



Poisoned chalices? The importance of understanding corporate pension fund trust deeds

Several recent corporate transactions, both proposed or completed, have raised concerns about the powers that trustees of certain pension schemes have over contribution levels, either generally or under specific circumstances (e.g. the change of control of the fund sponsor). For example, Time Warner and Apax were both reported to have been deterred from making a bid for ITV earlier this year because of such concerns; investors also walked away from both WH Smith and M&S, in part due to those companies' pension fund liabilities.

For various reasons, these and similar cases have generated a lot of comment in the media. Insight has already identified schemes that are not fully funded and taken this factor into account in our valuations. Our principal concern is to understand what would happen to companies with under-funded pension schemes in a take-over situation.

The trust deeds of some pension schemes allow trustees to require the target company to make up any deficit immediately, thus potentially substantially reducing the funds available to shareholders. The new Pension Protection Fund – created by the Government this year to pay compensation to members of defined-benefit pension schemes in the event that those schemes are insolvent – also has similar powers to require companies to plug funding gaps. (Insight is one of the two asset managers selected to manage this fund.)

Over the summer, Insight wrote to nine companies in which we invest to ask them to provide us with specific information

about their pension fund provisions and liabilities. We asked companies to explain the following:

- The extent to which trustees of the pension fund are empowered to determine or set the level of regular contributions or special payments from the sponsoring company.
- Whether there are specific circumstances under which the trustees of the pension fund have further or additional powers in respect of setting contributions from the sponsoring company.

The companies' responses varied significantly. Some companies responded in detail and most were able to fully reassure us that we had no reason to be concerned about the status of the pension fund in a take-over situation. In those cases, we did not adjust our valuations or investments.

However, one company refused to answer our questions, having taken legal advice. This rang loud alarm bells and added to our suspicion that we could face significant losses in the event of a take-over. In this case, it confirmed our view that we should not invest in the company.

In the coming quarter, we intend to write to many more companies held in our portfolios to ensure that we have fully and diligently evaluated the potential for hidden liabilities should these companies be subject to a take-over bid.

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