

Impact on a company's share price of its final salary pension scheme

It is often suggested that corporate investors do not fully understand the financial implications and risks associated with a defined benefit (DB) pension scheme. If investors do start to gain a greater understanding of a DB scheme then companies may come under pressure to alter their scheme's funding and investment strategy.

Introduction

In conjunction with the Centre for Global Finance at the University of the West of England we have undertaken some research to consider the historic impact of various pension-related events on a company's share price. This is the second of a series of notes considering various pension events that should theoretically impact on the value an investor would place on a company. The first note investigated a series of pension-related announcements and news stories relating to the BT pension scheme and found that some of them have had a significant impact on BT's share price (see <http://bwllp.co.uk/nm>)

Additional Pension Funding through use of an SPV

In response to ever increasing pension deficits companies are considering alternatives to cash funding in their negotiations with the pension scheme trustees. A number of companies have used a Special Purpose Vehicle (SPV) to help finance their pension scheme. SPVs allow a company to allocate certain assets and their associated future cashflow stream to a pension scheme without the company losing control of the assets.

Using an SPV in this way will provide the pension scheme with extra security, which should allow the company to negotiate a longer recovery period with the trustees. For further details on SPVs please see our note which available on our website at www.bwllp.co.uk/n6.

As an SPV will have presumably allowed the company to negotiate lower immediate cash contributions to the scheme you might expect the announcement of an SPV to have a positive impact on the company's share price. Equally does an SPV mean that the trustees are negotiating hard and there may be difficult funding negotiations at future valuations?

We have analysed five companies that have used an SPV to provide additional security to their pension schemes: Diageo, Interserve, ITV, Marks and Spencer and Whitbread. For each of the five companies, we have considered the impact of their SPV announcement on the company's share price relative to general market movements. In particular, we have focused on a comparison with the FTSE350 index and relevant FTSE Market indices.

Our analysis shows that the announcement of the use of an SPV did not have a statistically significant positive or negative impact on the company's share price.

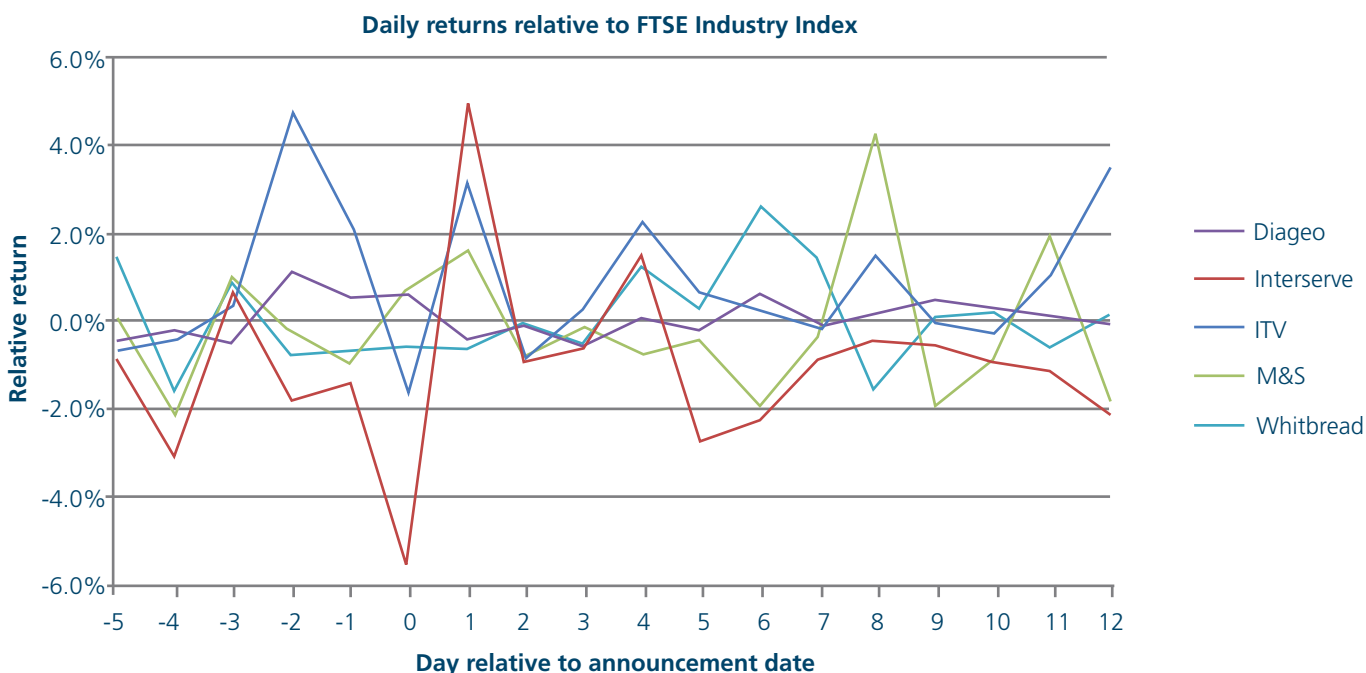


The following table summarises our findings.

Company	Value of the asset transferred	Asset transferred as % of deficit	Movement on day of announcement			Conclusion
			Company share price	FTSE350	Relevant Industry FTSE Index	
Diageo	£500m	58%	-1.7%	-2.3%	Beverages -2.3%	Company's share price movement relative to market indices not statistically significant
Interserve	£61.5m	25%	-8.5%	-3.2%	Supporting Services -2.7%	Share price dropped relative to the market index but this was reversed the next day
ITV	£124m	38%	-1.4%	-0.3%	Media +0.5%	Company's share price movement was negative relative to the industry index but not statistically significant given volatility seen during this period
Marks and Spencer	£500m	71%	+1.7%	+1.3%	General Retailers +0.9%	Company's share price movement relative to market indices not statistically significant
Whitbread	£228m	53%	-2.8%	-1.8%	Travel & Leisure -2.2%	Company's share price movement relative to market indices not statistically significant

Source: Centre for Global Finance at the University of the West of England & Barnett Waddingham LLP

Having also considered each company's share price during the period five days preceding the SPV announcement to twelve days after, our analysis again shows no statistically significant positive or negative impact on the company's share price during this time.



Source: Centre for Global Finance at the University of the West of England & Barnett Waddingham LLP

Equity Analyst Survey

To further our research we surveyed a group of equity analysts to find out the degree to which they consider the use of an SPV in a pension scheme funding agreement to be a positive indicator. Of the 17 analysts who responded 85% said that the use of an SPV would make no difference to their analysis of a company.

Closure of DB scheme

Over the last few years the majority of companies with a DB pension scheme have been seeking ways to manage their mounting pension costs. One of the first steps has been to close the DB scheme to new entrants and the Association of Consulting Actuaries (ACA) 2011 [pension trends survey](#) showed that nine out of ten companies have now done this. The same survey shows that four out of ten companies have then gone on to close their scheme to future accrual for all members.

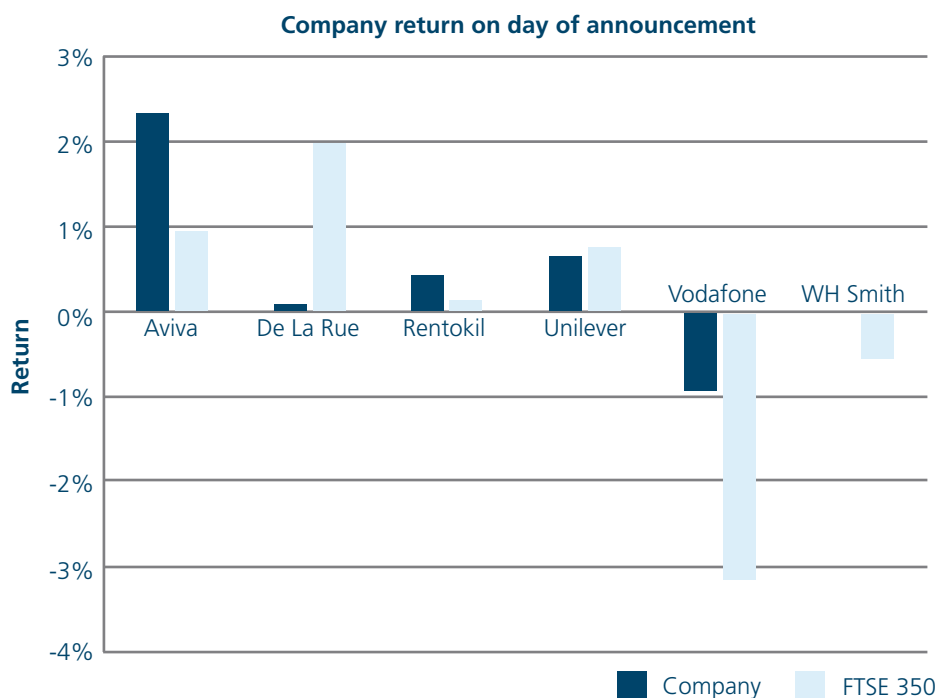
Closing the scheme to future accrual will stop the company building up further uncertain DB pension scheme liabilities and as a result an announcement that it intends to do this, might be viewed favourably by investors. However, the threat of industrial action often resulting from such changes can create uncertainty. Closing to accrual will also do nothing to tackle the pensions liabilities built up to date.

In order to consider how a company's announcement to close its DB scheme to future accrual impacts on its share price, we have analysed six companies that have announced that they will be closing their DB schemes for existing employees and details are set out in the table below:

Company	Number of employees affected	Size of DB Scheme Deficit	Conclusion
Aviva	7,600	£3bn	Positive share price movement relative to the FTSE350
De La Rue	Info not available	£204m	Negative share price movement relative to the FTSE350
Rentokil	3,000	£350m	Movement broadly in line with the FTSE350
Unilever	5,000	£1.78bn	Movement broadly in line with the FTSE350
Vodafone	4,000	£60m	Positive share price movement relative to the FTSE350
WH Smith	2,000	£41m	Movement broadly in line with the FTSE350

Source: Centre for Global Finance at the University of the West of England & Barnett Waddingham LLP

The impact of this announcement on the company's share price was mixed and even the sizeable differences seen by Aviva and Vodafone would not be viewed as statistically significant given the volatility in a company's share price relative to the FTSE350 over the period around the announcement date.



It is difficult to draw any firm conclusions from this analysis with both positive and negative outcomes. These differences should also be considered in the context of the normal volatility seen in share prices relative to market indices. It is also unclear how long it takes for these announcements to be reflected in investor's views of a company and hence have any impact on share price.

Equity Analyst Survey

To further our research we surveyed a group of equity analysts to find out how they view a DB scheme open to accrual. Of the 17 analysts who responded 59% said that they viewed an open DB scheme negatively when analysing a company.

Source: Centre for Global Finance at the University of the West of England & Barnett Waddingham LLP

Summary

From our research it is evident that certain pension events can have an impact on a company's share.

The research highlighted in this note suggests that a company considering the use of an SPV in its funding negotiations with the trustees should not be put off by concerns about investor reactions to such a move as there did not appear to be a statistically significant positive or negative reaction to the SPV announcements considered in our research.

Our research showed a mixed reaction by the market to an announcement that the company is closing its DB pension scheme to future accrual although the seemingly large differences in returns relative to the market would not necessarily be considered statistically significant given normal market volatility.

Given the strong views expressed in our equity analyst survey this lack of immediate reaction could be explained by the length of time that share prices may take to adjust to this type of announcement. Furthermore, this change is often associated with union and employee unrest and our previous note (www.bwlip.co.uk/nm) highlights the impact that uncertainty surrounding the pension scheme can have to a company's share price.



For further information

Please contact your usual Barnett Waddingham consultant if you would like to discuss this issue in more detail. Alternatively, please email:

corporateconsulting@barnett-waddingham.co.uk

November 2012
BW0502

Some information within this report has been sourced from third parties. We are reliant upon these third parties for the veracity of the information supplied. The content of this report is for information only and is not intended to provide and must not be construed as advice.

Barnett Waddingham LLP is a body corporate with members to whom we refer as "partners". A list of members can be inspected at the registered office. Barnett Waddingham LLP (OC307678), BW SIPP LLP (OC322417), Barnett Waddingham Investments LLP (OC323081), and Barnett Waddingham Actuaries and Consultants Limited (06498431) are registered in England and Wales with their registered office at Cheapside House, 138 Cheapside, London EC2V 6BW. Barnett Waddingham LLP is authorised and regulated by the Financial Services Authority and is licensed by the Institute and Faculty of Actuaries for a range of investment business activities. Barnett Waddingham Investments LLP and BW SIPP LLP are authorised and regulated by the Financial Services Authority. Barnett Waddingham Actuaries and Consultants Limited is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Amersham | Bromsgrove | Cheltenham | Glasgow | Leeds | Liverpool | London

www.barnett-waddingham.co.uk