

Open wide

The collective deficit of the UK's 7,800 defined benefit (DB) pension schemes, with assets of £771.2bn, insured under the Pension Protection Fund's industry financed safety net rose from £179.3bn at the end of May to £200.1bn at the end of June. This compares with a £13bn surplus this time last year.

Ring in the changes

The £29bn BT Group Pension Scheme (BTPS), the UK's largest DB scheme, with a deficit that could well top £11bn, has departed from its long held investment policy of having a significant weighting towards equities. Following a 17.5% decline in the value of its assets in 2008, the BTPS has vowed to pare back its 57% equity holding to 33% of the scheme's assets but retain its sizeable weighting in alternative assets. In making the decision, the trustees were mindful of the volatile effect the equities have had on the scheme's funding level and, therefore, the sponsor's annual contribution which, in BT's case, is contingent on the annual performance of the fund. Moreover, given that the majority of the BTPS's members are deferred and current pensioners – indeed the scheme currently pays out £1.4bn a year in pensions – reducing the equity weighting and adding to the scheme's existing £13bn investment in fixed income reflects the maturity of the scheme.

Give and take

In a totally unprecedented move, the trustees of the two British Airways DB schemes relinquished control of £330m of guaranteed bank lines of credit, secured on aircraft and transferred to the schemes by BA in 2006 as a deficit financing measure, to its stricken loss making parent, as BA sought to raise £680m of new capital to survive the crisis engulfing the airline industry and rebuild its balance sheet.

Whilst the trustees figured that by diverting the credit facility to the employer, BA's chances of survival would be greatly enhanced, the less well funded of the two schemes – the £6.2bn New Airways Pension Scheme - which is expected to announce a deficit in excess of £3bn in the autumn, is not to receive a replacement contingent asset unlike the fully funded £5.9bn Airways Pension Scheme, which will receive a £230m replacement asset.

I say tomato, you say tomato

The UK and US may be two countries divided by a common language but one thing they share are large pension funds with enormous deficits. Indeed, the two largest pension funds in the US – the Californian Public Employees Retirement System (CalPERS) and

the California State Teachers Retirement System (CalSTRS) – saw the combined value of their assets contract by nearly \$100m in the year to 30 June as both schemes took big hits from adverse market movements, notably on their real estate investments.

In an attempt to mitigate these losses, both schemes have, in recent months, progressively moved away from equities into fixed income and real estate to take advantage of lower prices. Indeed, CalPERS has agreed to buy back a shopping centre portfolio for \$1bn less than it sold it for in 2005 and has additionally renegotiated fees on its hedge fund and private equity investments. It has also filed a \$1bn lawsuit against the three leading credit rating agencies for the "wildly inaccurate" AAA ratings applied to certain mortgage backed securities. However, this doesn't disguise the fact that in order to meet their pension obligations in the long term, Californian state employees and the incumbent local governments may well need to raise contributions to cover the shortfall. Remember, this is the state of California, which has its own \$26.3bn deficit.

Executive pension costs

According to actuarial consultants Lane, Clark & Peacock, Britain's biggest companies are, on average, contributing 70% of executive pay to fund executive DB pensions, whilst those 48% of FTSE 100 executives who are members of defined contribution (DC) schemes receive employer contributions on average equivalent to 30% of pay. These figures compare to the 80% of DB scheme members whose employer contributions average between 15% and 20% of pay and those 85% of DC members where employer contributions average 12% of pay. However, the limits to be introduced on tax relief for pension contributions for high earners in April 2011, which will add £50,000 to the typical FTSE 100 director's tax bill, could well see a number of executives opt out of their company pension schemes and take cash in lieu.

Having your cake and eating it

Following on the back of Babcock International's longevity swap last month, the two DB schemes of RSA, the More Than insurer, have completed an innovative £1.9bn buy-in at minimal cost that covers the longevity risk associated with 55% of the schemes' pensioner liabilities. Described as a DIY buy-in, the deal also helps the sponsoring employer by reducing the amount of capital it needs to hold to back the pension schemes in meeting its solvency requirements. The deal, which didn't require RSA to commit any additional funds to the pension schemes, was structured around a so-called asset swap that lengthened the maturity of the schemes' gilt holdings so as to provide the necessary cash flows to match the insured liabilities. The deal, unlike a conventional buy-in, also allows the schemes to retain ownership of their gilt assets. Prior to executing the buy-in, the schemes had, in 2007, already embarked

on a derisking programme of reducing their equity exposure from 46% to 24% and using swaps to mitigate interest rate and inflation risk. So far, so good. However, such are the nuances of pension accounting standards, that by reducing the longevity risk within the schemes, an IAS 19 surplus at 31 March 2009 of £288m has become a £73m deficit. Is it any wonder that the Marathon Club, comprising trustees and senior executives representing pension scheme assets of £170bn, is calling for a fundamental review of the controversial accounting standard?

Cash (held) back

American Express UK has suspended employer contributions to the firm's stakeholder pension scheme for the next 18 months as a means of deferring further redundancies.

If the cap fits

Pubs and restaurants group Mitchells & Butlers has followed the lead taken by Marks & Spencer earlier this year in introducing a cap on pensionable pay for members of their DB scheme. Only the first 2% of any pay rise will be pensionable.

And finally...

According to IllicitEncounters.co.uk, an extramarital dating website, cheating husbands and wives spend on average £232 more per month on affairs than on their pension contributions.

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