Financing the deficit

human resource services

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Pension deficit funding

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human resource services

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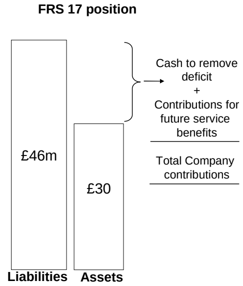
The pension scheme problem – the deficit

- Many UK pension schemes currently have a deficit
- Primarily caused by falling equity markets, lower expected future investment returns and increasing life expectancy
- Companies can no longer walk away from their pension promises
- The shortfall will have to be made good at some point

FRS 17 position



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A pension solution - background

- The solution is based on an idea first proposed by Fischer Black in 1981
- The principles of the idea are:
  - No change in the financial position of the combined entity (firm plus pension fund)
  - But there are tax advantages
  - And some cost savings
- There are a number of conditions needed for this to work

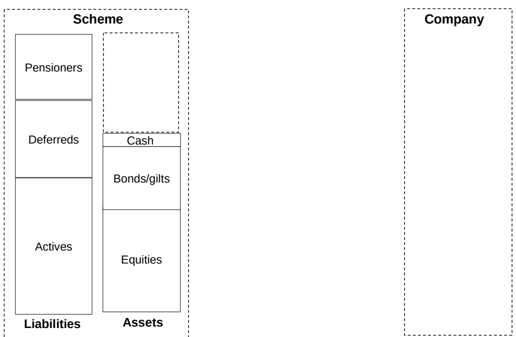
Pension fund deficit

Significant equity assets in pension fund

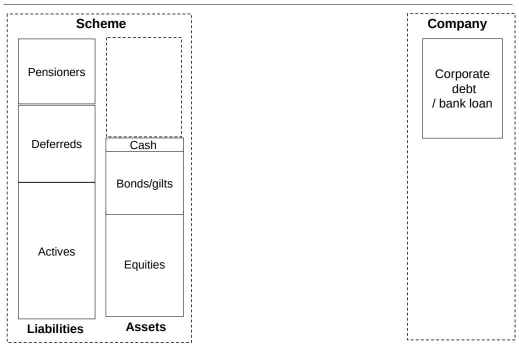
Tax paying

Low cost borrowing

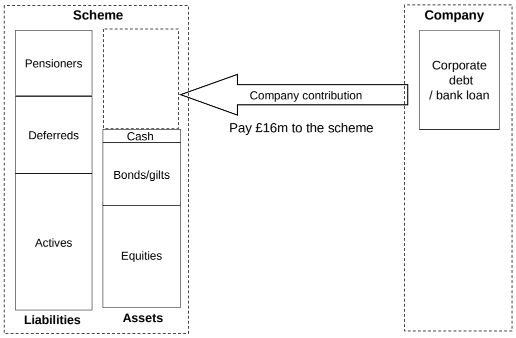
A pension solution



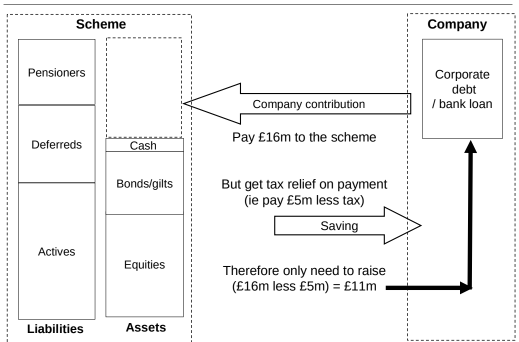
A pension solution



A pension solution



A pension solution



Why do it and what are the implications?

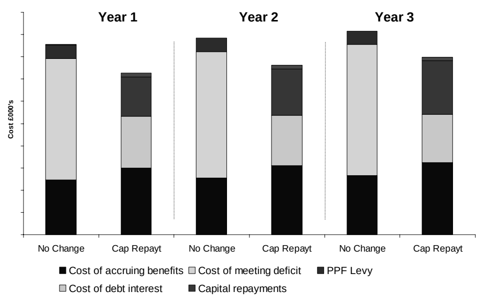
Why do it?

- There are tax savings
  - Debt interest payments receive tax relief ie reduce tax bill
- Good PR with employees
  - Confidence of receiving benefits
- Reduce costs
  - Reduce PPF levy
- Gross roll up
  - Gross roll up in the pension scheme versus net in the company
- There can be initial cash flow savings
  - Depends on how you organise debt

But

- Exchanging known flexible funding for prescriptive funding
- Need to satisfy the previous criteria

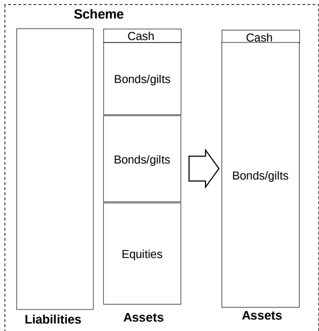
The proposal can reduce future cashflows



Protecting the funding position

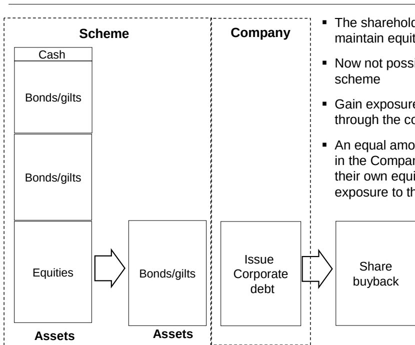
Protecting the funding position

- Remove funding risk from the pension fund
- Switch all equities to bonds



Maintaining equity exposure

Maintaining equity exposure



- The shareholders may want to maintain equity exposure
- Now not possible through scheme
- Gain exposure for shareholders through the company directly
- An equal amount of risk is added in the Company by buying back their own equities - keep exposure to the risk element

Summary

Maintaining equity exposure -

Summary

- Several ways to meet funding deficits
- Paying off the deficit in one go
  - Good HR
  - Tax advantageous
  - Cash savings
- Also consider protecting the fully funded scheme
- Equity exposure can be obtained but through the company

Maintaining equity exposure -

Questions?