PENSION INSURANCE CORPORATION

PENSION LIABILITIES WEIGH DOWN FTSE100 MARKET CAPS BY £340 BILLION– NEW STUDY

London, 27 October 2016 – UK plc's defined benefit (DB) pension funds, and in particular their ever-widening deficits, are currently very high on the political and social agenda. They also exert significant and ongoing downward pressure on the market values of FTSE 100 companies, according to analysis published today by Llewellyn Consulting. The study, "The ongoing influence of DB pensions on the market valuation of the Pension Plan Sponsor" was funded by Pension Insurance Corporation. It updates and extends a previous analysis published in 2014.[1]

Key points:

- The study confirms that there is a broadly one-for-one effect of pension deficits on the market value of companies, when the deficit is measured on a consistent "risk free" basis, which is broadly consistent with the market attaching an additional risk premium equivalent to an average 20% of disclosed pension obligations.
- Extrapolating this finding on the basis of recent pension liability data[2] would imply that the market valuations of FTSE 100 companies were depressed by up to £340 billion at 31 August 2016, incorporating both the reported deficit of £180bn and a further £160bn reflecting an additional c.20% risk premium associated with reported underlying pension liabilities of £795bn.
- The study shows that companies with larger pension liabilities are likely to be penalised the most by investors, even relative to those with similar percentage deficits, but which are based off lower overall total pension liabilities.
- Even those FTSE 100 companies that report a pension fund close to being fully funded, or even in surplus, are likely to be subject to a higher cost of capital directly correlated with the total size of their pension liabilities.

John Llewellyn, of Llewellyn Consulting, said, “The conclusions we are publishing today show that DB pension schemes continue to be large and extremely volatile elements in company balance sheets. Despite the huge levels of scrutiny given to DB schemes, it is clear that there is a disconnect between what investors are factoring in as the underlying pension obligations and what companies are actually reporting. In our view the overall impact of the liabilities on share prices must raise questions at least about the viability of dividends for some companies.”

David Collinson, Head of Strategy at PIC said: “These findings come at an important point in the debate about the future of DB pension funds. We have been happy to fund this important study to ensure that there is more transparency in this debate. As recent examples have shown, there is a material difference between what companies are reporting as pension liabilities and what is required to secure fully those pension promises should the sponsoring company become distressed. It would appear from the study that public market investors are implicitly recognising at least some of this difference in the value they place on companies that sponsor defined benefit pension funds”.

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Notes to Editors:

1) “The influence of DB pensions on the market valuation of the Pension Plan Sponsor”, Llewellyn Consulting, September 2014
2) Data from JLT Employee Benefits pension liability update, 31 August 2016
3) PIC has responded to the DWP Select Committee inquiry into DB pension funds. The submission is available at: http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/work-and-pensions-committee/pension-protection-fund-and-the-pensions-regulator/written/39475.html
4) The principle authors of the original study and this update are Pete Richardson, Senior Associate at Llewellyn Consulting, and Luca Larcher, doctoral student at the Department of Economics and Finance, Queen Mary University London.
5) Both the original study and this update have been published by Llewellyn Consulting in collaboration with Pension Insurance Corporation, which commissioned and financed the project and advised on data issues, and Queen Mary University, London.
6) The original study was the first in-depth analysis to have been done on this topic in the UK. It was based on data gathered from FTSE 100 companies for the period 2006 to 2012 (this update extends the analysis by a year to the accounting period ending in March 2014) and matches company financial- and DB-pension-related data taken

from the company financial statements and pension notes with corresponding stock market performance and company valuation data, so as to assess the significance of the scale and net surplus/deficit position of existing DB schemes for company market values.

7) The original study and this update seek to address this situation by applying a basic stock market valuation model to the largest UK companies, as represented by their FTSE 100 composition, so as to assess the possible significance of the scale and net asset position of existing DB schemes for company market values over the period.
8) The original study and this update also look at major issues related to the valuation of pension risks, most importantly with respect to the market valuation of DB pension obligations, as well as possible influence of 'corridor adjustments' to the pension accounts.

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About Pension Insurance Corporation

Pension Insurance Corporation plc ("PIC") provides tailored pension insurance buyouts and buy-ins to the trustees and sponsors of UK defined benefit pension funds. PIC brings safety and security to scheme members' benefits through innovative, bespoke insurance solutions, which include deferred premiums and the use of company assets as part payment. At 30 June 2016, PIC had £18.4bn in assets and had insured more than 130,000 pension fund members. Clients include FTSE 100 companies, multinationals and the public sector. PIC is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority and PRA (FRN 454345). For further information please visit www.pensioncorporation.com