Pensions on the ropes

A review of the IAS 19 pension disclosures of all companies in the Dutch AEX 25 – September 2010

PricewaterhouseCoopers

Pensions on the ropes

Pensions on the ropes – where next?

Last year we entitled our review of the pension disclosures of companies in the AEX 25 '**Pensions in crisis**'. So are pension still in crisis? Our 2010 analysis, which is based on company's disclosures prepared using International Financial Reporting Standards ("IFRS"), shows the contradictions and challenges facing companies in the Netherlands:

- IAS 19 **deficits** fell during the year, but only because of the cash pumped in by companies rather than improvements in financial markets.
- Companies expect to pay less **cash** into their pension plans in 2010 than they did in 2009, but most of this cash is to address deficits arising from past promises rather than reward for current employees.
- 2010 pension **costs** will be lower than 2009, but new accounting standards will lead to higher long term costs.

Such **conflicting messages** from a number of sources make it difficult for companies to understand their issues and form a coherent pension strategy.

The **next 12 months will see more developments**. The new Dutch government will add its opinion to the discussions. Greater risk sharing between employers and employees is likely to be on the menu giving companies the opportunity to move more of the pension risk off their balance sheets.

In the new world, **rising costs may be hard** to avoid as any attempt to pass on risks to employees will inevitably come at a price. It will also be a challenge for companies to make a clean slate for the future without investing significant cash to deal with the deficits of the past. None of the above will be easy and will require preparation, planning and hard choices.

For our 2009 review we address three issues: the state of IAS 19 deficits, the allocation of company cash payments between deficits and new benefits and pension expense.

If you have would like to discuss the issues raised in this document, please refer to the contact details at the back.

Pension deficits – recovering or bumping along at the bottom?

IFRS deficits fell from € 24.6bn to € 18.1bn during 2009. However if the impact of the extra payments companies made into their plans is removed, deficits would have increased. The benefit of the equity market recovery was dampened by falls in the yields on corporate bonds used to discount liabilities. A reversal of 2008's story.

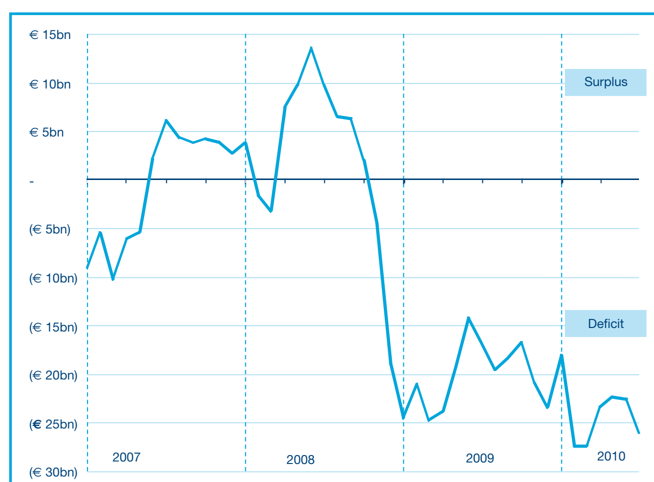

Figure 1. Estimated change in total IFRS accounting deficits of AEX 25 2007-date

Analysis

- Nine companies in the AEX 25 reported higher deficits than at the end of 2008, fifteen reported lower deficits.
- The main factor behind falling deficits in the year was the cash companies paid in rather than better market conditions.
- Although equity markets rebounded in 2009, the benefit of this was lessened by the reduced investment of pension funds and falls in credit 'spreads', the difference between yields on corporate and government bonds, which increased liabilities.
- So far in 2010 deficits have returned back to the levels of the end of 2008 – the extra cash ploughed into plans has not helped most companies accounting positions. Recently released mortality tables in the Netherlands, showing longer life expectancies, will lead to a further rise in deficits at the end of 2010.

PwC insight

Market conditions meant that 2008 accounting deficits were not yet showing the full effects of the crisis. 2009 shows a clearer picture – many companies still have significant IFRS deficits for their plans, 4% of market capitalisations on average.

Cash payments to pension plans – where's the money going?

Since 2005, AEX 25 companies have paid over € 32bn to their defined benefit pension plans. Less than half of this has been to cover the accounting cost of new benefits for employees. The remaining cash, and a rising proportion year-on-year, has been paid to meet deficits of benefits granted in previous years.

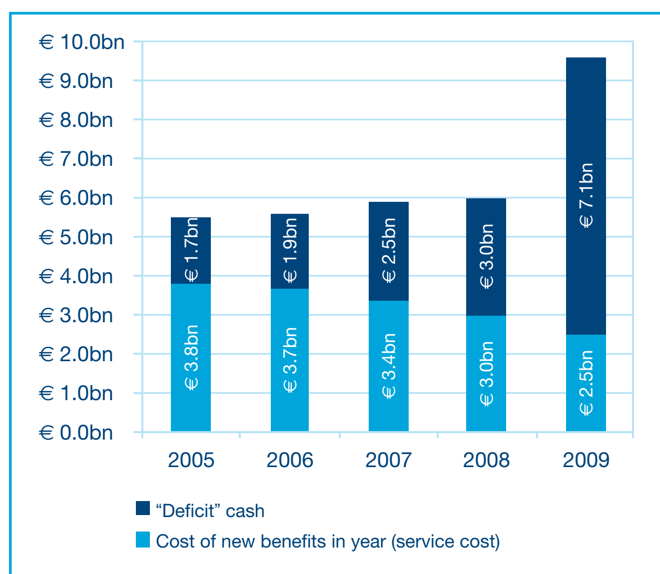

Figure 2. Cash payments to defined benefit pension plans split between cost of new benefits and deficits

Analysis

- Fourteen companies paid more cash into their defined benefit pension plans in 2009 than in 2008.
- Using accounting measures, half of the cash paid by AEX 25 companies over the last 5 years has been to tackle deficits with the rest to meet new benefits granted to employees.
- In 2010, based on published estimates, total AEX 25 cash should be lower, but eleven companies still expect to pay higher cash to their plans than in 2009 – the continuing legacy of 2008's market falls.

PwC insight

Companies indicate that the cash drain is one of the reasons why they are increasingly frustrated with their pension plans. The rising proportion of cash that is used to address the legacy of the past is one of the reasons why pensions have moved from an employee benefit to a financial challenge for employers.

Volatile pension costs – on the way out?

Company IFRS pension costs jumped from €1.2bn to €4.7bn in 2009, largely due to the deficits of 2008. 2010 will see a welcome fall in costs, but still higher than 2006-2008. Changes to IFRS, expected in 2013, will hit companies further with an increase in the long term costs for most companies.

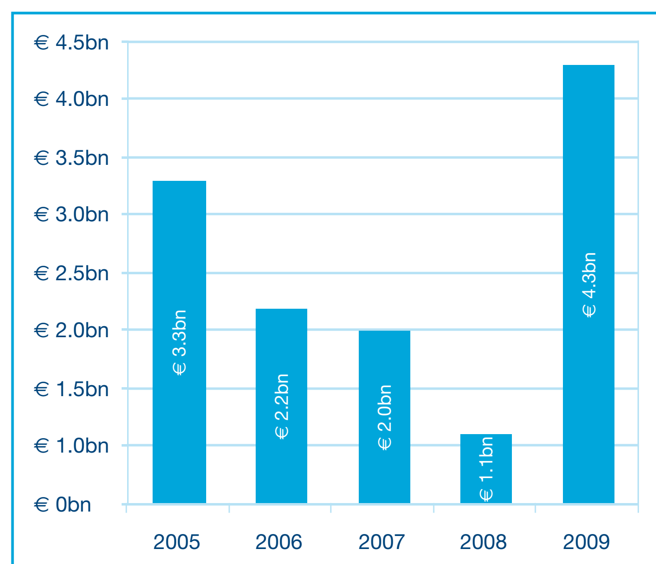

Figure 3. Total AEX 25 IFRS pension cost for pensions 2005-2010

Analysis

- Twenty-one companies saw a higher pension cost in 2009 compared to 2008, after adjusting for one-off items.
- This was largely a result of 2008's asset falls which meant companies could not take as much credit for the expected return on their pension plan assets.
- 2010 should see many companies cost fall – we estimate a total cost of €2.5bn to €3bn, largely due to higher asset values which companies can take credit for in the cost.

PwC insight

The International Accounting Standards Board (IASB) have already proposed changes to the standards used for accounting for pensions. These changes will remove much of volatility in costs which is a source of frustration for companies. However, long term costs will be higher as the new standard limits the extent to which companies can take credit for the expected return on their equity investments.

PwC contacts

PricewaterhouseCoopers has a successful track record in addressing corporate pension challenges given our breadth and depth of commercial, financial, legal, HR and pensions expertise.

If you wish to discuss the information contained in this document or how we can help you, please call your regular contact or alternatively:

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