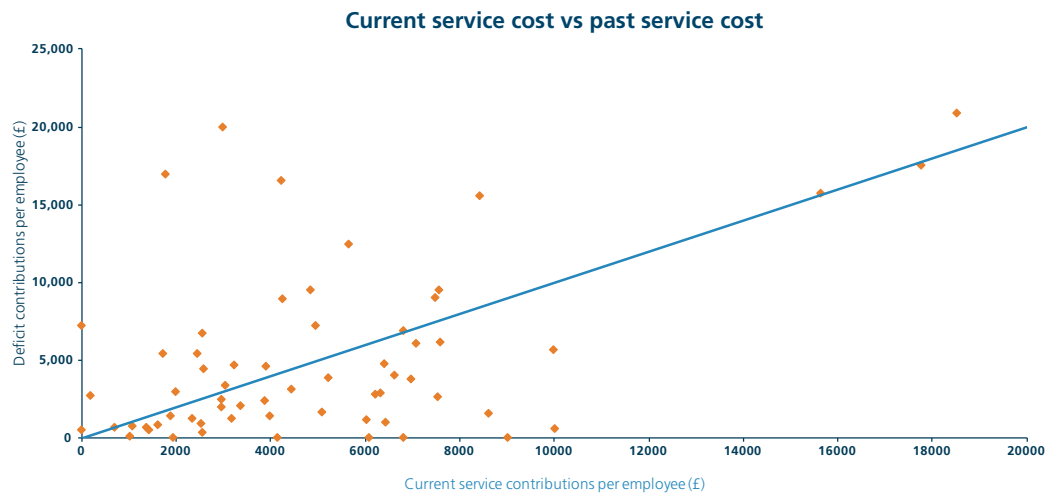
At current contribution rates it will take an average of 4.2 years for the employers with scheme deficits to clear these, assuming that further deficits do not arise in the meantime.

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In many cases, companies paid lower contributions towards current service benefits than towards past service deficits.

The following graph compares the future service cost of retirement benefits per employee against the annual contributions paid in relation to past service deficit, also on a per employee basis.

Companies 2, 14, 20, 29, 34, 35 and 78 have been omitted due to a lack of data and Companies 7, 12, 19, 33, 42, 50, 65, 66, 71 and 74 are deemed to be outliers.



Source: financial statements as at 31 December 2014

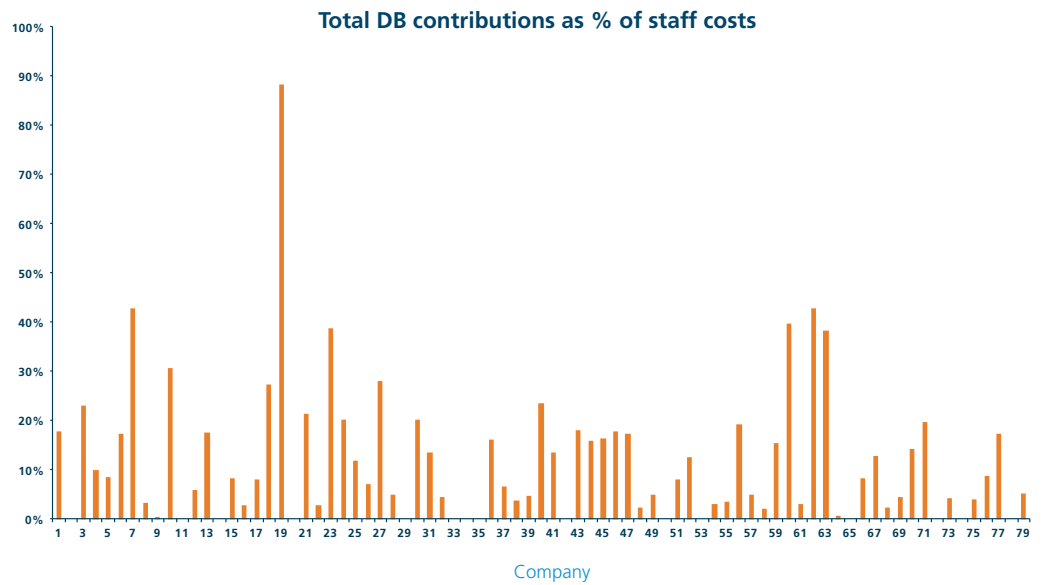
The average deficit contribution paid per employee in 2014 was around £4,900 and the average amount paid in relation to current service benefits was around £5,200 (this includes both DB and defined contribution (DC) arrangements). However, there are some significant variations around both of these amounts. The average deficit contribution per employee is higher than the FTSE350 companies, which paid around £2,500 per employee in relation to past service deficits.

In many cases, companies paid lower contributions towards current service benefits than towards past service deficits (those above the blue line).

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The income statement may not provide a full breakdown of these costs, meaning that analysts' perceptions of companies' performance can be distorted.

The chart below demonstrates that pension contributions can represent a very significant proportion of total staff costs reported on the income statement. The impact of DB contribution requirements within these figures is diluted by employees who are not members of any pension arrangement and, to a lesser extent, those in DC arrangements. Nonetheless, in some cases, pension contributions are substantially increasing the cash outlay associated with employees' total remuneration. The income statement may not provide a full breakdown of these costs, meaning that analysts' perceptions of companies' performance can be distorted. Companies 2, 11, 14, 20, 29, 34, 35, 53 and 78 have been omitted due to a lack of data, and Companies 33, 42, 50, 65 and 74 are deemed to be outliers.



Source: financial statements as at 31 December 2014

On average, pension contributions paid to DB schemes only (in relation to both past service deficit and current service) represented 14.1% of the total staff cost reported in the financial statements. However, the figure for individual companies varied greatly, from 0% up to 88%. These figures are excluding outliers. The average contribution is higher than for FTSE350 companies, where the equivalent figure is 6%.

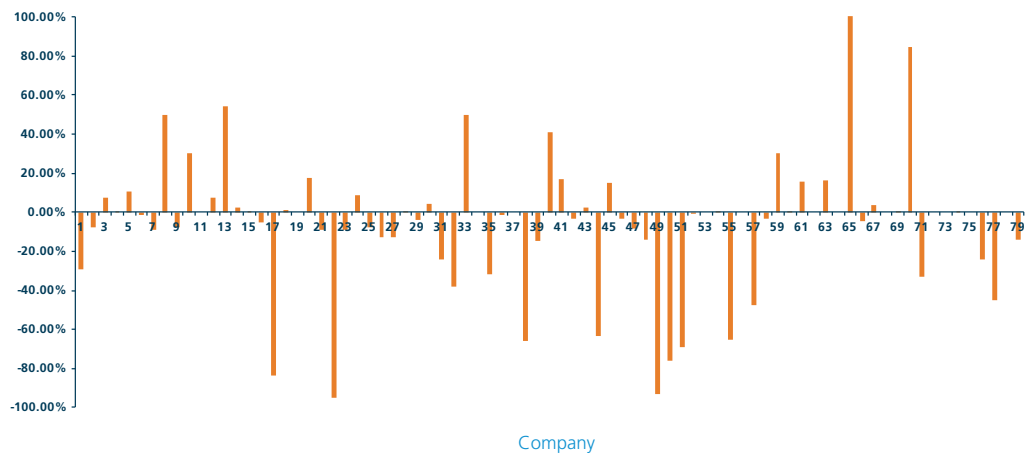
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The contribution level decreased on average by 6.6% between year-end 2013 and year-end 2014.

Changes in employer contributions

The chart below shows the percentage change in employer contributions to their defined benefit schemes between 2013 and 2014. The contribution level decreased on average by 6.6% between year-end 2013 and year-end 2014. Companies 11, 19, 53, 68, 72 and 78 have been omitted due to a lack of data and Company 62 is deemed to be an outlier.

Percentage change in DB contributions between 2013 and 2014



Source: financial statements as at 31 December 2014

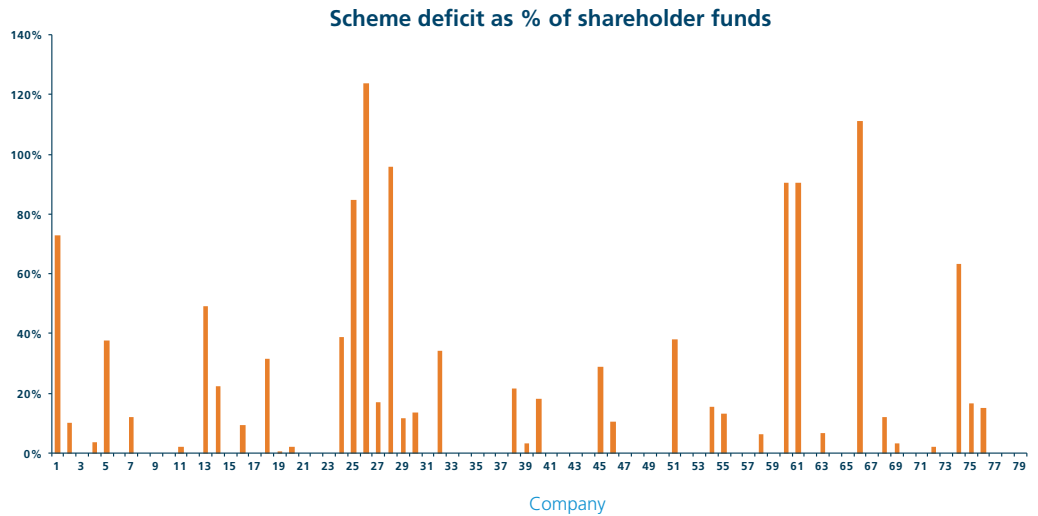
The aggregate contribution paid into these DB schemes in 2014 was approximately £2.3bn, which is lower than the 2013 aggregate contribution of £2.6bn.

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Scheme deficits amount to 31% of shareholder funds on average.

Impact on shareholder funds

The following chart shows past service deficits as a percentage of shareholder funds, excluding Companies 3, 10, 17, 22 and 70 which disclosed negative shareholder funds and Companies 33, 37, 41 and 47 have been deemed to be outliers. Those cases with no scheme funding deficit, including the 30 schemes in surplus, have also been excluded.



Source: financial statements as at 31 December 2014

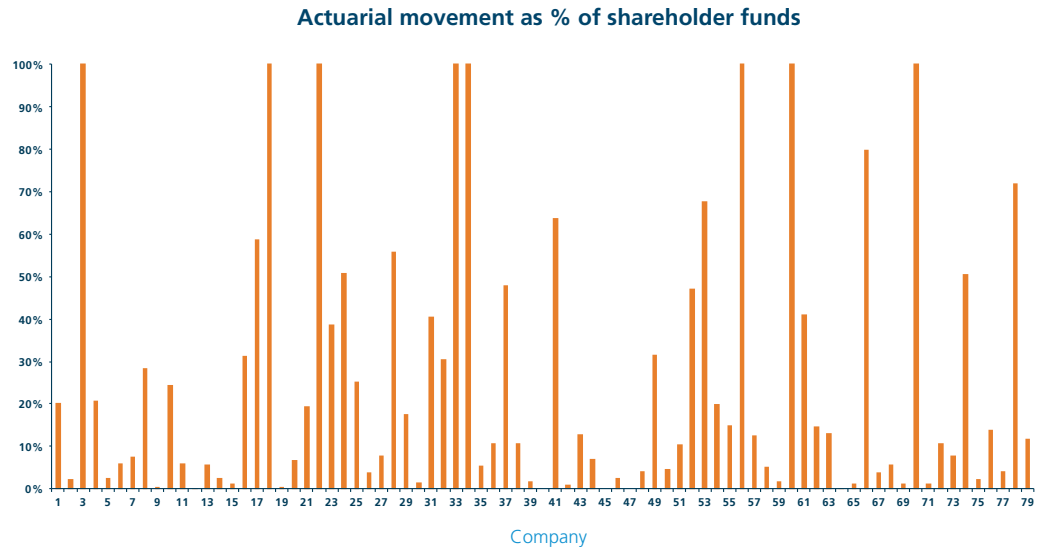
For the remaining cases, scheme deficits amount to 31% of shareholder funds on average. The return on shareholder funds could be impacted by this percentage during the period over which the deficit is removed. This can significantly affect the companies’ ability to transfer funds back to their parent companies.

Of course, cash contributions are not the only way to reduce deficits. For example, companies could consider re-risking the scheme’s investment strategy (i.e. increasing the allocation to growth assets) or undertaking incentive exercises (providing scheme members with options to amend their benefits in ways they might find attractive, but which result in a saving to the scheme – e.g. pension increase exchange, or flexible early retirement).

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On average, actuarial movement was about 47% of shareholder funds. Movements at this level are potentially manageable, but in the case of 12 Companies, where the movement is over 60% of shareholder funds, this will have a significant impact on the parent companies' holdings in the UK subsidiary.

The following chart shows 'actuarial movements' as a percentage of shareholder funds. The actuarial movement consists of the impact of changes in assumptions, experience gains/losses on liabilities, and experience gains/losses on assets.



Source: financial statements as at 31 December 2014

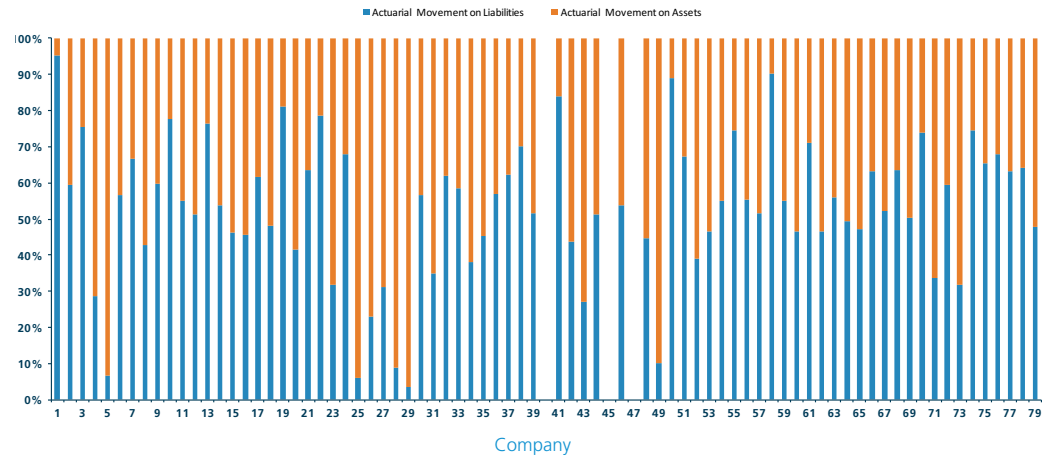
On average, actuarial movement was about 47% of shareholder funds. Movements at this level are potentially manageable, but in the case of 12 Companies, where the movement is over 60% of shareholder funds, this will have a significant impact on the parent companies' holdings in the UK subsidiary. Given the volatile nature of actuarial assumptions and investment returns, such movements are likely to reoccur on a regular basis.

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In 47 cases, more than half, actuarial movements on the liabilities were more significant than those on the assets.

The following chart shows the split of actuarial movements between liabilities (including both experience gains/losses and changes in assumptions) and assets in each case. Companies 40, 45 and 47 have been excluded due to lack of data.

Split of actuarial movement between assets and liabilities



Source: financial statements as at 31 December 2014

The chart shows that in 47 of the cases, more than half, actuarial movements on the liabilities were more significant than those on the assets.

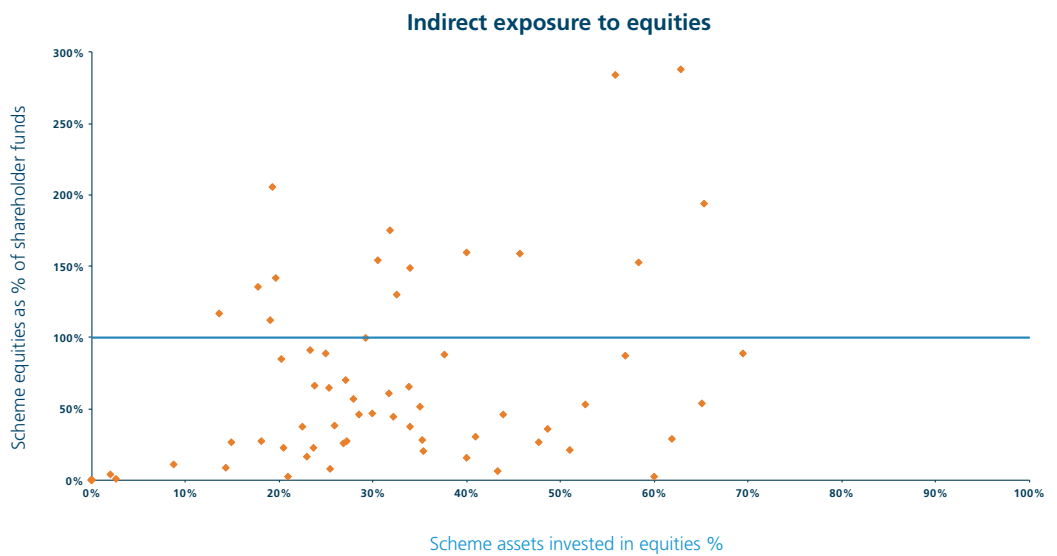
However, it is likely that the majority of the movements in liabilities seen relates to changes in assumptions. Specifically, changes to the discount rate, inflation assumption, and longevity assumptions. In years where no formal valuation has been completed (usually two out of every three years) it is common for disclosures to be prepared using a roll-forward method where experience gains/losses on liabilities may automatically be reported as zero.

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It would seem there is a case here to suggest that some of the parent companies are almost as exposed (or even more exposed) to the performance of their schemes' equity holdings as to the performance of their own subsidiary companies.

Indirect exposure to equity markets

A company's indirect exposure to equity markets via its pension scheme investments is sometimes overlooked. The chart below shows the level of equity investment both as a percentage of shareholder funds (vertical axis) and as a percentage of total scheme assets (horizontal axis). Companies 3, 10, 17, 22 and 70 have been omitted as they disclosed negative shareholder funds. Companies 32, 33, 34, 44, 56 and 66 have been removed as they were outliers.



Source: financial statements as at 31 December 2014

The risk associated with investment in equities via the pension scheme could be deemed very significant in some cases. For example, in the case of Company 4, the scheme's equity allocation is approximately 56% and yet this represents around 284% of the parent company's stake (measured by the value of shareholder funds) in the UK subsidiary.

The specific arrangements between subsidiary companies and their parents can sometimes lead to misleading results.

However, it would seem there is a case here to suggest that some of the parent companies are almost as exposed (or even more exposed) to the performance of their schemes' equity holdings as to the performance of their own subsidiary companies.

If this position is deemed undesirable then the schemes' holdings in equities could be reduced (in exchange for assets more closely aligned with the liabilities, such as bonds, property or liability driven investment funds). However, such change could lead to a significant increase in the expected cost of providing benefits under the scheme.

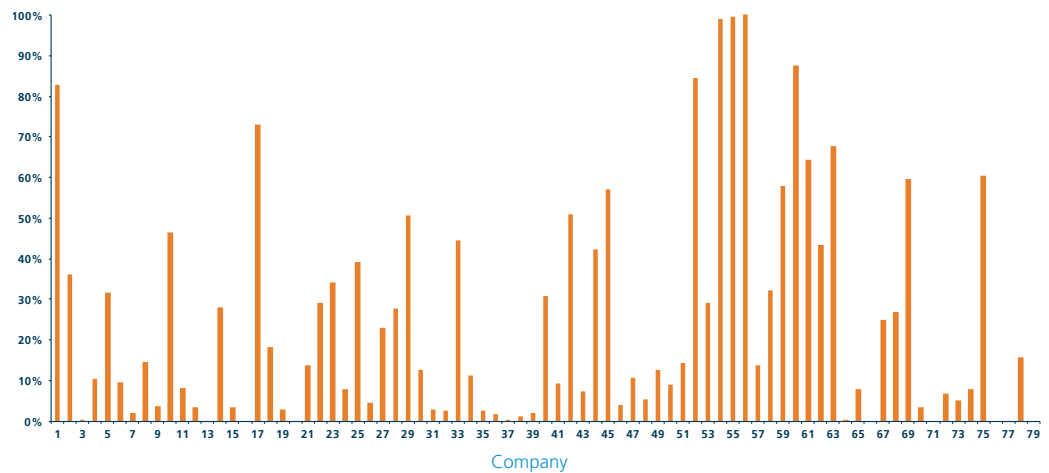
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On average, the UK liabilities account for 27% of the global liabilities related to DB schemes.

UK and global comparison: Impact of UK DB liabilities

The chart below shows the companies DB liabilities as a proportion of their global DB liabilities. Companies 16 and 20 have been excluded due to insufficient data and companies 13, 66, 71, 76 and 79 have been omitted as they were deemed to be outliers.

2014 UK DB liability as a proportion of global DB liabilities



Source: financial statements as at 31 December 2014

On average, the UK liabilities account for 27% of the global liabilities related to DB schemes. However, the distribution is wide, as illustrated above, the results range from less than 1% to 100%.

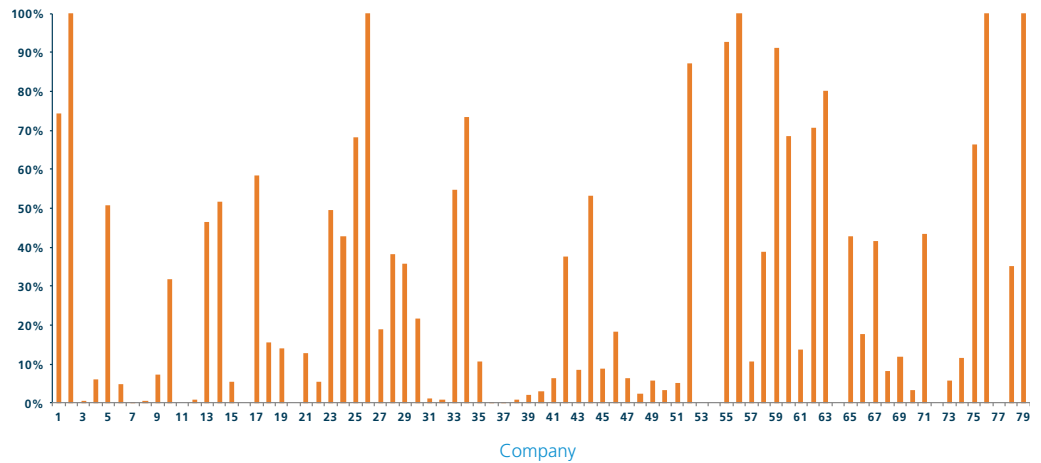
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While the remaining companies equate to an average of 31% of global contributions being made by UK subsidiaries, the variation in the proportions across the companies is extensive from 1% to 100%.

Impact of UK DB contributions

The following chart displays the companies UK contributions as a proportion of the global contributions made to DB schemes. Companies 16, 20, 54, 64 and 77 have been omitted due to a lack of data.

2014 UK DB contributions as a proportion of global DB contributions



Source: financial statements as at 31 December 2014

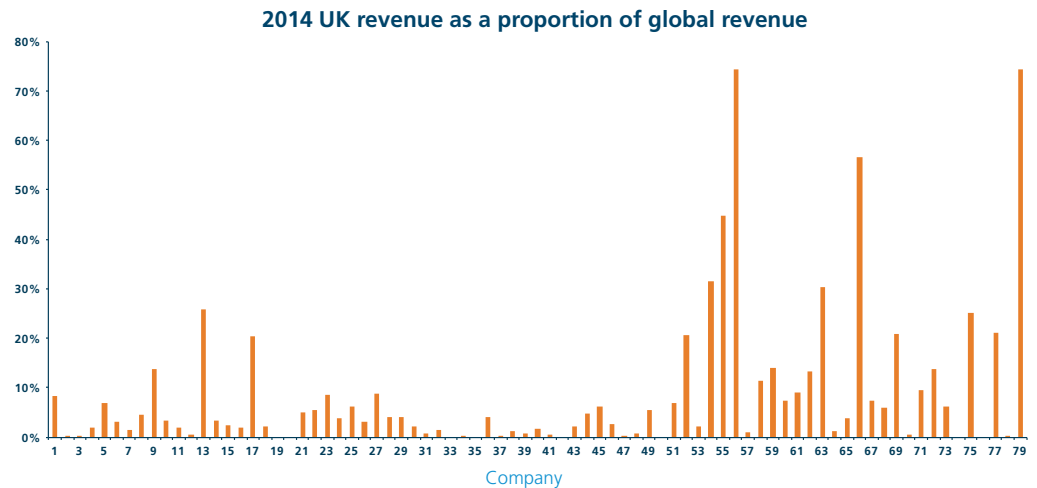
While the remaining companies equate to an average of 31% of global contributions being made by UK subsidiaries, the variation in the proportions across the companies is extensive from 1% to 100%.

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The average proportion of global revenue produced by UK subsidiaries for the companies shown is 9%.

UK subsidiary revenue

To provide context for the UK proportions of the global liabilities and contributions previously shown, the following chart shows the UK revenue as a proportion of the global revenue. Company 76 has been removed as it is deemed to be an outlier.



Source: financial statements as at 31 December 2014

Except for five companies with UK revenue contributing more than 30% (Companies 54, 55, 56, 66 and 79), for all other companies the result is under 30%. The average proportion of global revenue produced by UK subsidiaries for the companies shown is 9%. Removing the five companies mentioned above reduces it to 6%.

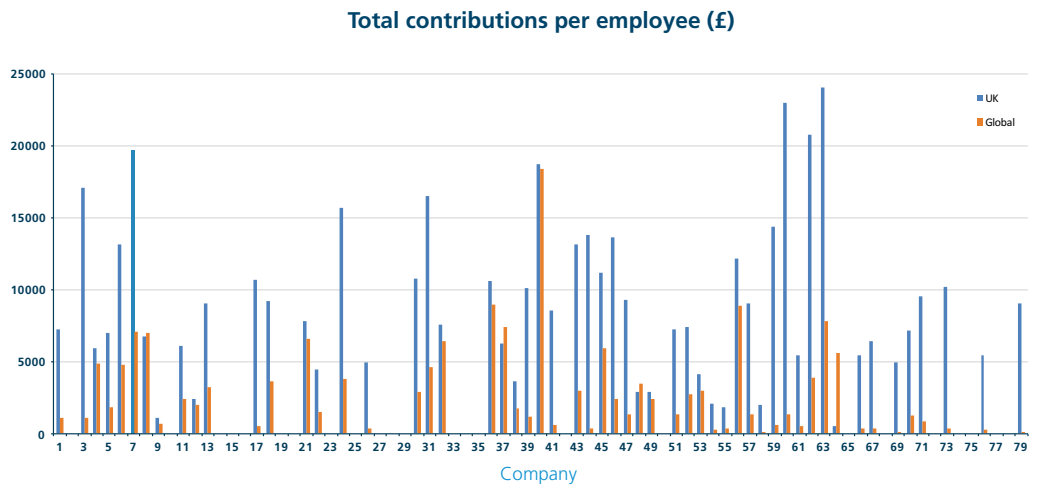
This is an interesting result, because despite UK subsidiaries on average producing 9% of the global revenue, they account for on average 27% and 31% of the global DB liabilities and contributions respectively.

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The average UK contribution in 2014 was just over £9,000, whereas the average global contribution was just over £3,000 per employee.

Global total pension contributions

The following chart puts into context the total contributions made globally into both DB and DC pension schemes per employee compared with the corresponding figure for the UK. 15 companies have been omitted due to a lack of data (Companies 2, 14, 15, 16, 19, 20, 23, 28, 29, 34, 35, 68, 75, 77 and 79) and Companies 10, 25, 27, 33, 42, 50, 65, 72 and 74 have been removed as they are deemed to be outliers.



Source: financial statements as at 31 December 2014

Interestingly, for the majority of these schemes the contributions made to UK schemes per employee were significantly in excess of the equivalent global contribution. The average UK contribution in 2014 was just over £9,000, whereas the average global contribution was just over £3,000 per employee.

Summary of data

The following table provides a summary of some of the information used in this survey:

2014 year end	DB Scheme Assets (£m)	DB Scheme Liabilities (£m)	Surplus/(Deficit) (£m)	Deficit Contributions (£m)	Service Costs (£m)	UK Subsidiary Revenue (£m)
1	70	110	-40	2	0	142
2	1,000	1,260	-260	25	0	36
3	20	20	0	1	0	45
4	100	100	0	0	2	145
5	30	40	-10	1	0	133
6	60	60	0	1	0	79
7	20	20	0	0	0	16
8	3,340	3,000	340	3	0	763
9	20	20	0	1	0	725
10	7,370	8,090	-720	70	63	1,314
11	90	90	0	0	0	53
12	70	70	0	0	1	77
13	1,530	1,850	-320	17	30	1,164
14	4,040	4,580	-540	83	6	2,446
15	240	230	10	6	1	737
16	90	90	0	2	1	496
17	1,930	2,530	-600	33	11	1,691
18	1,410	1,500	-90	8	15	681
19	230	260	-30	26	4	0
20	3,010	3,050	-40	25	0	0
21	450	430	20	21	5	866
22	1,340	1,720	-380	3	0	846
23	1,550	1,260	290	24	7	3,616
24	120	140	-20	1	1	1,226
25	350	450	-100	5	6	742
26	290	390	-100	9	0	611
27	1,740	2,120	-380	25	22	13,204
28	470	530	-60	5	6	1,209
29	200	220	-20	12	0	323
30	1,260	1,430	-170	26	29	2,153
31	550	520	30	4	0	438
32	500	520	-20	2	0	447
33	5,780	7,110	-1,330	109	55	0
34	1,010	810	200	35	0	1
35	110	110	0	2	1	0
36	430	390	40	0	7	4,159
37	20	30	-10	1	0	35

2014 year end	DB Scheme Assets (£m)	DB Scheme Liabilities (£m)	Surplus/(Deficit) (£m)	Deficit Contributions (£m)	Service Costs (£m)	UK Subsidiary Revenue (£m)
38	130	150	-20	2	0	536
39	120	120	0	2	2	401
40	4,130	4,580	-450	31	0	1,497
41	30	50	-20	1	1	107
42	2,000	1,780	220	18	3	0
43	290	280	10	3	2	280
44	350	330	20	2	1	175
45	2,930	3,040	-110	15	13	813
46	50	50	0	1	0	199
47	270	290	-20	1	0	28
48	270	240	30	1	2	316
49	3,770	3,450	320	23	2	3,082
50	230	220	10	2	0	0
51	1,090	1,350	-260	6	18	10,762
52	1,700	1,650	50	7	45	2,356
53	20	20	0	0	0	57
54	700	780	-80	13	5	2,168
55	130	150	-20	3	0	841
56	20,590	20,480	110	312	164	11,719
57	140	140	0	0	3	770
58	40	40	0	1	0	570
59	1,220	1,180	40	65	0	5,485
60	810	940	-130	23	0	345
61	90	130	-40	2	0	485
62	9,430	9,270	160	335	34	4,470
63	4,310	4,610	-300	99	48	7,107
64	10	10	0	0	0	979
65	1,640	1,580	60	27	6	320
66	510	540	-30	0	3	287
67	430	430	0	6	2	561
68	170	190	-20	1	0	196
69	220	220	0	1	0	183
70	130	170	-40	1	0	55
71	1,210	1,030	180	0	12	225
72	10	10	0	0	0	217
73	50	50	0	1	0	219
74	90	100	-10	4	0	0
75	100	120	-20	2	0	800
76	610	660	-50	13	17	1,519
77	180	180	0	5	5	602
78	20	20	0	2	0	12
79	850	790	60	10	1	620

2013 year end	DB Scheme Assets (£m)	DB Scheme Liabilities (£m)	Surplus/(Deficit) (£m)	Deficit Contributions (£m)	Service Costs (£m)	UK Subsidiary Revenue (£m)
1	60	100	-40	2	0	150
2	830	1,050	-220	24	4	40
3	20	20	0	0	0	50
4	90	100	-10	0	2	160
5	30	40	-10	1	0	110
6	60	50	10	1	0	40
7	20	20	0	0	0	10
8	3,080	2,810	270	2	0	790
9	20	20	0	1	0	740
10	6,930	7,330	-400	37	65	950
11	80	80	0	0	0	80
12	60	60	0	0	1	70
13	1,720	2,100	-380	20	10	1,050
14	3,580	4,120	-540	62	25	2,290
15	200	190	10	6	1	630
16	80	80	0	2	2	470
17	1,590	2,090	-500	258	11	1,640
18	1,170	1,270	-100	7	16	620
19	190	230	-40	5	5	0
20	2,550	2,770	-220	21	0	0
21	390	360	30	24	4	820
22	1,270	1,520	-250	61	0	900
23	1,320	1,160	160	26	8	2,870
24	110	120	-10	1	1	980
25	300	380	-80	6	5	680
26	270	340	-70	9	1	640
27	1,740	1,880	-140	31	22	19,230
28	420	490	-70	5	6	1,440
29	160	180	-20	12	1	310
30	1,140	1,310	-170	25	27	1,980
31	490	490	0	5	0	360
32	460	470	-10	4	1	410
33	4,870	5,940	-1,070	61	48	0
34	850	740	110	35	0	0
35	90	90	0	3	1	0
36	370	330	40	1	7	4,030
37	20	20	0	1	0	40
38	120	130	-10	4	1	560
39	100	100	0	2	3	450
40	3,830	4,080	-250	22	0	1,500
41	30	40	-10	1	1	100
42	1,720	1,570	150	19	3	0
43	230	260	-30	3	2	280

2013 year end	DB Scheme Assets (£m)	DB Scheme Liabilities (£m)	Surplus/(Deficit) (£m)	Deficit Contributions (£m)	Service Costs (£m)	UK Subsidiary Revenue (£m)
44	320	310	10	5	1	160
45	2,740	2,700	40	11	13	800
46	40	40	0	1	0	190
47	240	270	-30	1	0	30
48	230	200	30	1	2	320
49	3,440	3,430	10	360	1	2,660
50	230	200	30	8	0	0
51	1,000	1,180	-180	59	21	9,570
52	1,360	1,400	-40	6	46	2,090
53	20	20	0	0	0	50
54	640	730	-90	13	5	1,760
55	120	130	-10	8	0	820
56	18,850	18,790	60	302	174	11,420
57	120	120	0	3	2	490
58	40	40	0	1	0	590
59	1,030	1,040	-10	47	3	5,540
60	650	810	-160	23	0	340
61	80	120	-40	1	0	490
62	7,880	8,390	-510	76	38	4,030
63	3,880	4,210	-330	73	54	8,230
64	10	10	0	0	0	740
65	1,400	1,380	20	11	5	290
66	470	480	-10	0	3	290
67	370	370	0	5	2	570
68	150	170	-20	0	0	160
69	190	190	0	1	0	150
70	120	150	-30	0	0	30
71	1,010	930	80	6	12	200
72	10	10	0	0	0	190
73	40	40	0	1	0	220
74	80	80	0	4	0	0
75	90	110	-20	2	0	810
76	540	560	-20	23	17	1,370
77	160	160	0	13	5	760
78	20	20	0	0	0	10
79	710	670	40	11	1	620

Contact information

If you would like to discuss any of the matters raised in this survey then please contact Andrew Vaughan FIA, who is a corporate actuary based in our London office, on:

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