SOCIETY OF ACTUARIES

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*Response to McCrory-Bartel Discussion of Bader-Gold*

1. McCrory-Bartel comment that by moving its pension fund from equities to matching bonds The Boots Company is "virtually guaranteeing itself higher pension contributions than would have been the case with a significant equity portfolio".
2. As Head of Corporate Finance at The Boots Company and Member of the Pension Fund Investment Committee I would like to respond to this comment.
3. McCrory-Bartel are right, as far as they go, that if Boots Pension Fund holds bonds, not equities and equities outperform bonds, the Company's cash contributions will be higher. So far, so obvious.
4. We should not forget, of course that regulations require the injection of cash to maintain solvency, which may be at inconvenient times. Boots was also, by good luck of timing, able to lock-in a surplus, selling equities near their peak, which maintains contributions at their current level for the long run.
5. These are mere quibbles. Since the purpose of Boots is to create value for its shareholders, the real question should be "Is shareholder value reduced or increased by moving to matching bonds in the pension fund?"
6. Pension fund asset allocation, equities versus bonds, has no first-order impact on shareholder value. By holding equities in its pension fund Boots is doing nothing that the individual shareholder cannot do directly. The shareholder can thus adjust her own portfolio in response to Boots' move by selling bonds in her portfolio and buying equities to retain her chosen equity/ bond balance.
7. Moving to matching bonds has some second-order advantages, which materially increase shareholder value.

- Dividend tax credit – Individuals continue to receive a dividend tax credit, which was removed for pension funds in 1997. This means under the UK tax system it is more tax efficient for individuals to hold equities.
- Increase in gearing – By reducing pension fund risk, Boots has been able to increase risk directly by repurchasing £300m of its own shares, within the same credit rating from Standard & Poor's and Moody's. This in turn creates shareholder value by replacing equity with debt.
- Reducing transaction costs and management time – The transaction costs have also been slashed from about £10m to £0.3m per annum.
- Reducing agency costs – Increasing transparency allows shareholders to focus on Boots' operating performance, without any pension distortions.

In concentrating on shareholders we should not forget the 72,000 members of the Pension Plan. Their security has been increased, since the value of Fund assets should always be enough to pay all accrued pensions regardless of movements in financial markets.