

# ACCOUNTING FOR PENSION COSTS

SURVEY OF ASSUMPTIONS AT END 2006



Barnett Waddingham

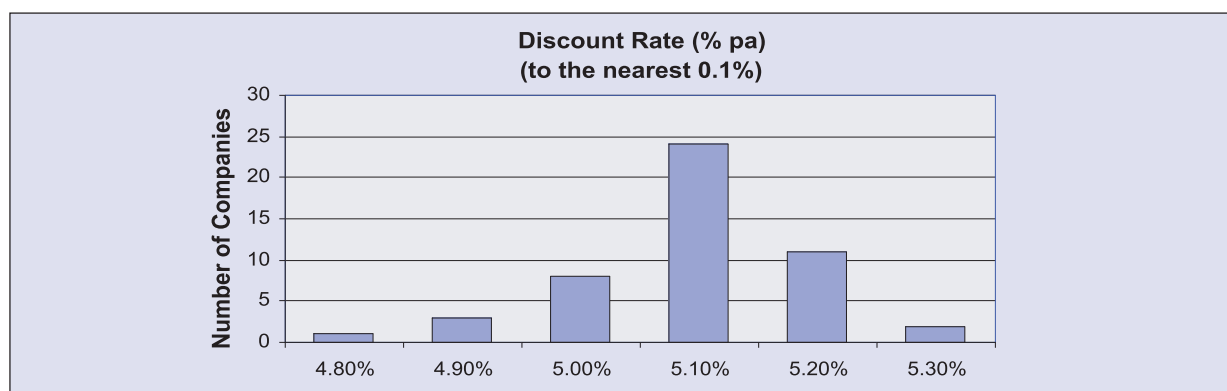
## INTRODUCTION

This is our 6th annual survey of the assumptions adopted by FTSE100 companies for determining the value of their pension liabilities for accounting purposes.

This survey is based on the data in the published accounts of FTSE100 companies with financial years that ended on 31 December 2006. At the time of writing, 50 companies had published results, 36 of which also appeared in last year's survey.

## DISCOUNT RATE

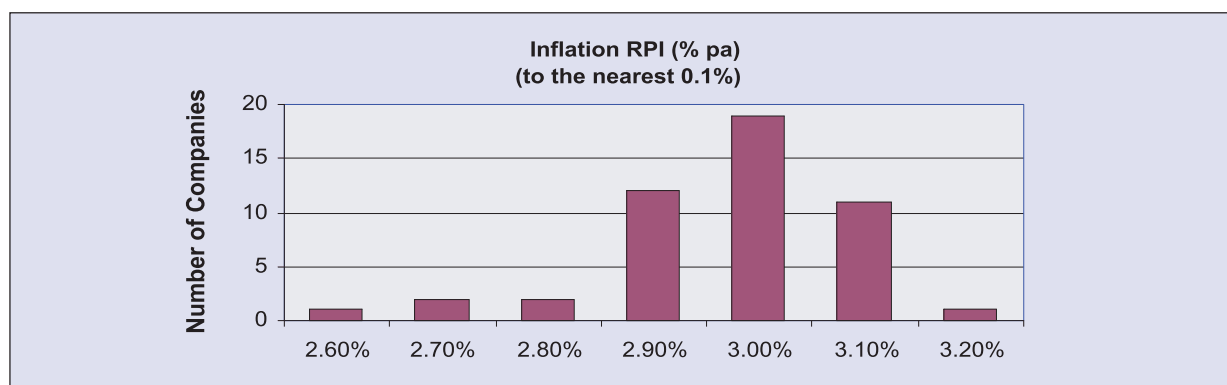
The discount rates used by the companies in our survey are set out below.



At 31 December 2006, the yield on the iBoxx over 15 year, AA-rated corporate bond index was approximately 5.1% (2005: 4.75%) and it can be seen that the majority of companies used a discount rate at, or very close to, this level.

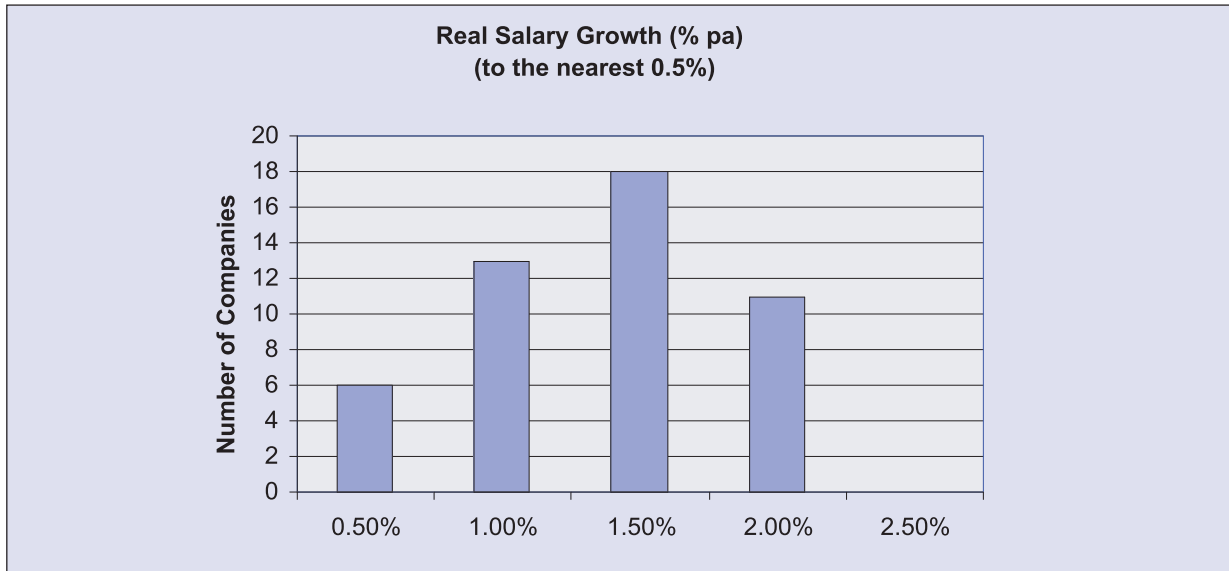
## INFLATION RATE

The difference in yields on index-linked and fixed interest gilts was approximately 3.1% at 31 December 2006 (2005: 2.9%), which was comparable to the Bank of England spot rate at 20 years. Most companies assumed that inflation would be slightly lower, with the average at 3.0%.



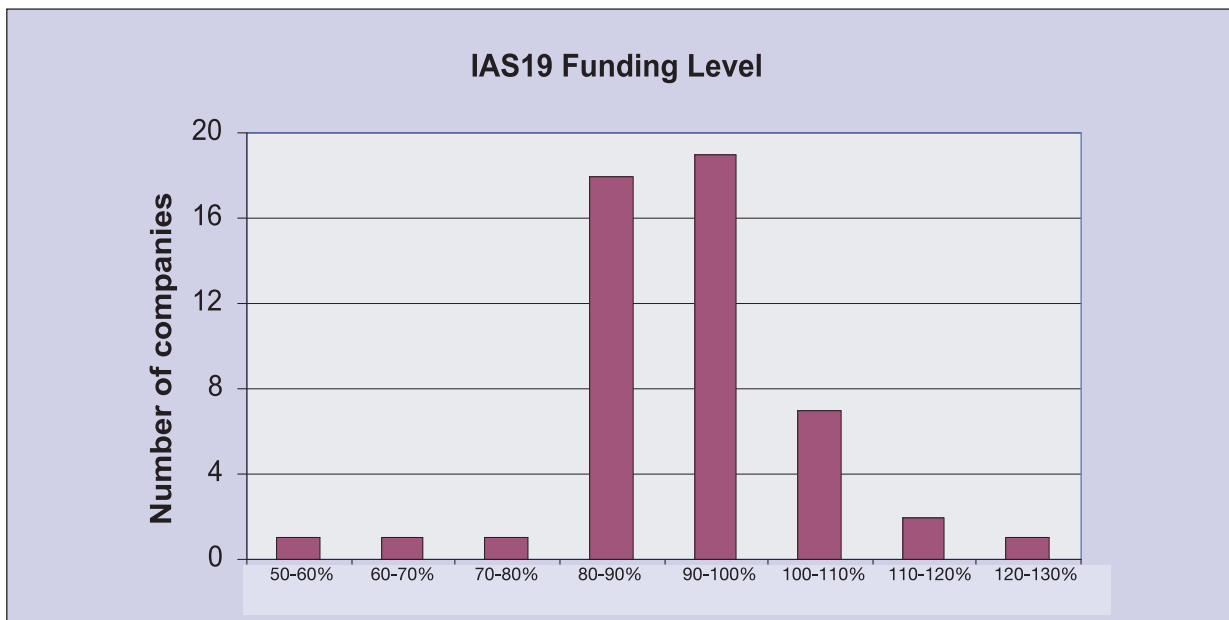
## SALARY INCREASES

Some companies may use a scale for promotional salary increases in addition to a general salary growth assumption and therefore a comparison of the disclosed salary increase rates may not be a like-for-like comparison in all cases. We have nevertheless shown below the disclosed salary increase assumption relative to the assumed rate of price inflation (i.e. real salary growth). The average real salary growth was 1.4% in 2005 and remained broadly the same for 2006.



## SURPLUS/DEFICIT

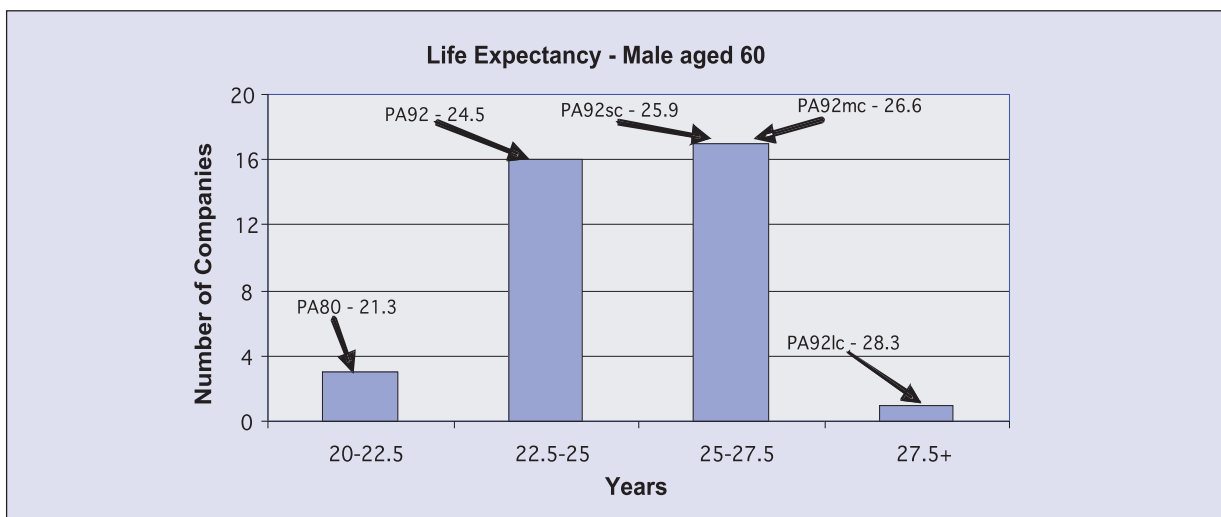
The average IAS19 funding level for the companies in our survey increased to approximately 92% at 31 December 2006 compared to 86% at 31 December 2005. This was due to the increase in discount rates and investment gains over the year.



## LIFE EXPECTANCY

Although the accounting standards do not explicitly require the disclosure of life expectancy assumptions, more and more companies are doing so. Approximately three-quarters of the companies in this year's survey disclosed information on the life expectancy assumption, either by stating the assumed life expectancy or by referring to the mortality tables used.

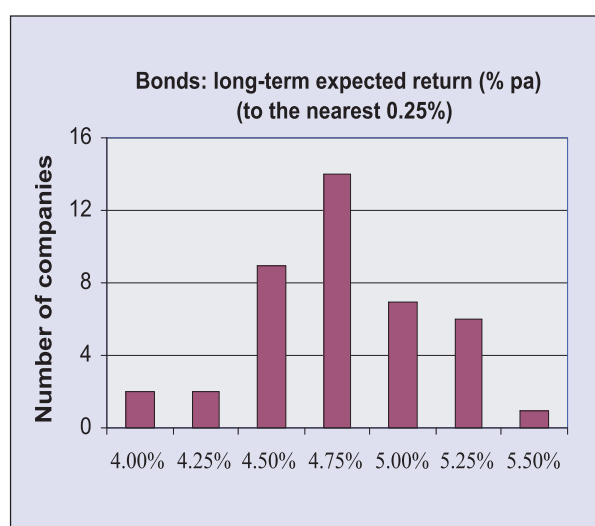
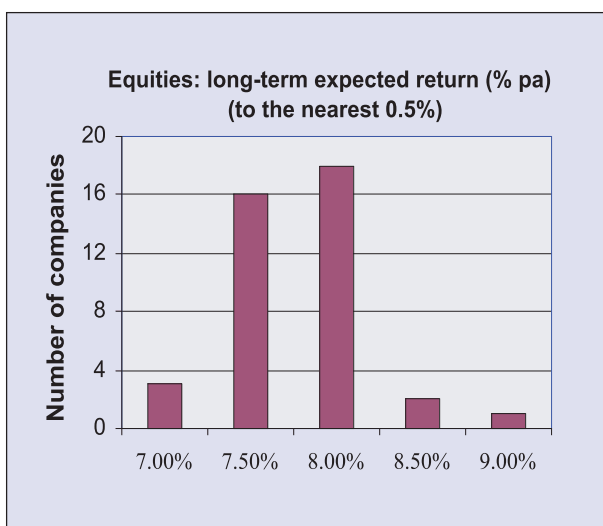
We have shown below the assumptions used for the life expectancy for a man aged 60 and also labelled the life expectancy implied by some of the more commonly used mortality tables.



The different assumptions may be explained by the different characteristics of the scheme membership. Nevertheless, the range of assumptions does appear very wide (and can have a very material impact on the pension liability) and it will be interesting to see in future surveys, whether the range narrows now that more companies are disclosing this information.

## EXPECTED INVESTMENT RETURNS

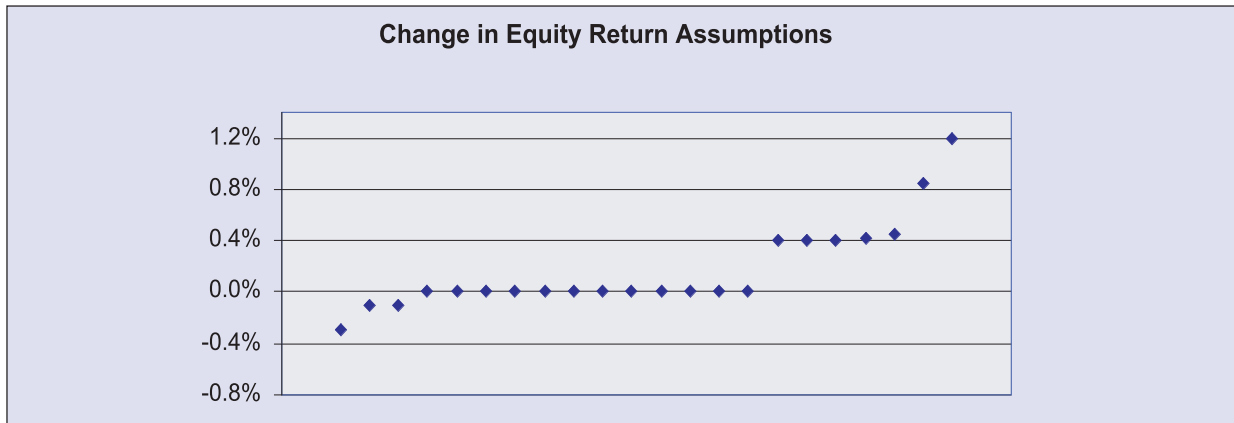
The expected returns on equities and bonds disclosed at 31 December 2006 are set out below.



The average expected equity return was 7.75%, compared to the average yield on long-dated gilts of 4.5% and so implying an average "Equity Risk Premium" of 3.25% per annum (2005: 3.4%). The average expected bond return was 4.75%, which is broadly half way between the average yields on long-dated gilts and long-dated corporate bonds at the year end.

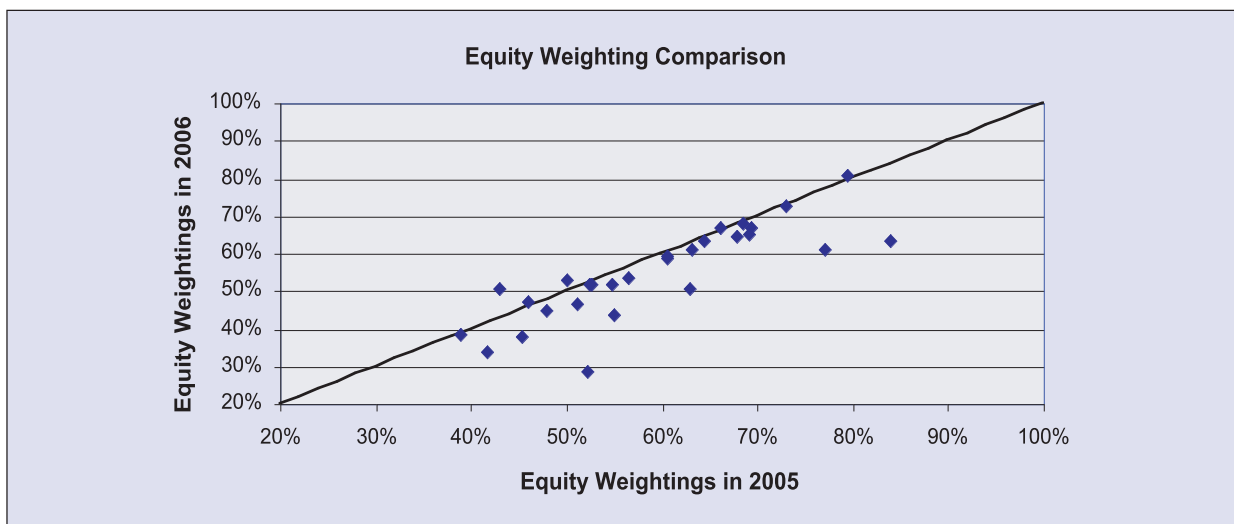


The majority of companies chose to leave the equity return assumption unchanged from 2005. However, three companies reduced their assumption and seven increased their assumption, as illustrated in the chart below.



## ASSET ALLOCATION

The chart below shows the percentage of assets invested in equities for companies in the 2006 survey, and compares this with the percentage invested in equities by the same companies in the 2005 survey. The straight line represents an unchanged equity weighting from 2005 to 2006. Those companies that fall below the line have reduced their equity weighting.



Generally, the equity weighting has reduced or remained broadly unchanged. The increase in equity values over the year implies that there has been some switching away from equities.

We hope that this analysis is helpful to companies in formulating their own assumptions under IAS19 (or FRS17).

*Please contact your usual Barnett Waddingham consultant to discuss any of the above.*

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