



European companies with UK defined benefit schemes

Analysing levels of deficit, contributions paid and risk

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 75 European companies with around £103.1 billion 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 2015 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 14.9% 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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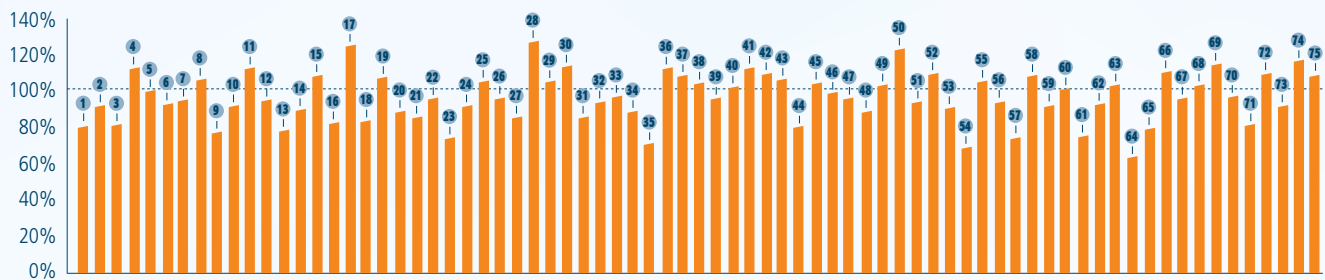
Note: Where figures are not available from a particular company's accounts, we have estimated them based on other information, if possible, or excluded them from the relevant section of analysis.

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 97%, which is higher than the average funding level of FTSE350 companies' DB schemes at the same date of 95%. There were 31 companies with funding surpluses, which are an uncommon sight within the FTSE350. The least well-funded scheme had a funding level of 64%.

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.

SCHEME FUNDING LEVELS 2015



CHANGES IN FUNDING LEVEL

The following chart shows percentage change in the funding levels between 2014 and 2015. Companies 50 and 68 have been excluded as they have been deemed to be outliers. The funding level has increased by 2.2% on average between year-end 2014 and year-end 2015.

PERCENTAGE CHANGE IN FUNDING LEVEL BETWEEN 2014 AND 2015



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). These companies are 5, 6, 16, 20, 21, 33, 35, 40, 57 and 61. Companies 22, 23, 27, 29, 36, 43 and 68 are not included due to insufficient data and Companies 1, 28, 34, 39 and 66 have been removed as they were deemed to be outliers.

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.

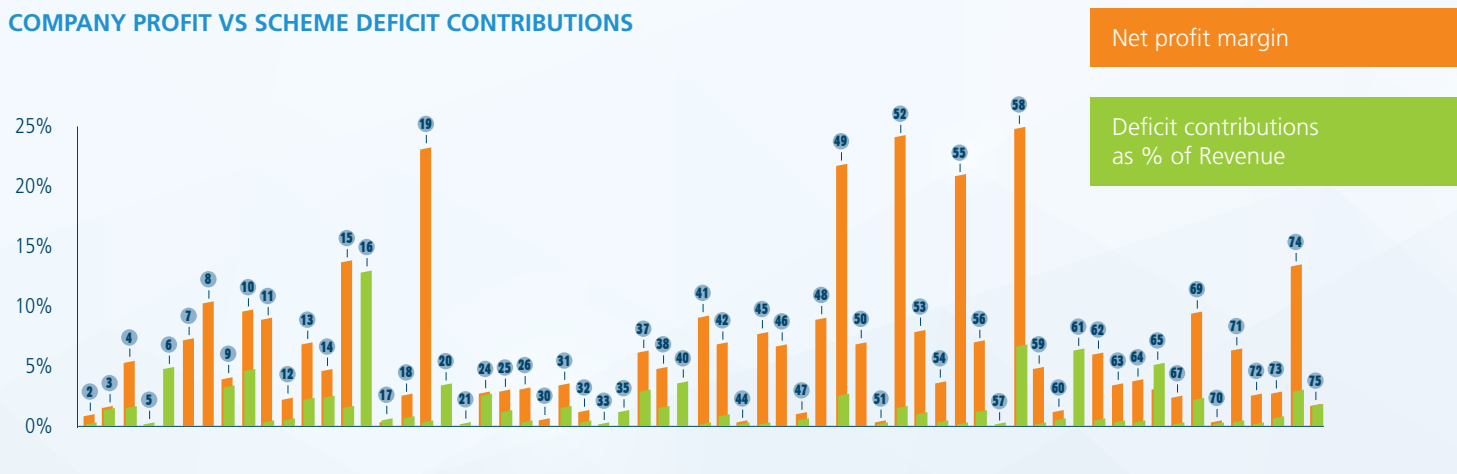
The aggregate contribution paid into all of the DB schemes in this report in 2015 was approximately £2.4 billion, with contributions relating to UK past service deficits amounting to £1.6 billion. This represents 1.9% of total UK revenues, which is greater than the 0.9% of total revenue contributed by 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 6.8 years for the employers with scheme deficits to clear these (as measured on an accounting basis), assuming that further deficits do not arise in the meantime.

COMPANY PROFIT VS SCHEME DEFICIT CONTRIBUTIONS



The following graph compares the future service cost of retirement benefits (both DB and defined contribution (DC)) per employee against the annual contributions paid in relation to past service deficit, also on a per employee basis.

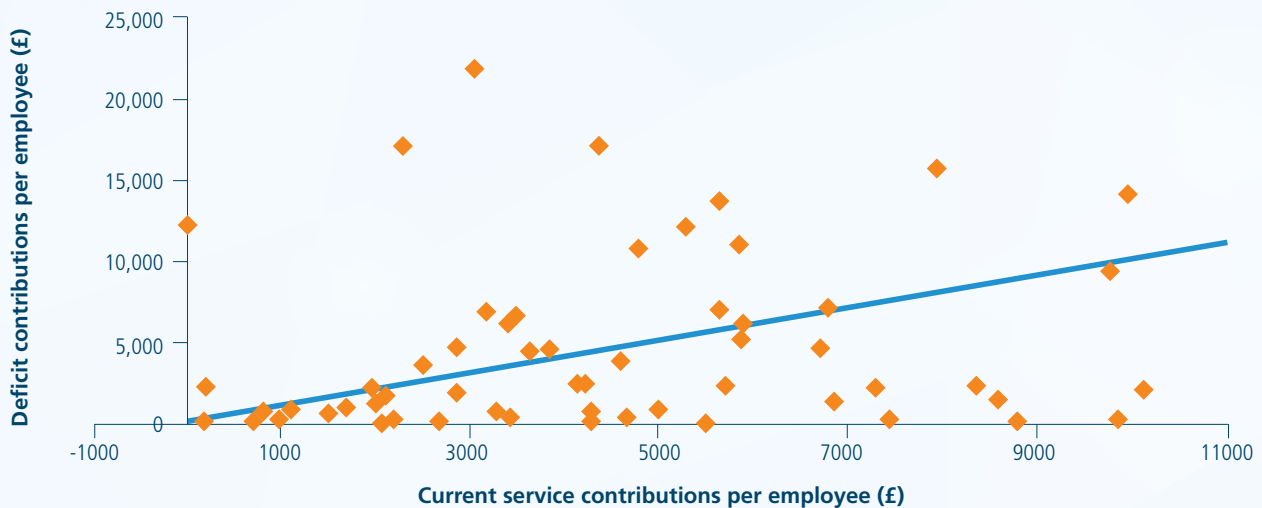
Companies 10, 23, 28 and 29 have been omitted due to a lack of data and Companies 6, 16, 20, 22, 27, 34, 36, 39, 43, 50, 68 and 74 are deemed to be outliers.

The average deficit contribution paid per employee in 2015 was around £5,700 and the average amount paid in relation

to current service benefits was around £4,700 (this includes both DB and defined contribution (DC) arrangements). The average deficit contribution per employee is higher than the FTSE350 companies, which paid around £2,800 per employee in relation to past service deficits.

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

CURRENT SERVICE COST vs PAST SERVICE COST

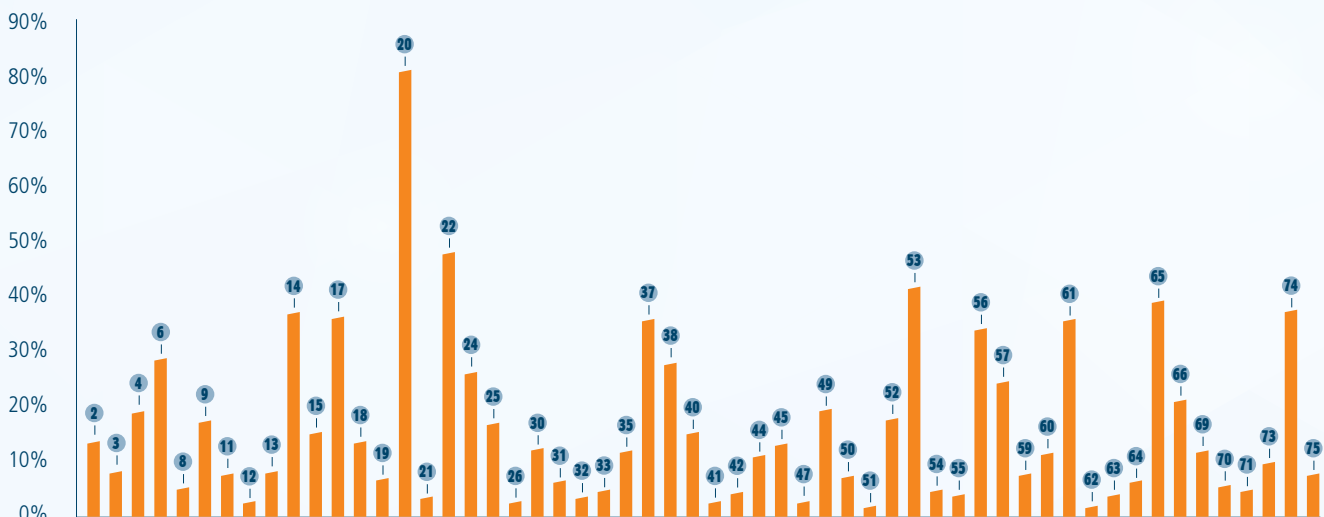


The chart below demonstrates that pension contributions can represent a very significant proportion of total staff costs reported on the income statement. The impact of DB contribution requirements within these figures is diluted by employees who are not members of any pension arrangement and, to a lesser 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 1, 10, 23, 28 and 29 have been omitted due to a lack of data, and Companies 16, 27, 34, 36, 39, 43, 58 and 68 are deemed to be outliers.

On average, pension contributions paid to DB schemes only (in relation to both past service deficit and current service) represented 15% of the total staff cost reported in the financial statements. However, the figure for individual companies varied greatly, from 0% up to 82%. These figures are excluding outliers. The average contribution is higher than for FTSE350 companies, where the equivalent figure is 6%.

TOTAL DB CONTRIBUTIONS AS % OF STAFF COSTS

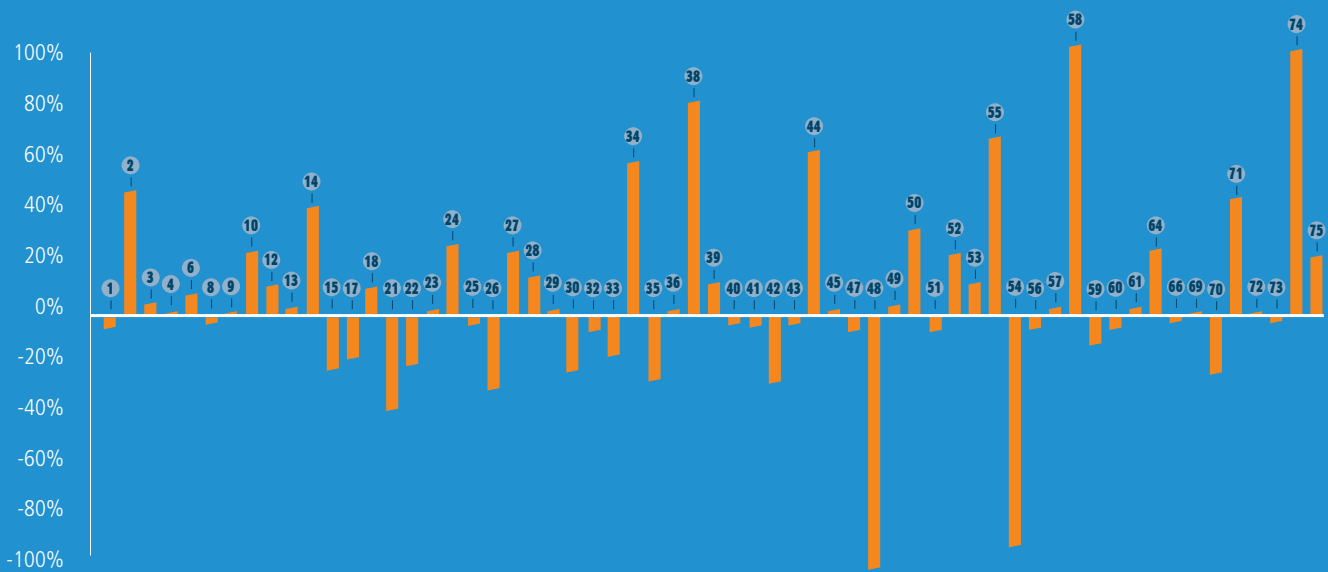


In some cases, pension contributions are substantially increasing the cash outlay associated with total staff costs. The income statement may not provide a full breakdown of these costs, meaning that analysts' perceptions of companies' performance can be distorted.

Changes in employer contributions

The chart below shows the percentage change in employer contributions to their DB schemes between 2014 and 2015. The contribution level increased by 6.1% on average between year-end 2014 and year end 2015. Companies 7, 46 and 67 have been omitted due to a lack of data and Companies 16, 19, 20, 37, 65 and 68 are deemed to be outliers.

PERCENTAGE CHANGE IN DB CONTRIBUTIONS BETWEEN 2014 AND 2015



The aggregate contribution paid into these DB schemes in 2015 was approximately £2.4 billion, which is higher than the 2014 aggregate contribution of £2.2 billion.

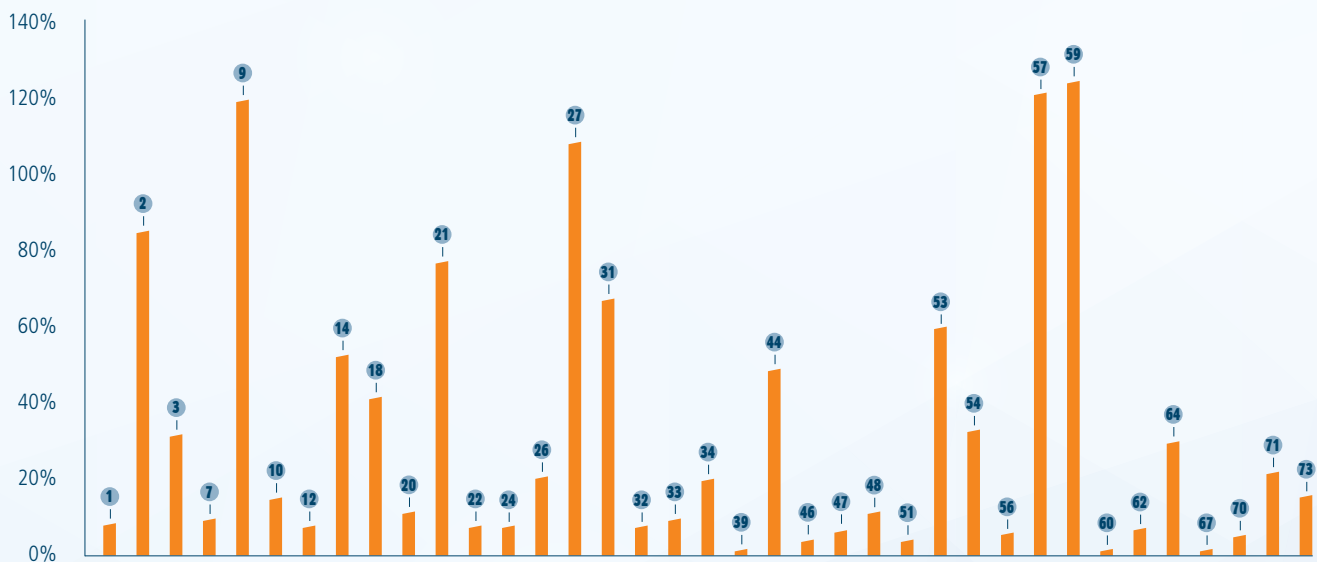
Impact on shareholder funds

The following chart shows past service deficits as a percentage of shareholder funds, excluding Companies 6, 13, 16 and 23 which either disclosed negative shareholder funds or have been omitted due to lack of data and Companies 35, 61 and 65 have been deemed to be outliers. Those cases with no scheme funding deficit, including the 31 schemes in surplus, have also been excluded.

For the remaining cases, scheme deficits amount to 32% 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.

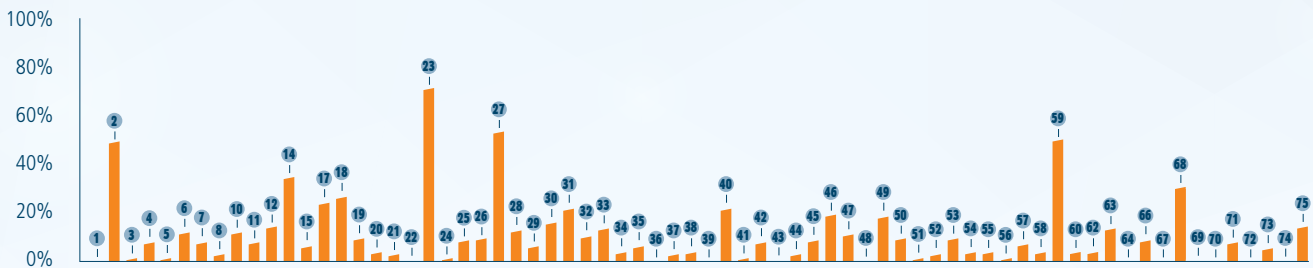
Of course, cash contributions are not the only way to reduce deficits. For example, companies could consider re-risking the scheme's investment strategy (i.e. increasing the allocation to growth assets) or undertaking incentive exercises (providing scheme members with options to amend their benefits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

SCHEME DEFICIT AS % OF SHAREHOLDER FUNDS



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. Companies 9, 13, 16, 61 and 65 have excluded as they have been deemed to be outliers.

ACTUARIAL MOVEMENT AS % OF SHAREHOLDER FUNDS



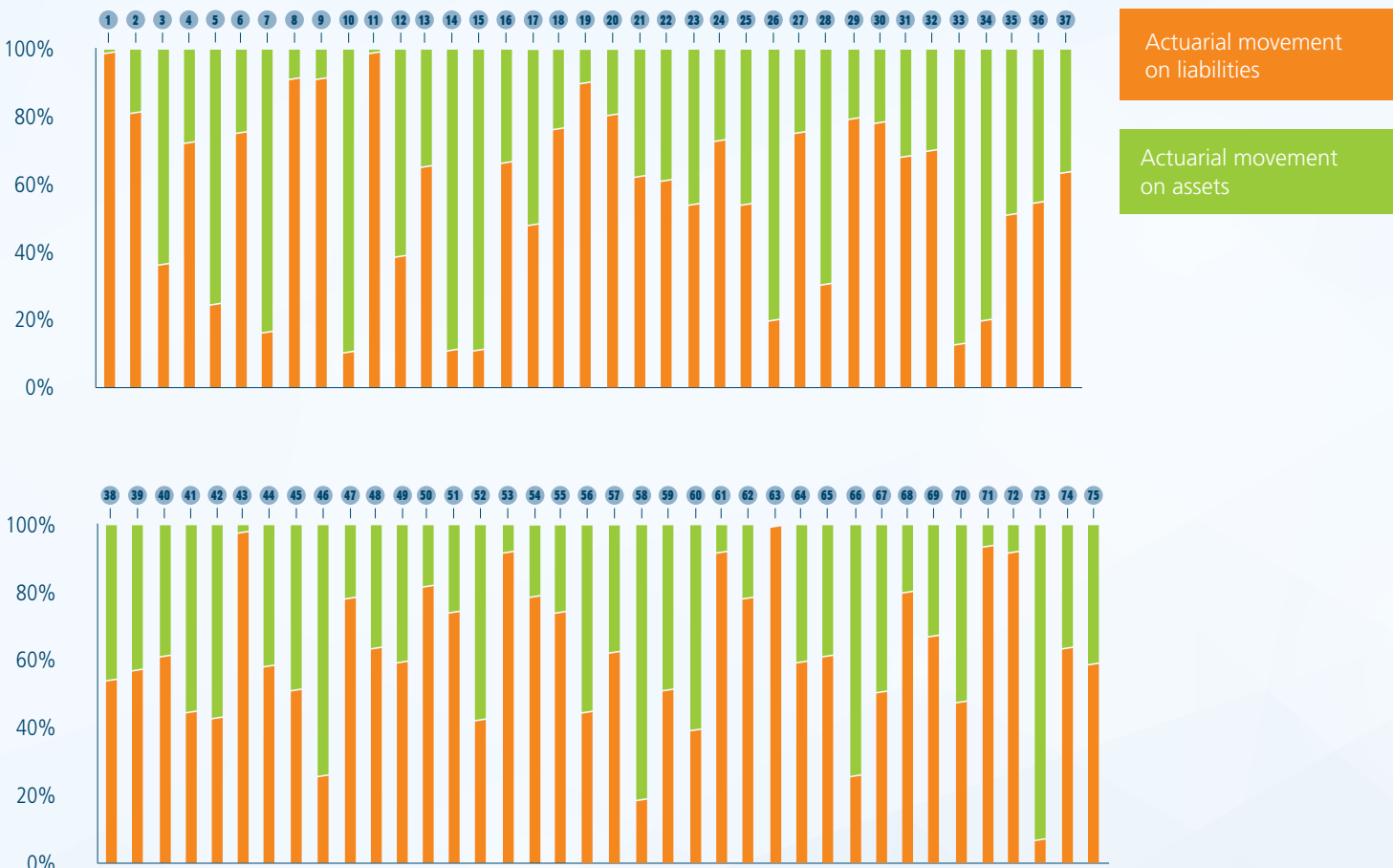
On average, actuarial movement was about 11% of shareholder funds. Movements at this level are fairly manageable, but in the case of one company, where the movement is over 60% of shareholder funds, this will have a significant impact on the parent companies' holdings in the UK subsidiary. Given the volatile nature of actuarial assumptions and investment returns, such movements are likely to reoccur on a regular basis.



The following chart shows the split of absolute actuarial movements between liabilities (including both experience gains/losses and changes in assumptions) and assets in each case. The chart below shows that in 54 of the cases, more than half, actuarial movements on the liabilities were more significant than those on 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.

SPLIT OF ACTUARIAL MOVEMENT BETWEEN ASSETS AND LIABILITIES



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 6 and 19 have been omitted as they disclosed negative shareholder funds or due to lack of data. Companies 2, 13, 16, 23, 25, 26, 31, 35, 58, 59, 61 and 65 have been removed as they were deemed to be outliers.

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 29, the

scheme's equity allocation is approximately 67% and yet this represents around 168% 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 a change could come with a significant increase in the expected cost of providing benefits under the scheme.

INDIRECT EXPOSURE TO EQUITIES



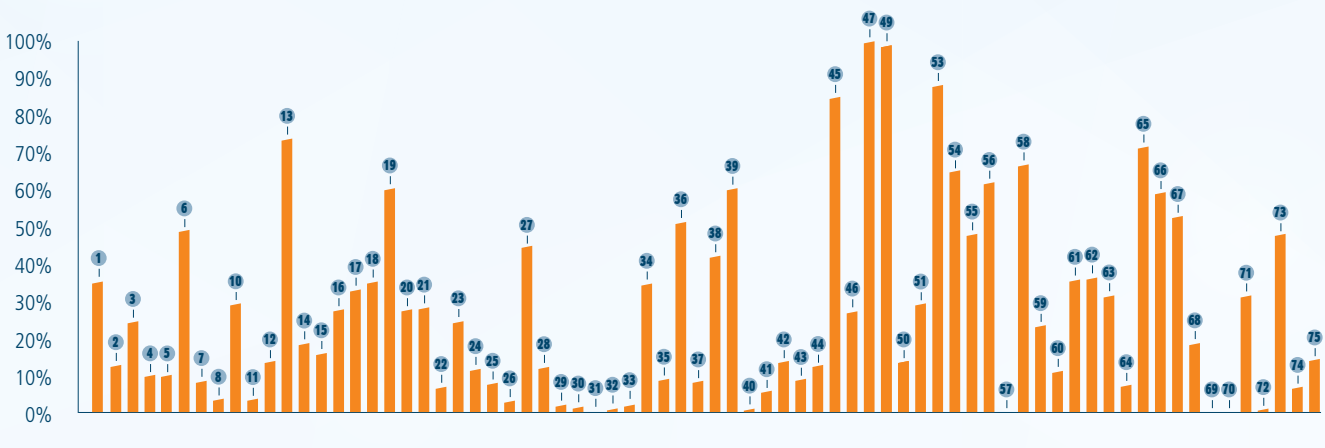
UK and global comparison

IMPACT OF UK DB LIABILITIES

The chart below shows the companies' DB liabilities as a proportion of their global DB liabilities. Companies 9, 48 and 52 have been omitted as they were deemed to be outliers.

On average, the UK liabilities account for 28% of the global liabilities related to DB schemes, although the below shows that there is quite a large spread around this.

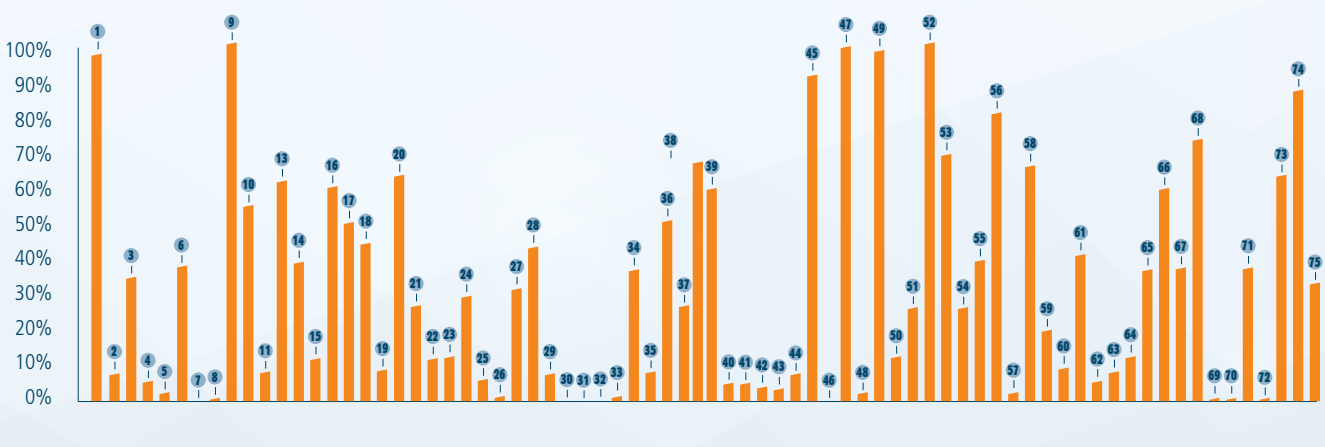
2015 UK DB LIABILITY AS A PROPORTION OF GLOBAL DB LIABILITIES



IMPACT OF UK DB CONTRIBUTIONS

The following chart displays the companies' total contributions to UK DB schemes as a proportion of the global contributions made to DB schemes. Company 12 has been omitted due to a lack of data. Across the companies, UK DB contributions represent on average 32% of global DB contributions but the variation across companies is extensive, ranging from 1% to 100%.

2015 UK DB CONTRIBUTIONS AS A PROPORTION OF GLOBAL DB CONTRIBUTIONS

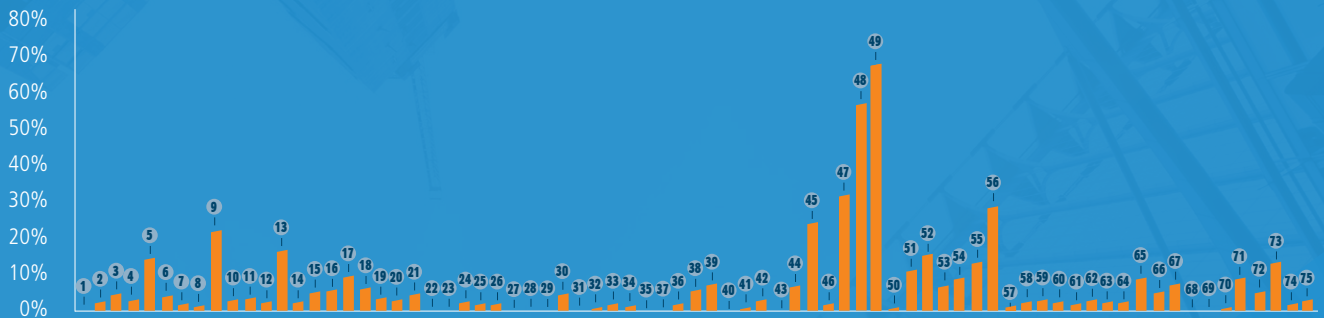


UK subsidiary revenue

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.

Except for three companies with UK revenue contributing more than 30% (Companies 47, 48 and 49), for all other companies the result is less than 30%. The average proportion of global revenue produced by UK subsidiaries for the companies shown is 7%. Removing the three companies mentioned above reduces it to 5%.

2015 UK REVENUE AS A PROPORTION OF GLOBAL REVENUE



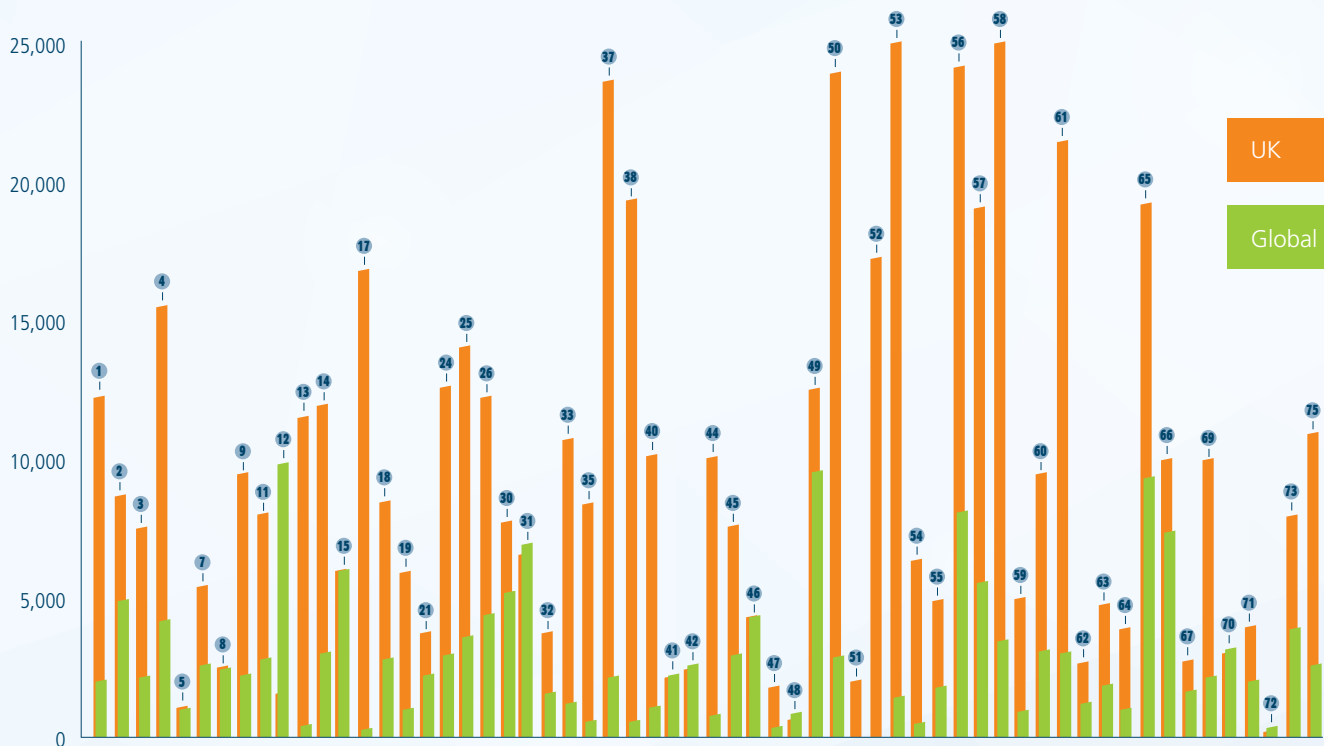
Despite UK subsidiaries on average producing 7% of the global revenue, they account for on average 28% and 32% of the global DB liabilities and contributions respectively.

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. Five companies have been omitted due to a lack of data (Companies 10, 23, 28 and 29) and Companies 6, 16, 20, 22, 27, 34, 36, 39, 43, 68 and 74 have been removed as they are deemed to be outliers.

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 2015 was just under £10,500, whereas the average global contribution was just under £2,900 per employee.

2015 TOTAL CONTRIBUTIONS PER EMPLOYEE (£)



Summary of data

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

2015

	DB Scheme Assets (£m)	DB Scheme Liabilities (£m)	Surplus/ (Deficit) (£m)	Deficit Contributions (£m)	Current Service Costs (£m)	UK Subsidiary Revenue (£m)
1	1,000	1,220	-220	24	0	35
2	130	140	-10	0	3	141
3	30	40	-10	2	0	102
4	60	50	10	1	0	71
5	20	20	0	1	0	718
6	7,280	7,750	-470	71	71	1,433
7	90	90	0	0	0	49
8	70	60	10	0	1	73
9	1,920	2,470	-550	36	11	1,057
10	4,140	4,520	-380	102	8	2,142
11	240	220	20	6	1	1,001
12	90	90	0	2	2	426
13	1,930	2,440	-510	36	9	1,415
14	1,340	1,500	-160	19	14	693
15	470	430	40	15	5	926
16	1,390	1,650	-260	106	0	800
17	1,330	1,050	280	19	7	3,646
18	310	370	-60	7	4	793
19	5,220	4,770	450	3	7	627
20	1,930	2,190	-260	105	27	2,903
21	470	550	-80	2	6	1,100
22	340	350	-10	17	7	0
23	90	120	-30	4	0	0
24	1,150	1,240	-90	51	17	1,965
25	1,390	1,300	90	9	4	666
26	510	520	-10	2	0	444
27	5,750	6,580	-830	130	72	0
28	990	770	220	40	0	24
29	110	100	10	2	2	0
30	430	370	60	0	7	4,868
31	20	30	-10	1	0	43
32	120	130	-10	2	0	487
33	120	120	0	2	2	358
34	4,070	4,570	-500	83	57	1,126
35	30	40	-10	1	0	107
36	1,980	1,720	260	19	3	0

	DB Scheme Assets (£m)	DB Scheme Liabilities (£m)	Surplus/ (Deficit) (£m)	Deficit Contributions (£m)	Current Service Costs (£m)	UK Subsidiary Revenue (£m)
37	320	290	30	9	3	287
38	340	320	20	3	1	192
39	2,860	2,910	-50	19	25	968
40	40	40	0	1	0	25
41	270	240	30	0	2	229
42	4,110	3,710	400	16	2	1,706
43	230	220	10	2	0	0
44	910	1,140	-230	7	28	10,889
45	1,730	1,640	90	2	51	2,277
46	20	20	0	0	0	58
47	700	740	-40	14	4	2,231
48	130	140	-10	0	0	860
49	20,660	20,110	550	303	192	11,333
50	150	120	30	0	4	383
51	40	40	0	1	0	545
52	1,290	1,180	110	80	0	5,393
53	830	920	-90	26	0	321
54	90	130	-40	2	0	489
55	9,450	9,000	450	12	37	4,573
56	4,380	4,640	-260	88	55	6,590
57	80	110	-30	2	2	1,042
58	2,100	1,900	200	52	7	324
59	490	530	-40	0	2	324
60	430	430	0	4	3	671
61	120	150	-30	4	1	60
62	150	170	-20	1	0	170
63	210	210	0	1	0	181
64	70	100	-30	1	3	182
65	120	160	-40	4	0	67
66	1,100	990	110	0	11	224
67	10	10	0	0	0	253
68	90	90	0	9	0	0
69	10	10	0	0	0	19
70	10	10	0	0	0	107
71	50	70	-20	3	0	685
72	0	0	0	0	0	320
73	700	760	-60	14	21	1,658
74	200	170	30	16	4	509
75	890	810	80	12	3	603

Summary of data

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

2014

	DB Scheme Assets (£m)	DB Scheme Liabilities (£m)	Surplus/ (Deficit) (£m)	Deficit Contributions (£m)	Current Service Costs (£m)	UK Subsidiary Revenue (£m)
1	1,000	1,260	-260	25	0	40
2	100	100	0	0	2	150
3	30	40	-10	1	0	130
4	60	60	0	1	0	80
5	20	20	0	1	0	720
6	7,370	8,090	-720	70	63	1,310
7	90	90	0	0	0	50
8	70	70	0	0	1	80
9	1,760	2,080	-320	36	11	1,210
10	4,040	4,580	-540	83	6	2,100
11	230	230	0	6	0	920
12	90	90	0	2	1	430
13	1,930	2,530	-600	35	9	1,690
14	1,410	1,500	-90	8	15	680
15	450	430	20	21	5	870
16	1,340	1,720	-380	3	0	850
17	1,350	1,100	250	24	7	3,600
18	310	400	-90	6	3	710
19	5,320	5,150	170	0	4	610
20	1,740	2,120	-380	25	22	3,170
21	460	530	-70	6	6	1,190
22	230	260	-30	26	4	0
23	90	110	-20	4	0	0
24	1,260	1,430	-170	26	29	2,150
25	1,430	1,370	60	9	4	440
26	500	520	-20	2	0	450
27	5,780	7,110	-1,330	109	55	0
28	1,010	810	200	35	0	0
29	110	110	0	2	1	0
30	430	390	40	0	7	4,160
31	20	30	-10	1	0	30
32	130	150	-20	2	0	540
33	120	120	0	2	2	400
34	4,130	4,580	-450	31	58	1,500
35	30	50	-20	1	1	110
36	2,000	1,780	220	18	3	0

	DB Scheme Assets (£m)	DB Scheme Liabilities (£m)	Surplus/ (Deficit) (£m)	Deficit Contributions (£m)	Current Service Costs (£m)	UK Subsidiary Revenue (£m)
37	290	280	10	3	2	280
38	350	330	20	2	1	170
39	2,930	3,040	-110	21	19	1,570
40	40	40	0	1	0	30
41	270	240	30	1	2	210
42	3,770	3,460	310	23	2	2,680
43	230	220	10	2	0	0
44	930	1,180	-250	5	17	10,330
45	1,700	1,650	50	7	45	2,360
46	20	20	0	0	0	60
47	700	780	-80	13	5	2,170
48	130	150	-20	3	0	840
49	20,590	20,480	110	312	164	11,720
50	140	140	0	0	3	770
51	40	40	0	1	0	570
52	1,220	1,180	40	65	0	5,490
53	810	940	-130	23	0	350
54	90	130	-40	2	0	490
55	9,430	9,310	120	335	34	4,470
56	4,310	4,610	-300	101	48	7,110
57	80	110	-30	2	2	980
58	1,940	1,860	80	30	7	360
59	510	540	-30	0	2	290
60	430	430	0	4	3	550
61	110	160	-50	4	1	70
62	160	180	-20	1	0	160
63	220	220	0	1	0	180
64	60	100	-40	1	2	150
65	130	170	-40	1	0	60
66	1,210	1,030	180	1	10	210
67	10	10	0	0	0	220
68	90	100	-10	4	0	0
69	10	10	0	0	0	10
70	10	10	0	0	0	100
71	50	60	-10	2	0	550
72	0	0	0	0	0	330
73	680	730	-50	17	19	1,520
74	180	180	0	5	5	600
75	890	840	50	10	3	620

Glossary

ACCRUED BENEFITS

The amount of pension and other benefits accumulated before a particular date.

ACTUARIAL MOVEMENT (GAINS/LOSSES)

Actuarial gains and losses arise when a scheme's experience is different to what has been assumed. They are usually split in three ways:

- Differences between expected interest on scheme assets and the returns actually achieved
- Differences between actuarial assumptions and the experience of the membership over the period, e.g. pension increases being higher than expected would lead to an actuarial loss
- Changes to actuarial assumptions over the period - for example, an increase in inflation expectations compared to the previous year would likely lead to an actuarial loss

ASSET BACKED CONTRIBUTIONS (ABCS)

ABCs involve an employer transferring an asset to a special purchase vehicle for a fixed term. This forms a contractual funding arrangement under which an income stream is provided to a scheme via a special purpose vehicle. That income stream is usually given a net present value by the trustees and is treated as an asset, thereby reducing or eliminating the scheme's deficit.

CURRENT SERVICE COST

The value of benefits accrued by members over an accounting period less any contributions paid by members. The calculation makes advance provision for future salary increases if the scheme is a final salary arrangement.

DEFICIT CONTRIBUTIONS

Additional contributions from sponsoring employers, above the ongoing future service contributions, required in order to fund the deficit in respect of a scheme's past service liabilities.

EMPLOYER COVENANT

The employer covenant can be described as a sponsoring employer's willingness and ability to meet its legal obligations towards a pension scheme. The trustees of a scheme will make an assessment of the employer covenant as part of the triennial valuation process.

FUNDING LEVEL

The relative value of a scheme's assets and liabilities, usually expressed as a percentage (also known as the 'funding ratio').

LIABILITIES

The estimated value, using actuarial methods and assumptions, placed on the defined benefit (DB) obligations of a pension scheme. These DB obligations include the present value of future pension instalments and contingent benefits and may include the expected value of future expenses.

LIABILITY DRIVEN INVESTMENT (LDI)

An investment management style in which a bond portfolio is built up to (broadly) match the cashflows of the liabilities, either by investing in those bonds directly, or in synthetic bonds created using swaps. This can be done directly, or using appropriate pooled funds. The use of swaps allows for the option of 'gearing' so that the portfolio is fully immunised against interest rate and inflation movements, but some of the assets are still available to invest in risk-seeking assets (which then adds risk back in to the portfolio).

PAST SERVICE COST

The increase in the present value of the DB obligation resulting from the introduction of benefits or changes to benefits due for employee services in prior periods resulting in the current period (e.g. allowing a member to early retire without the usual reduction). Past service costs may be negative when existing benefits are changed so that the present value of the DB obligation decreases.

PENSION INCREASE EXCHANGE (PIE)

An offer, usually from a DB scheme sponsor, under which a member would give-up future (non-statutory) pension increases in exchange for a one-off uplift to their pension.

RECOVERY PLAN

A recovery plan must be put in place if a scheme's Statutory Funding Objective (SFO) is not met. The recovery plan must set out how and when the SFO will be met but there is no statutory minimum period over which the shortfall must be made up.

TECHNICAL PROVISIONS

The value of a DB scheme's accrued benefits assessed for the purpose of a triennial valuation. The technical provisions are required by law to be calculated using assumptions which are prudent, i.e. they must include margins against actual experience being worse than expected.



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