LCP INSIGHT CLARITY ADVICE

# *Deficits have reduced but risks remain...*

LCP Ireland Pensions Accounting Briefing

2018

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*This is the 10th year LCP Ireland have published the Pensions Accounting Briefing. While risks clearly remain, it is encouraging to see a steady improvement in average funding levels together with a reduction in the level of equity exposure.*

*Conor Daly*
*Partner*

# 1. Introduction

*Pension disclosures are a significant element of many company accounts. By analysing these disclosures, we aim to measure the exposure of companies to pension risks and highlight the steps that companies are taking to address pension issues in these challenging times.*

This briefing covers 15 of the largest companies (by market capitalisation) listed on the Irish Stock Exchange (ISEQ) and other exchanges that have defined benefit pension arrangements in Ireland. All of these companies are required to report under International Accounting Standards (IAS19 for pension costs) in accordance with EU regulations. We have also covered 11 semi-state/state-controlled companies with defined benefit pension schemes that have published pension accounting information for their 2017 financial year. These bodies have reported under IAS19 or the equivalent local standard FRS102.

*15*

Number of companies listed on the ISEQ and other exchanges included in this briefing.

*11*

Number of semi-state/state-controlled companies included in this briefing.

The information and conclusions in this report are based solely on a detailed analysis of the information companies have disclosed in their annual report and accounts for their 2017 financial year and other publicly available information. We did not approach companies or their advisers for additional information.

This is the 10th such report published by LCP Ireland. The first report published in 2009 reflected a very challenging post-crash environment with average funding levels at 81% and significant deficits disclosed for some of the largest pension schemes in the country. Since the 2009 report, the average funding levels have improved despite a continuing low interest rate environment. The improvements in funding were due to a combination of strong performance in the pension scheme assets combined with contributions paid and liability management exercises performed by employers and schemes.

# 2. Executive summary

## *Pension deficits remain volatile*

Pension scheme deficits remained volatile over 2017. We estimate that the combined deficit of the schemes analysed was **€2.2bn** at 31 December 2017. This represents **a decrease of €1.4bn or 40%** from the estimated position at the start of the year.

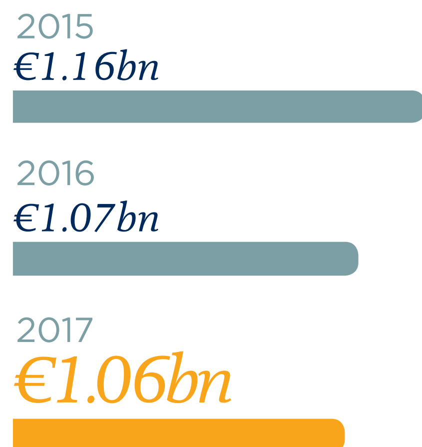
The decrease in estimated deficits occurred largely due to increases in bond yields, significant contributions and strong investment performance over 2017. The reduction in deficits was also due to some liability management exercises during 2017.

Financial markets remained favourable for the first nine months of 2018 with further increases in yields and strong equity performance. We estimate that the deficit for companies analysed had fallen to **€0.4bn by 30 September 2018.** Indeed, it is estimated the deficit fell to nil in mid-September 2018. However, October 2018 has been a more challenging month with increased volatility and falls in the equity markets.

## *Pension contributions remain a significant cost*

The companies analysed paid substantial contributions, over €1.06bn, to their pension schemes in 2017. This follows contributions of €1.07bn in 2016 and €1.16bn in 2015. It is clear that pensions remain one of the most significant costs for these organisations.

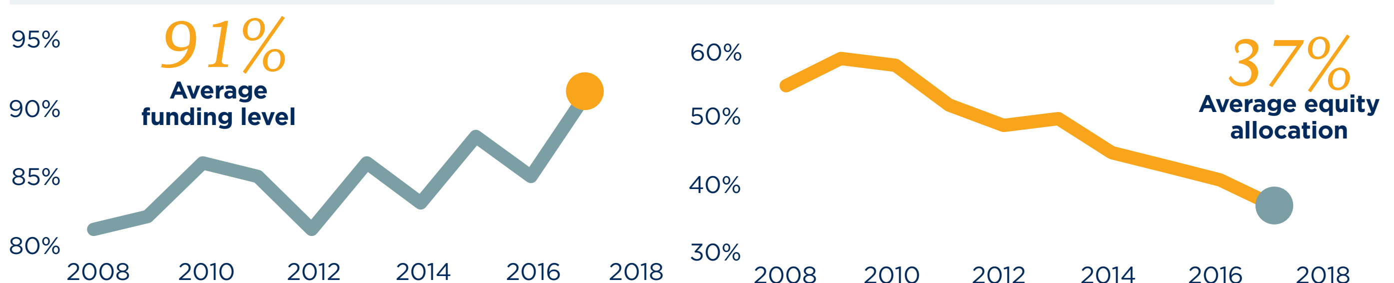
In many cases, the employer contributions were significantly higher than the cost of accrual as attempts continue to eliminate past service deficits.




## *10-year trends show an improvement in funding levels and a reduction in risk*

An analysis of the funding levels disclosed by companies since the 2009 LCP Ireland Pensions Accounting Briefing shows an improving trend. Following the 2008 market crash, many schemes were in significant funding difficulty with an average funding level disclosed of 81%. The average funding level disclosed in this report is 91%.

In addition, the average allocation to equities for the companies analysed fell significantly over the last 10 years from a high of 59% disclosed in the 2010 briefing to 37% in 2018. This reflects a clear move to diversify assets away from more volatile equity holdings.

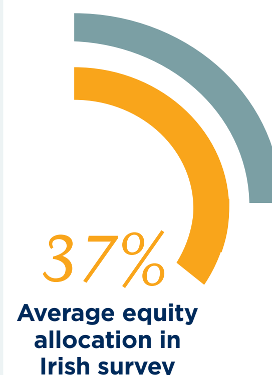


## *Risk and volatility remains high*

While the reduction in the equity allocation has helped reduce risk, the reported proportion of Irish scheme assets in equities (37%) remains high when compared to other jurisdictions. For example, defined benefit pension schemes operated by FTSE 100 companies in the UK now hold on average under 25% of their assets in equities.[1]

In addition, the reported proportionate holdings in liability matching bond assets (37%) has not increased significantly in recent years and as a result, the funding levels remain exposed to movements in bond yields.

While the prevailing low bond yields are no doubt a contributory factor in the reluctance to switch into liability matching assets (e.g. bonds), it would be most regrettable if trustees continue to feel obliged to take high levels of risk to seek outperformance in order to deliver members' benefits.




## *Discount rates remain low*

The value placed on pension liabilities is very dependent on market conditions at the valuation date and the assumptions used in the valuation exercise – particularly the discount rate. As pension liabilities tend to be very long term, a small change in the discount rate can have a very significant impact on the disclosed balance sheet liability.

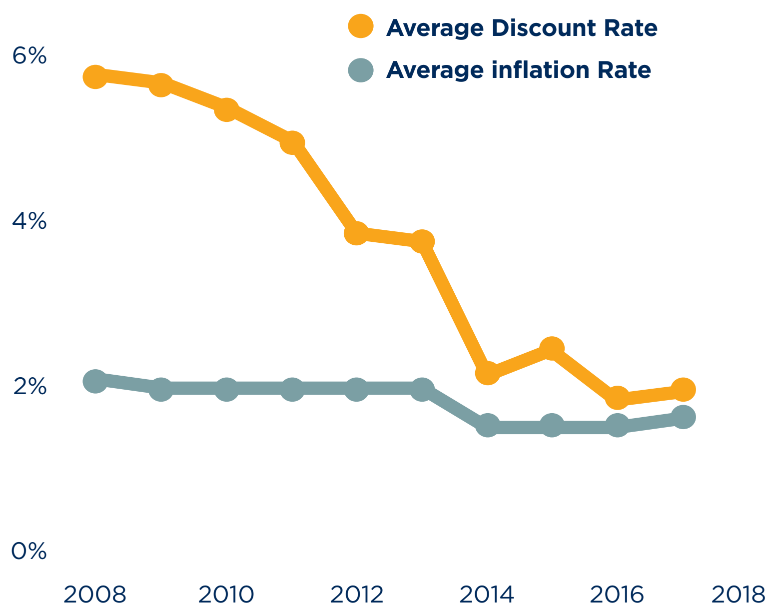
A review of the average discount rate used by companies since the 2009 LCP Ireland Pensions Accounting Briefing shows a significant reduction from an average discount rate of 5.8% in YE2008 to an average of 2.0% in YE2017. The corresponding impact on a pension scheme with long term liabilities has been an increase of c75% in the value of disclosed liabilities. Bond yields (and hence discount rates) remain low and it continues to be a challenging time for employers operating defined benefit pension schemes.

We have seen evidence of some divergence in the assumptions adopted by companies as different interpretations are taken of the appropriate market yield at the valuation date.

## *What have companies been doing to manage their pension liabilities?*

Many companies have carried out pension transfer value and similar exercises over the year.

There were also a number of examples of transfer value exercises where members were offered transfers values (in some cases with enhancements in excess of the standard transfer value) to another pension arrangement in exchange for their accrued defined benefits (**Kerry Group, Total Produce, UDG Healthcare**).




[1] LCP Accounting for Pensions Spring 2018 update

*If yields rise in the Euro area this could lead to lower bulk annuity pension buy out costs. Given the improved funding of Irish DB schemes, this could lead to opportunities to remove risk. CFOs need to prepare for this in 2019.*

*Roma Burke*
*Partner*

# 3. Developments in Irish pension provision in 2018

## 3.1. IORP II Directive

The IORP II Directive must be transposed into Irish law, and the laws of all EU Member States, by 13 January 2019. This EU Directive sets out additional requirements on pension schemes in the areas of governance, risk management and communication with members.

The Directive will result in increased focus on "fit and proper" standards for pension scheme trustees with more ongoing assessments of the qualifications, skills and experience of the members of a trustee board. Trustees will also be required to prepare written policies on risk management, internal audit, and where relevant, actuarial and outsourced activities.

One of the notable administrative changes relates to disclosures to pension scheme members. Currently, under Irish pensions disclosure legislation, there is no statutory requirement to provide an annual benefit statement for deferred members. This will no longer be the case once IORP II is implemented. This may cause a problem for administrators and Trustees who may have difficulty contacting members who left many years ago.

The Directive also requires the consideration of environmental, social and governance (ESG) factors in relation to making investments.

While the aims of the Directive are well intentioned, it is likely to result in additional legislative and compliance costs in the operation and management of pensions.

## 3.2. GDPR

The new EU General Data Protection Regulation (GDPR) came into force on 25 May 2018. GDPR has increased organisations' data protection obligations. It aims to strengthen and unify data protection for all individuals within the EU and reshape how organisations across Europe process personal data. The GDPR introduces some new requirements which may require trustees of pension schemes to change their existing processes or risk facing sanctions.

## *3.3. Roadmap for Pensions Reform 2018-2023*

The Government published proposals for a significant reform of future State, private and public service pension provision in February 2018. The proposals set out a 5 year plan ("Roadmap for Pensions Reform 2018-2023").

**New automatic enrolment savings scheme**

The government proposes to develop and implement a State sponsored supplementary retirement savings system in which workers will be automatically enrolled by 2022. The objective of this scheme will be to help individuals to accumulate sufficient wealth to sustain personal living standards in retirement.

The Government subsequently published a "Strawman" proposal for consultation setting how auto-enrolment might work. Key features include:

- All employees in the private sector between 23 and 60 earning over €20k and without existing pension provision would be automatically enrolled
- Mandatory contributions building up to 6% of Salary for employer and 6% of Salary (of net pay) for employees
- The tax relief on employee contributions - currently fully deductible at the marginal rate - would be replaced by a State top up of €1 for every €3 of employee contribution. This would be equivalent to an effective 25% tax relief for all employees - significantly lower than the 40% rate currently enjoyed by higher rate earners.

The proposals are not set in stone and legislation has yet to be prepared. Public consultation is expected to be finalised in 2019 with legislation expected to be introduced in 2020.

**Governance and regulation of occupational pension provision**

The Government's view is that the large number of pension schemes in operation creates difficulties in terms of transparency, cost and public/employee confidence in pension provision. This confidence has also been dented in the past ten years by difficulties encountered within some high-profile pension schemes.

To tackle this issue, the Government has committed in the Roadmap for Pensions Reform 2018-2023 to implementing a revised regulatory framework, underpinned by new legislation transposing the IORP II Directive into Irish Law. It is proposed

that this framework will require higher standards of management and pension scheme governance, while also reducing and rationalising the number of pension schemes and types of pension savings vehicles.

Relevant to trustees of occupational pension schemes, the new regime is likely to require trustees to undergo a fitness and probity assessment, meet annual Continuing Professional Development requirements and demonstrate compliance with a new set of professional standards. New trustee membership rules would require Trustee Boards to appoint a minimum of two trustees, where at least one has a mandatory minimum trustee qualification of level seven or greater in the National Framework of Qualifications and at least one other trustee with a minimum of two years' experience of acting as a trustee.

We have seen a wide range of governance standards in the operation of pension schemes. Any initiative which is aimed at ensuring a pre-defined minimum level of professional standard of governance is therefore welcome. However, we would urge the Government and Pensions Authority to ensure there remains a place for the fit and proper lay trustee and not to lose sight of the valuable contribution made by lay trustees in the protection of members' interests.

**Defined benefit (DB) schemes**

The changes to the governance and regulations outlined above will have a direct impact on DB schemes. In addition, the Government has stated that it intends to provide improved levels of protection for scheme members and beneficiaries. (This could include, for example, the introduction of a minimum notice period for wind up, as previously proposed, but deferred, in 2017). The government also intends to introduce more effective oversight of the financial status of DB schemes and hold a consultation with a view to identifying "appropriate and sustainable" funding standard reform options.

**State pension**

The State pension system is expected to be reformed to "improve its transparency, fairness and sustainability". To meet these objectives, the Government proposes to set a formal benchmark for the State Pension of 34% of average earnings and then develop proposals to index the State Pension in the future.

The age at which the State Pension will commence will be linked to life expectancy and there will be changes to the way in which the State Pension is funded, with a view to making the system sustainable on a long-term basis (possibly by combining PRSI and USC). Changes are also proposed to the way in which an individual qualifies for the full State Pension, and potentially an option to defer the State Pension past State Pension Age (and receive an actuarially increased pension at a later age).

**Tax expenditure**

In respect of private/occupational pension schemes, the Roadmap indicates the Government intends to "review the cost of funded supplementary pensions to the Exchequer...this will include an assessment of the economic and social benefits delivered and an evaluation of equity in the distribution of tax expenditure on pensions." Such a review could result in significant changes to the tax system for pension schemes.

## 3.4. Liability Management Exercises

We have seen continuing evidence of employer-led initiatives to manage the risk and quantum of pension liabilities. Such liability management exercises include scheme amendments such as a closure to future accrual, a cap on future pensionable salary increases, an increase in normal retirement ages, and the transfer of pensioner liabilities to an insurer. There were also a number of specific references this year to Enhanced Transfer Value (ETV) exercises.

An ETV exercise generally involves the company offering an incentive of a top up to the standard transfer values payable to members if they agree to transfer out their benefits from a defined benefit plan within a designated period. Such exercises can be attractive to companies as a method to eliminate a proportion of the defined benefit liability completely, often with the additional benefit of an improvement in the company's balance sheet. A well run ETV exercise can result in an improved outcome for some members and the company. However, such exercises are not without their own risks and exposures and we would recommend that considerable care should be taken to ensure that new risks are not introduced by such an exercise.

## 3.5. Budget 2019

The State Pension (Contributory) is increasing by €5 per week from late March 2019. A consequence of the increase is the small reduction in liabilities for defined benefit schemes that are integrated with the State Pension.

This follows increases of €5 per week in 2017 and 2018 and €3 per week in 2016. The State Pension (Contributory) is paid to people from the age of 66 who made the required Irish social insurance contributions.

*Without action employers rely on cash contributions and investment to ensure benefits get paid. Proactive liability management improves your chances of meeting your obligations and avoiding surprises.*

*Martin Haugh*
*Partner*

# 4. LCP's analysis of pension accounting disclosures

## 4.1. Introduction

We have analysed the financial position of 26 companies' defined benefit pension schemes. A full list of the companies can be found in Appendix 1.

We took the 30 largest companies (by market capitalisation) on the ISEQ and analysed the 11 companies with material defined benefit pension arrangements. The companies analysed are unchanged from last year's report.

In a similar manner to previous years, we have also included **DCC, Grafton, Greencore** and **UDG Healthcare** (these companies are listed on other exchanges, but operate significant defined benefit pension schemes in Ireland) and analysed the largest pension schemes for semi-state/state-controlled companies that publish accounts.

We have reported on the financial position of the defined benefit pension arrangements sponsored by these companies and, where possible, we have excluded liabilities relating to post-retirement healthcare from our analysis. The figures analysed include all defined benefit pension arrangements (including overseas arrangements, if applicable), except where indicated.

## 4.2. Reported funding levels

The accounting standards look at the pension scheme assets and funded liabilities at the accounting date. Of the companies analysed in this survey, four reported sufficient assets to meet their funded liabilities (**AIB, Kingspan, UDG Healthcare** and **Irish Continental Group**). Last year **AIB** and **Kingspan** were the only companies which reported sufficient assets to meet their funded liabilities.

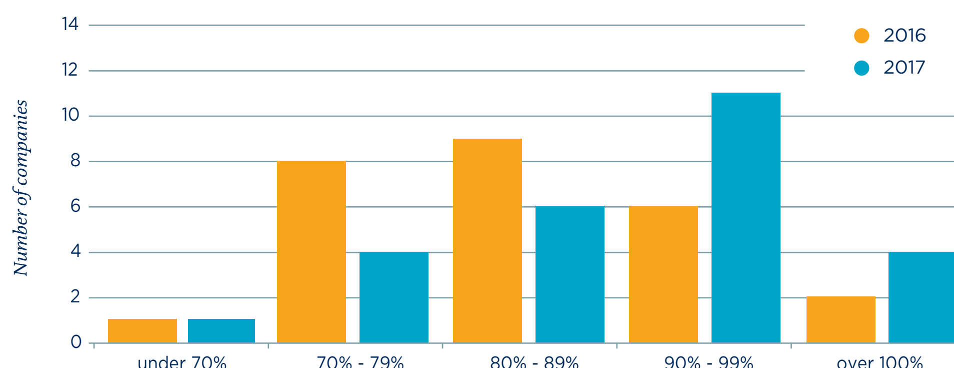
**UDG Healthcare** disclosed the highest funding level (116%), while two companies (**Central Bank of Ireland** and **CIE**) disclosed funding levels of less than 75%.

The average funding level for the schemes analysed improved from 85% in 2016 to 91% in 2017. The following chart shows how funding levels have changed over the year for the companies analysed.

91%

The average funding level (assets as a proportion of funded liabilities) for the companies analysed was 91% in 2017.

**Ratio of assets to funded liabilities (%)**



This improvement in funding levels was primarily due to increases in yields on high quality corporate bonds (used to place a value on the accounting liabilities) in 2017 which decreased the liabilities. The strong equity returns in 2017 was another contributory factor.

In some specific cases the funding position disclosed at the year-end was better than would have been expected having regard to market movements alone. There were a variety of factors contributing to this including significant contribution payments and liability management exercises.

## 4.3. Development of pension scheme deficits during 2018

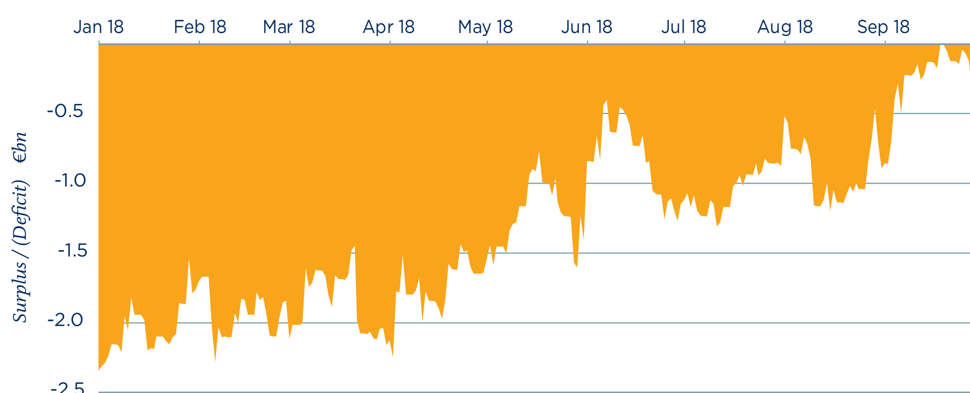
We have also considered the movement in the pension scheme balance sheet positions during 2018.

Eurozone and US equities have performed well in 2018. Global equities, as measured by the FTSE World Index, were up approximately 8.4% in 2018 to the end of September. Investor fears in Q1 2018 concerning President Trump's plans to impose tariffs on steel and aluminium imports to the U.S rescinded and returns were also boosted by strong economic data and President Trump's tax cuts.

On the liability side, high quality corporate bond yields as at the end September 2018 were higher on average than as at the end of 2017. These higher yields mean that IAS19 liability values have fallen during 2018 (as pension scheme liabilities are calculated by reference to these yields for accounting purposes).

LCP estimates that the aggregate pension deficit for the Irish funded schemes of the companies analysed stood at €0.4bn as at 30 September 2018 (€2.2bn at 31 December 2017).

**Projected aggregate pension deficit**



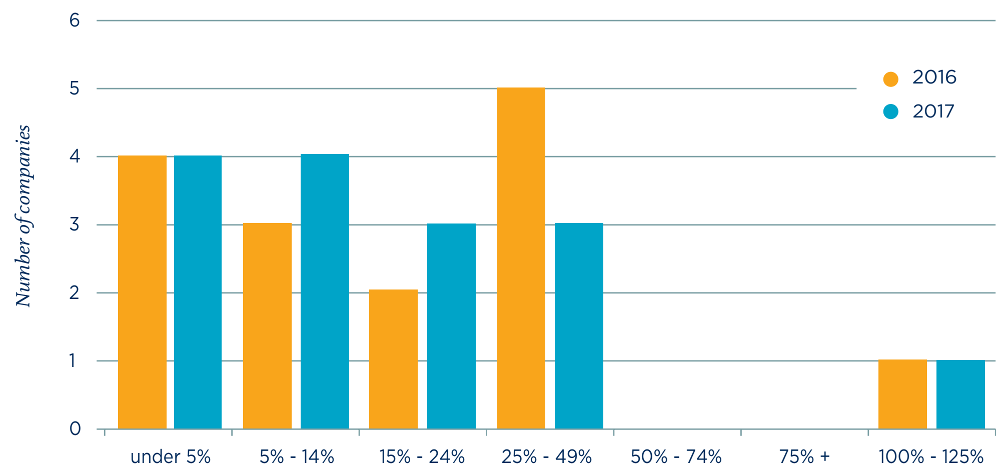

Note: Data is for the Irish funded pension arrangements of the companies analysed and has been estimated from the pensions disclosures in their published company accounts [2].

As the graph demonstrates, there can be significant volatility in the level of deficits from month to month as equity values and bond yields fluctuate. Indeed, it is estimated that the deficit was fully eliminated in mid-September.

[2] Projected deficits calculated using LCP's daily online scheme monitoring tool LCP Visualise.

## *4.4. Company exposure to pension schemes*

**Funded accounting liabilities as a proportion of market capitalisation (%)**




# 20%

The total funded pension scheme liabilities expressed as a proportion of market capitalisation for the companies analysed was 20%.

The chart above shows the size of the pension accounting liabilities relative to market capitalisations for the companies analysed (**AIB** has been excluded from this analysis as its disclosed market capitalisation was distorted by the limited amount of stock actively traded). The total pension liability, expressed as a proportion of market capitalisation, decreased over the year (from 25% in 2016 to 20% in 2017).

The following lists the companies with the largest pension scheme liabilities expressed as a percentage of their market capitalisation at their 2017 year-end dates:

- **Bank of Ireland:** 101% (102% in 2016)
- **Greencore:** 43% (47% in 2016)
- **Smurfit Kappa:** 34% (45% in 2016)

## *4.5. Contributions compared to benefits earned*

We have analysed how the employer contributions compare with the expected cost of benefits earned:

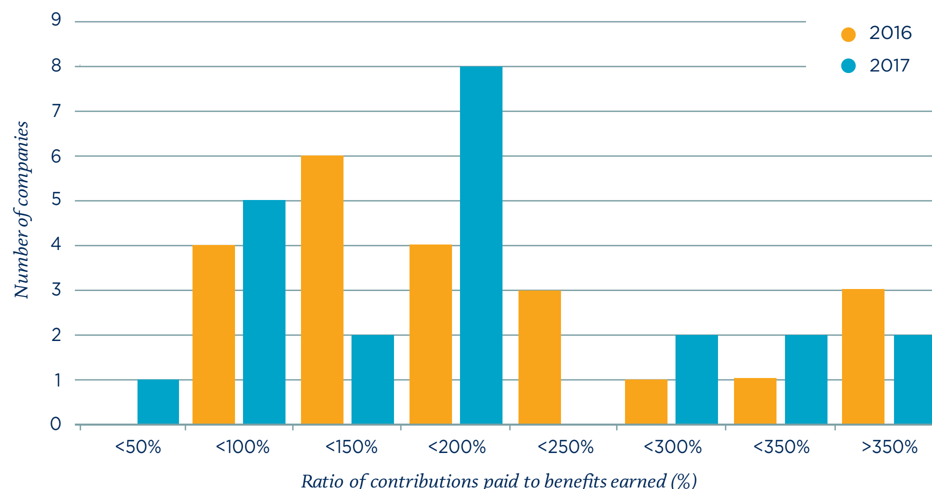
- The cost of benefits earned under IAS19 is determined by the assumptions at the start of the accounting year.
- Typically, employer contributions are set following recommendations by the Scheme Actuary and are designed to ensure that there are sufficient assets to meet benefit payments as they fall due.

Our analysis of the accounting disclosures shows that the majority of companies pay contributions that are in excess of the cost of benefit accrual under IAS19 as attempts are made to reduce past service deficits. On average, companies paid contributions of just under 2.0 times (2016: 2.1 times) the cost of benefit accrual on the accounting basis.

The contributions made by **Kerry Group** and **Bord na Mona** were over 4 times the cost of benefit accrual under IAS19.

**An Post, Aryzta, Central Bank, CIE, Ervia** and **NTMA** paid contributions that were less than the estimated cost to cover benefits earned during the year on the accounting basis.

**Employer contributions compared to benefits earned**



# 37%

The average equity allocation for the pension schemes analysed fell during 2017. This is still significantly higher than pension schemes in other jurisdictions.

*As Irish DB schemes' funding positions continue to improve, we are seeing a very welcome de-risking of their investments.*

*Oliver Kelly*
*Head of Investment Consulting Ireland*

## 4.6. Trends in asset allocations

Where companies disclose a breakdown of their Irish or Eurozone pension scheme asset allocation, this is the one which we have analysed.

The average level of exposure to equities fell from 41% in 2016 to 37% in 2017. The average allocation to bonds increased slightly from 36% to 37% and the allocation to other asset classes increased from 23% to 26%.

We have also analysed the allocation to other asset classes. The majority of companies disclosed an allocation to property assets. The average allocation was 7% in 2017 for those with property assets (7% in 2016).

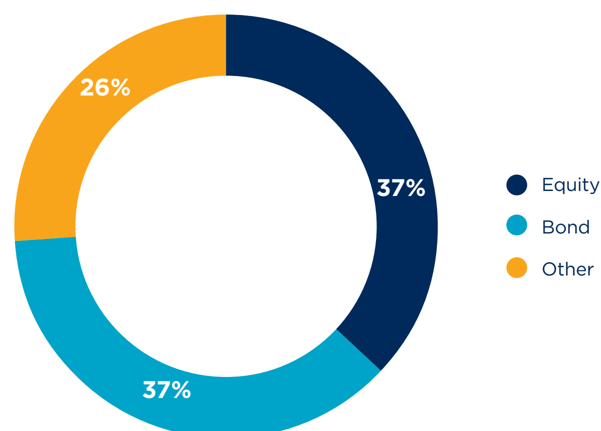
Some companies also disclosed an allocation to cash assets – the average allocation was 4% in 2017 for those with cash assets (6% in 2016).

Five companies disclosed an allocation to Liability Driven Investment – with **Kingspan** (54%) and **Bank of Ireland** (31%) disclosing the highest allocations.

Two companies disclosed an allocation to hedge funds – **Diageo** (9%) disclosing the highest allocation.

The average split of assets for the pension schemes analysed is shown in the following chart.

**2017 Asset allocation**




Companies who reported the highest equity holdings were **Kerry Group** (60%), **NTMA** (56%), **An Post** (48%) and **Grafton** (47%). On the other end of the spectrum, **Total Produce** (19%), **Diageo** (22%) and **Bank of Ireland** (24%) disclosed the lowest equity holdings.

The Pensions Authority has commented that investment strategies which rely on equities to outperform bonds in order to meet pension scheme

liabilities entail considerable risk, which, in their view, will fall particularly on the younger members. To address this, the Authority has said that it intends to raise this directly with defined benefit pension scheme trustees as part of their programme of increased direct engagement.

There is evidence that a number of trustee boards are reviewing their investments and in many cases implementing de-risking strategies or altering the mix of their return-seeking portfolios. We expect this trend to continue as many schemes review their asset strategies as part of their funding proposals.

The shift from equities is particularly evident at an individual company level with some accounts showing significant reductions in equity allocations during 2017:

- **Ornua:** equity holding reduced from 65% to 42%
- **Kingspan:** equity holding reduced from 67% to 46%
- **Grafton:** equity holding reduced from 64% to 47%.

Some companies reported increases in equity holdings. For example, **NTMA** reported an increase in its equity holdings of 7%. In previous years we reported that Irish pension schemes had higher than average allocations to equities when compared to other jurisdictions. Our current analysis would continue to support this assertion.  For example, in the UK, approximately 25%[3] of pension scheme assets were allocated to equities at the 2017 year-end compared with 37% for the Irish scheme assets in this report.

The largest reported increases in bond holdings were as follows:

- **UDG Healthcare:** bond holding increased from 23% to 40%
- **Total Produce:** bond holding increased from 33% to 47%
- **CIE:** bond holding increased from 38% to 49%.

Some companies reported reductions in bond holdings. For example, **Bord na Mona** (12%) and **Aryzta** (9%) reported reductions in bond holdings.

**Aryzta** and **Total Produce** reported the highest property holdings:

- **Aryzta:** property holding increased from 23% to 26%
- **Total Produce:** property holding increased from 16% to 19%.

The highest reported cash holdings were **UDG Healthcare** (23%) and **DCC** (10%).

*Irish DB schemes have significantly de-risked over the past 10 years which will improve members' confidence of their future benefit promises being met.*

*Fergus Collis,*
*Senior Consultant*

[3] (UK) LCP Accounting for Pensions Spring 2018 update

## *4.7. Key assumptions*

We consider below the various assumptions used to place a value on pension benefits for accounting purposes. Where a company operates pension schemes in more than one country, we have considered the assumptions used for Ireland or the Eurozone (if available). Where a company has disclosed a range of assumptions, we have used our judgement to estimate the relevant point in the range for the Irish pension scheme.

*2.0%pa*

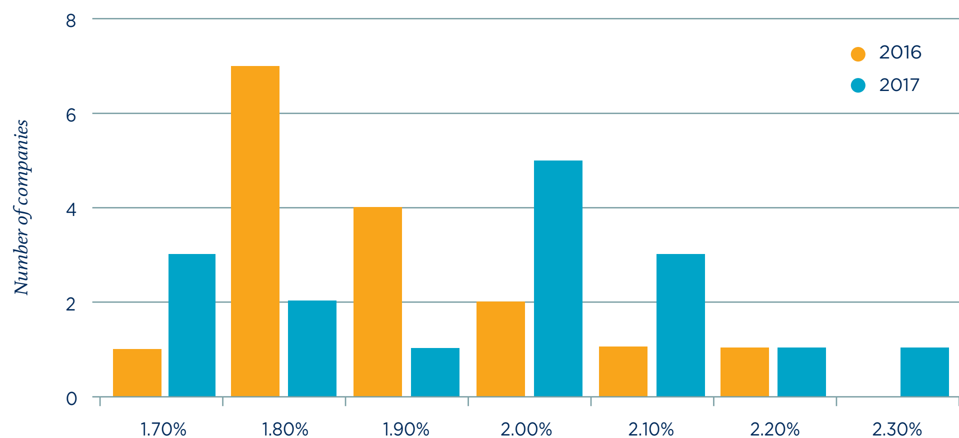
The average discount rate adopted by the companies in this report increased from 1.9% in 2016 to 2.0% in 2017

**Discount rates**

The discount rate is the key assumption used to value pension liabilities. Under IAS19 and FRS102, this assumption is based on the yields available on long-dated high quality (typically AA-rated) corporate bonds in the currency of the liability at the valuation date.  The yields on high quality corporate bonds, and hence the discount rates, will fluctuate from day to day in line with market conditions.

In the following chart, we have analysed companies reporting with December 2017 year-ends. As this shows, there was an increase in the discount rates disclosed compared to last year.

**Discount rates used at 31 December (% pa)**




The average discount rate for companies reporting at 31 December 2017 was 2.0% pa – an increase from the average discount rate of 1.9% pa as at 31 December 2016 and reflecting the commensurate rise observed in corporate bond yields over 2017. The highest discount rate was disclosed by **NTMA** (2.3%). Most schemes reported a small increase in the discount rate. **CIE** disclosed a decrease in the year to 31 December 2017.

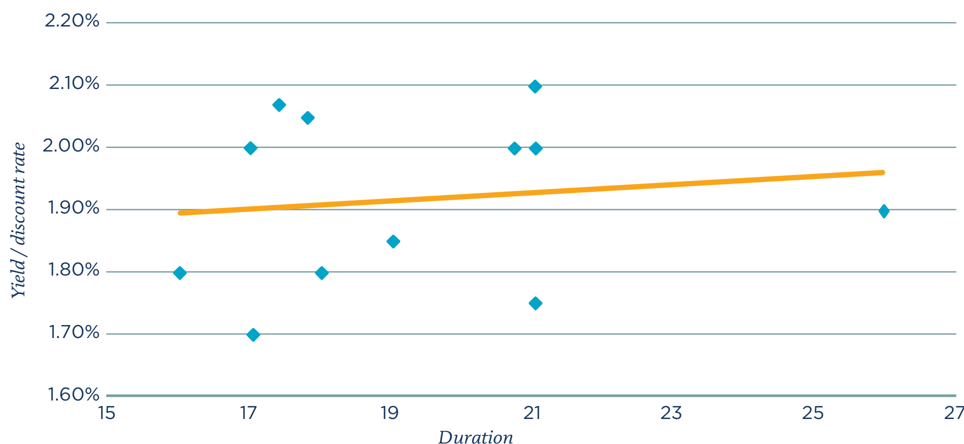
The accounting standard (IAS19) requires that the discount rate used is determined by reference to market yields at the end of the reporting period on high quality corporate bonds of a currency and term consistent with the currency and term of the pension scheme liabilities. This is generally interpreted as a discount rate in line with AA-rated corporate bonds of appropriate duration.

While in theory, pension schemes with similar durations should be valued using similar discount rates at a particular point in time, in practice, the lack of a deep market in long duration corporate bonds can result in different modelling techniques and some divergences in discount rates.

As pension schemes tend to be long duration, a small change in the discount rate can have a very large impact on the balance sheet position. For example, **Kerry Group** reported that a decrease of 0.5% pa in the discount rate would increase the scheme liabilities by 11.2% at the accounting date. Similarly, **An Post** reported a decrease of 0.25% in the discount rate would increase the pension scheme liabilities by 4.0%.

The discount rates used as at 31 December 2017 have been charted against the disclosed durations below for the 12 companies with such disclosures and a year-end at 31 December 2017 and clearly shows some divergences in approach. We have used the duration for the Irish pension scheme when this is separately identified.

**Discount rates used at 31 December 2017 by duration**

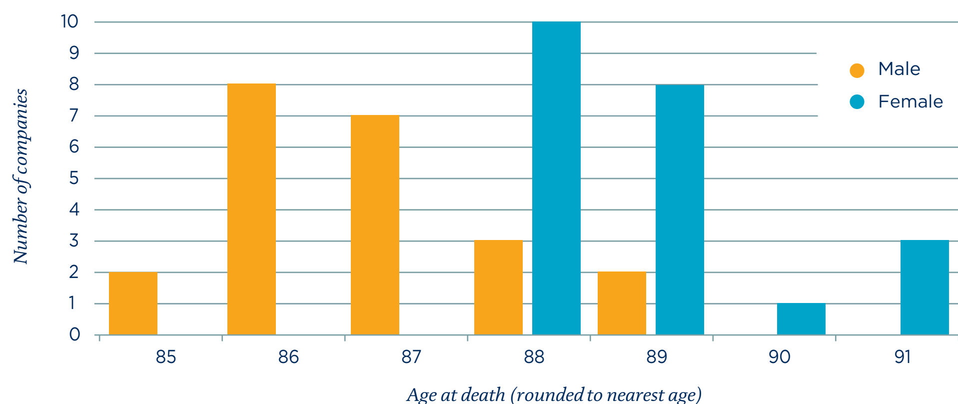


### Life expectancy

All of the companies analysed have disclosed some information about their life expectancy assumption.

The following chart shows the range of life expectancies for males and females assumed by the companies analysed for members retiring at age 65 at the balance sheet date in 2017.

**Life expectancy assumption**
**Individuals aged 65 on accounting date**




The average assumption was that male members at age 65 at the accounting date would live to age 87.2 (89.3 for females). This is very similar compared to last year where the average male life expectancy at age 65 disclosed was 87.2 (89.4 for females).

However, this overall average hides some changes where some companies increased their assumed life expectancy and others decreased their assumption. **Coillte** and **Irish Aviation Authority** disclosed a reduction of 0.6 of a year for male pensioners at age 65.

An increase in the assumed life expectancy will result in an increase in the value of the liabilities. An increase of 1 year will lead to an increase of approximately 3% in companies' disclosed pension liabilities.

### Future improvements in life expectancy

As well as setting assumptions to estimate how long current pensioners will live, companies must also decide how quickly life expectancies for future pensioners will increase as a result of improvements in mortality.

Allowing for future improvements will increase pension scheme liabilities and, as a result, deficits on the balance sheet. The majority of companies analysed disclosed sufficient information in their accounts to determine the allowance they were making for future improvements in mortality.

On average, the companies analysed are assuming that, over the next 20 years, the life expectancy of male retirees will increase by approximately 2.1 years. This represents a slight decrease to the assumptions made by the companies last year.

### Long term inflation

While there are some uncertainties when setting the inflation assumption and a number of approaches are available, the average inflation assumption disclosed by companies reporting at 31 December 2017 was 1.7% (1.6% at 31 December 2016).

> *Schemes and employers need to start looking at the future and developing plans for the removal of defined benefit liabilities from their balance sheet. There will be opportunities and only the best prepared will be able to take advantage of them.*
>
> *John Lynch*
> *Partner*

# 5. Appendices

*Appendix 1 - Accounting disclosure listing*
*Appendix 2 - Accounting risk measures*

# Appendix 1 - Accounting disclosure listing

This table shows the key disclosures made by the companies included in our analysis. The source of the data is each company's annual report and accounts for the accounting period ending in 2017. The market value of assets and surplus/(deficit) figures relate to the worldwide position of each company, not just the Irish schemes. All figures are rounded to the nearest million Euros. The assumptions for the discount rate and price inflation refer to those disclosed for the companies' main Irish or Eurozone schemes where available. We have excluded from our survey companies who had no evidence of significant defined benefit provision. Some companies' 2016 figures may have been restated. The surplus/(deficit) figures allow for any asset ceiling applied

| | | 2017 | Surplus/(Deficit) | | | | 2016 | Surplus/(Deficit) | |
|---|---|---|---|---|---|---|---|---|---|
| **Irish Companies** | Year-end | Market value of assets €m | Total €m | Funded schemes €m | Discount rate % pa | Inflation % pa | Market value of assets €m | Total €m | Funded schemes €m |
| Aryzta | Jul | 59 | (7) | (5) | 0.65% | not stated | 60 | (13) | (11) |
| Bank of Ireland | Dec | 7,248 | (478) | (478) | 2.10% | 1.65% | 7,292 | (446) | (446) |
| C&C Group | Feb | 189 | (18) | (18) | 1.7%-1.95% | 1.50% | 195 | (28) | (28) |
| CRH | Dec | 2,622 | (377) | (175) | 2.05% | 1.75% | 2,556 | (591) | (444) |
| DCC | Mar | 119 | 0 | 0 | 2.00% | 1.75% | 112 | 0 | 0 |
| Diageo | Jun | 10,506 | (558) | (239) | 2.10% | 1.60% | 9,878 | (1,425) | (1,125) |
| Glanbia | Dec | 186 | (42) | (42) | 1.80% | 1.5%-1.6% | 367 | (110) | (110) |
| Grafton | Dec | 269 | (26) | (26) | 1.85% | 1.45% | 260 | (37) | (37) |
| Greencore | Sep | 543 | (142) | (142) | 1.65% | 1.45% | 576 | (188) | (188) |
| Irish Continental Group | Dec | 283 | 5 | 5 | 1.80% | 1.60% | 275 | (13) | (13) |
| Kerry Group | Dec | 1,353 | (124) | (94) | 2.0%-2.1% | 1.70% | 1,366 | (353) | (323) |
| Kingspan | Dec | 77 | (14) | 8 | 1.3%-2.6% | 1.0%-3.2% | 77 | (14) | 7 |
| Smurfit Kappa | Dec | 1,953 | (848) | (331) | 1.70% | 1.60% | 1,954 | (884) | (367) |
| Total Produce | Dec | 175 | (17) | (17) | 2.00% | 1.70% | 189 | (38) | (38) |
| UDG Healthcare | Sep | 57 | 8 | 8 | 2.05% | 1.65% | 63 | (6) | (6) |

| State controlled bodies | Year-end | 2017 Market value of assets €m | 2017 Surplus/(Deficit) Total €m | 2017 Surplus/(Deficit) Funded schemes €m | Discount rate % pa | Inflation % pa | 2016 Market value of assets €m | 2016 Surplus/(Deficit) Total €m | 2016 Surplus/(Deficit) Funded schemes €m |
|---|---|---|---|---|---|---|---|---|---|
| AIB | Dec | 6,328 | 96 | 96 | 2.07% | 1.35% | 6,413 | 8 | 8 |
| An Post | Dec | 3,116 | (55) | (55) | 2.00% | 1.75% | 2,969 | (283) | (283) |
| Bord na Mona | Mar | 333 | (16) | (12) | 1.70% | 1.30% | 320 | (34) | (30) |
| Central Bank of Ireland | Dec | 688 | (306) | (306) | 1.90% | 1.90% | 639 | (333) | (333) |
| CIE | Dec | 2,093 | (784) | (784) | 1.75% | 1.75% | 1,987 | (730) | (730) |
| Coillte | Dec | 306 | (76) | (76) | 2.10% | 1.75% | 293 | (108) | (108) |
| Ervia | Dec | 430 | (128) | (128) | 1.75% | 1.70% | 403 | (129) | (129) |
| Irish Aviation Authority | Dec | 541 | (85) | (85) | 2.10% | 1.65% | 513 | (159) | (159) |
| NTMA | Dec | 153 | (34) | (34) | 2.30% | 1.75% | 131 | (42) | (42) |
| Ornua | Dec | 137 | (41) | (41) | 2.10% | 1.65% | 133 | (45) | (45) |
| VHI | Dec | 267 | (40) | (40) | 2.20% | 1.70% | 235 | (27) | (27) |

This briefing analyses 11 companies of the largest 30 companies on the ISEQ with defined benefit pension arrangements. Company size has been determined by the weighting on the ISEQ benchmark index at 29 December 2017. The briefing also analyses the most significant state owned/controlled companies/bodies (where accounts were available) and four public companies that are listed on other exchanges but who operate significant defined benefit pension schemes in Ireland (DCC, Grafton, Greencore and UDG Healthcare). The 2017 figures are as at the end of the accounting periods ending in 2017. The 2016 figures are as at the start of the accounting period. All figures shown were taken from pensions accounting disclosures.

We have converted the figures provided in pounds sterling in the DCC, Diageo, Grafton and Greencore and US dollars in the UDG Healthcare accounts using the Euro conversion rate applicable at each company's year-end (DCC: 1.1717 at 31 March 2017 (2016: 1.2626), Diageo: 1.1387 at 30 June 2017 (2016: 1.1965), Grafton: 1.1254 at 31 December 2017 (2016: 1.1720), Greencore: 1.1342 at 30 September 2017 (2016: 1.1577) and UDG Healthcare (0.8464 at 30 September 2017 (2016: 0.8960)).

# *Appendix 2 - Accounting risk measures*

The tables show the key results of analysis of the 2017 accounting disclosures made by the largest companies on the Irish Stock Exchange, the largest state-controlled companies/bodies with defined benefit pension arrangements and four other companies who operate significant defined benefit pension schemes in Ireland (DCC, Grafton, Greencore and UDG Healthcare). The pension figures relate to the worldwide position of each company (not just their Irish pension schemes) but exclude healthcare and defined contribution pension arrangements where possible. Equity allocations are based on Irish or Eurozone schemes where disclosed.

The source of the data is each company's annual report and accounts for the accounting period ending in 2017. Figures provided in company accounts in sterling or US dollars have been converted to Euro using the conversion rates outlined in Appendix 1.

The assets and liabilities in these tables are as outlined in the accounting disclosures before any adjustment for any asset ceiling. The surplus/(deficit) figures allow for any asset ceiling applied. The surplus/(deficit) figures are before allowing for deferred tax.

Traditionally some companies with overseas pension schemes do not fund them via an external scheme, instead backing the pension scheme with company assets, which may result in a larger total deficit (when including unfunded arrangements) being disclosed.

The source of market capitalisation figures is the ISEQ weightings as at the companies' year-ends.

All figures shown have been calculated using unrounded numbers. Therefore some metrics shown may differ from those calculated using the rounded figures.

**Largest funded liabilities**

| Company | 2017 Liabilities €m | 2016 Liabilities €m |
|---|---|---|
| Diageo | 10,745 | 11,003 |
| Bank of Ireland | 7,726 | 7,738 |
| AIB | 5,694 | 6,153 |
| An Post | 3,171 | 3,252 |
| CIE | 2,877 | 2,717 |

**Largest funded deficits**

| Company | 2017 Deficits €m | 2016 Deficits €m |
|---|---|---|
| CIE | 784 | 730 |
| Bank of Ireland | 478 | 446 |
| Smurfit Kappa | 331 | 367 |
| Central Bank of Ireland | 306 | 333 |
| Diageo | 239 | 1,125 |

| Largest funded liabilities compared to market capitalisation | | | |
|---|---|---|---|
| **Company** | **Liabilities €m** | **Market cap €m** | **2017 Liabilities/ Market cap %** |
| Bank of Ireland | 7,726 | 7,654 | 101% |
| Greencore | 684 | 1,577 | 43% |
| Smurfit Kappa | 2,282 | 6,677 | 34% |
| Irish Continental Group | 279 | 1,094 | 25% |
| Total Produce | 192 | 836 | 23% |

| Largest funded deficits compared to market capitalisation | | | |
|---|---|---|---|
| **Company** | **Deficits €m** | **Market cap €m** | **2017 Deficits/ Market cap %** |
| Greencore | 142 | 1,577 | 9% |
| Bank of Ireland | 478 | 7,654 | 6% |
| Smurfit Kappa | 331 | 6,677 | 5% |
| Total Produce | 17 | 836 | 2% |
| C&C Group | 18 | 1,225 | 1% |

| Highest equity allocation | | |
|---|---|---|
| **Company** | **2017 Equity allocation %** | **2016 Equity allocation %** |
| Kerry Group | 60% | 60% |
| NTMA | 56% | 49% |
| An Post | 48% | 49% |
| Grafton | 47% | 64% |
| Kingspan | 46% | 67% |

| Lowest equity allocation | | |
|---|---|---|
| **Company** | **2017 Equity allocation %** | **2016 Equity allocation %** |
| Total Produce | 19% | 35% |
| Diageo | 22% | 30% |
| Bank of Ireland | 24% | 23% |
| AIB | 26% | 26% |
| C&C Group | 28% | 26% |

| Highest (funded) funding level | | | | |
|---|---|---|---|---|
| **Company** | **2017 Assets €m** | **2017 Liabilities €m** | **2017 Assets/ Liabilities %** | **2016 Assets/ Liabilities %** |
| UDG Healthcare | 57 | 49 | 116% | 91% |
| Kingspan | 77 | 69 | 111% | 110% |
| AIB | 6,328 | 5,694 | 111% | 104% |
| Irish Continental Group | 283 | 279 | 102% | 95% |
| DCC | 119 | 119 | 100% | 100% |

| Lowest (funded) funding level | | | | |
|---|---|---|---|---|
| **Company** | **2017 Assets €m** | **2017 Liabilities €m** | **2017 Assets/ Liabilities %** | **2016 Assets/ Liabilities %** |
| Central Bank of Ireland | 688 | 993 | 69% | 66% |
| CIE | 2,093 | 2,877 | 73% | 73% |
| Ornua | 137 | 178 | 77% | 75% |
| Ervia | 430 | 557 | 77% | 76% |
| Greencore | 543 | 684 | 79% | 75% |

| Largest employer contributions | | |
|---|---|---|
| **Company** | **2017 Contributions €m** | **2016 Contributions €m** |
| Diageo | 251 | 202 |
| Bank of Ireland | 217 | 220 |
| CRH | 123 | 133 |
| Kerry Group | 86 | 125 |
| Smurfit Kappa | 75 | 83 |

| Largest service cost | | |
|---|---|---|
| **Company** | **2017 Service cost €m** | **2016 Service cost €m** |
| Diageo | 151 | 134 |
| Bank of Ireland | 117 | 123 |
| CIE | 73 | 46 |
| CRH | 62 | 61 |
| An Post | 49 | 45 |

**Largest employer contributions compared to service cost**

| Company | Contributions €m | Service cost €m | 2017 Contributions/ Current service cost % | 2016 Contributions/ Current service cost % |
|---|---|---|---|---|
| Kerry Group | 85.5 | 13.8 | 620% | 606% |
| Bord na Mona | 9.6 | 2.3 | 425% | 485% |
| Smurfit Kappa | 75.0 | 24.0 | 313% | 332% |
| C&C Group | 3.4 | 1.1 | 309% | 591% |
| VHI | 18.3 | 6.2 | 295% | 144% |

**Largest increase in funding level**

| Company | 2017 Funding level % | 2016 Funding level % | Increase in Funding level % |
|---|---|---|---|
| UDG Healthcare | 116% | 91% | 27% |
| Kerry Group | 94% | 81% | 16% |
| Irish Aviation Authority | 86% | 76% | 13% |
| Aryzta | 93% | 84% | 10% |
| CRH | 94% | 85% | 10% |

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