Case Study 2

2.5.1 Kingspan Pension Risk Management Exercise[1]

Unit:	Study Unit 3 – Strategic Treasury Solutions
Case:	Case 2 – Treasury evolution
Date:	1 September 2016
Summary:	Questions relating to the management of risk and corporate finance with regard to defined benefit pension schemes in Kingspan.
Key words:	pensions, risk, debt, cost of capital, WACC

Question 1
Comment on the extent to which the pension deficit should be regarded as "free" debt; how would you recommend that it should be factored into cost of capital estimates?

Student notes
Consider:

- Points for and against the pension deficit's status as debt
- Whether strictly it belongs in WACC calculation
- If it is in the WACC calculation, what interest rate should be attributed to it?
  - For instance, pension fund liabilities imply a discount rate – so use this?
  - Or use a cost of borrowing – after all if the pension liability was made good, the company would borrow (or take cash off deposit) to do so.
  - Or some other rate?
- If the company brings the pension deficit into the WACC calculation, what are the implications for the treatment of other liabilities?

Question 2
Comment on the risks for Kingspan plc inherent in the pension fund, both financial and non-financial.

Student notes
Consider:

- Financial – Interest rates, Inflation, Equity, Mortality, basis (accounting versus regulatory versus buyout versus triennial valuation), credit – sponsor company unlikely to be Kingspan plc and need to protect sponsor "covenant"

[1] Post your responses to the various questions and discuss your thoughts and responses in the Case study 2 forum in light of the answers posted by fellow group members and the model answer released by the tutors. You are expected to post during the Case study 2 timeline – see course site U3/Case 2 for dates.

- Non financial – power of trustees to force action or veto action (such as the sale of the business or an acquisition) conservatism forced on trustees by law, PPF attitude and levy (Dunn and Bradstreet[2] influence), conflicts between parties (deferred pensioners, pensioners, employee members, trustees if officers or senior management of sponsor, shareholders, lenders)

[2] Dunn & Bradstreet is a UK commercial (but not financial) credit rating agency appointed by the UK Pensions Regulator to assess sponsors' credit standing.