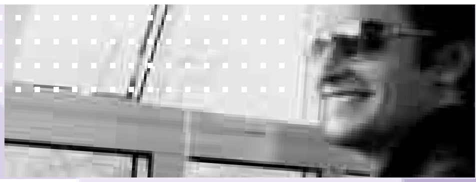
Dimension

giving you the **facts** about your pension

April 2004
Issue 10 (active members)
Issue 9 (deferred and pensioner members)

Road to **recovery**



This special issue of 'Dimension' is a joint trustee and company announcement. We have produced it to tell you about:

- **the company's commitment to improve the ALSTOM Pension Scheme's funding level;**
- **the results of the valuation at 5 April 2003; and**
- **ALSTOM Holdings' support for the scheme (our parent company).**

The company have proposed a recovery plan to restore the scheme's funding level, after the trustees' actuary found a deficit (not enough money to cover the benefits it owes).

Many other UK pension schemes are in the same position, at least partly because:

- investment conditions have been very difficult over the past three years; and
- people are living longer.

It's important to remember that a valuation gives a 'snapshot' of a scheme's position on just one date. And, valuations done for different purposes will produce different results – none of them is a 'right' result.

According to the Government's standard measurement of pension scheme funding, the Minimum Funding Requirement (MFR), the scheme was fully funded at 5 April 2003. But on the same date, using more cautious assumptions, the trustees' actuary estimated that it had a deficit. (You can read more about valuations and assumptions inside.)

The joint review

As we mentioned in the last issue of 'Dimension', the company and the trustees are carrying out a joint review. Work is still going on, but here is a summary of what they have agreed so far.

	Contributions	Investment	Benefits
Short term	The company will pay: ● regular contributions (8% of members' salaries) to keep the scheme 100% funded according to the MFR; ● £9 million for discretionary benefits which have already been granted (agreed by the company and the trustees).	The trustees will switch 5% of the scheme's investments from shares to bonds (to reduce the risk that the scheme's value will fall in the short term).	The trustees and the company have decided to temporarily stop agreeing to future early retirements. If you are already retired and receiving a pension from the scheme, this does not affect you.
Longer term	The company will start paying extra contributions each year (aimed at restoring the funding level) after April 2005.	The trustees and the company will carry out 'asset/liability modelling' to find the most suitable investment strategy for the future.	The trustees and the company will look at how to balance the amount of money that comes into the scheme with the amount it pays out.

ALSTOM

The valuation results

The trustees' actuary, Ian Skinner of Watson Wyatt LLP, carried out a valuation using information that was current on 5 April 2003. The results show that the investment returns were lower than predicted, while the liabilities are higher than predicted.

Here is a summary of the results:

- The actuary's valuation showed a deficit of £406 million at 5 April 2003. This is higher than the deficit shown in the company accounts at 31 March 2003 (which was measured in December 2002), because the trustees' actuary worked it out using more cautious assumptions and up-to-date membership information. This represents a funding level of 70%. (Look inside, under 'What is a valuation?' for more about the funding level and assumptions.)
- The Government's standard measurement of pension scheme funding, the Minimum Funding Requirement (MFR), showed the scheme with a funding level of 101% at 5 April 2003. This means that the company is not legally obliged to pay more than the amount needed to keep the funding level at 100% on the MFR.
- If the scheme had closed on 5 April 2003 and no new benefits had built up from that date, the funding level would have been about 54%.

What's happened since?

Since the valuation date, investment performance has improved and the value of the scheme's assets has risen. The trustees' actuary will see if this has improved the funding level when he carries out his yearly check with information current on 5 April 2004.

What happens next?

The trustees and the company have been discussing how to:

- reduce the deficit; and
- increase protection for members while the scheme has a deficit.

We explain more about what the trustees and the company are doing opposite, under 'The joint review'.

Open to find out how a valuation works

A commitment from ALSTOM Holdings

ALSTOM Limited's parent company in France, ALSTOM Holdings, have given their commitment to the ALSTOM Pension Scheme. Although the company are recovering from a difficult time for the business, they have confirmed their support for the scheme.

The joint review

The trustees and the company are working to agree a long-term plan for the future of the ALSTOM Pension Scheme. The joint review covers benefits, contributions and investment.

The joint review working group has met several times and has agreed these things:

1 The company are committed to reducing the deficit.

2 The company have guaranteed to make extra contributions to the scheme, starting in 2005. Every year, at 31 December, the company will check the funding level and change the extra contributions, if necessary. The company expects that, over the long term, the deficit will be completely cleared by a combination of extra payments and higher investment returns. It is normal to take a long-term view of pension schemes.

If ALSTOM Limited cannot make the extra payments over the next five years, ALSTOM Holdings will make them.

3 The company have confirmed that they continue to support the scheme. Neither the trustees nor the company want to do anything that will cause the scheme to be wound up.

4 The company and the trustees' actuary will carry out a review of the scheme every year.

5 The trustees and the company agree that the scheme needs to control the amount it pays out. To protect members' interests, the trustees and company have decided to temporarily stop agreeing to future early retirements.

6 The company have agreed to appoint an independent chairman for the trustee board. On 23 March 2004 they appointed Nick Salmon, the former executive vice-president of ALSTOM Holdings, as a temporary chairman of the trustees. This follows Paul Barron's resignation. They will be looking for a suitable permanent independent chairman over the next three to six months.

7 The company have an interest in the scheme's investment strategy, as they pay contributions to the scheme, and carry some of the risk that the investments may lose money. So, a company representative has joined the scheme's investment committee.

ALSTOM Holdings have guaranteed that:

- They will meet all the obligations of the ALSTOM Pension Scheme.
- They will not take any action that will cause the scheme to be wound up.
- They will continue this support for a minimum of five years. By this time the other actions the trustees and company are taking should be improving the scheme's position.
- In return for this commitment, they have asked the trustees to invest at least 47.5% of the scheme's assets in shares. (Please note that the scheme does **not** invest in ALSTOM shares.)
  You can read more about shares and bonds inside.

What is a **valuation?**

A valuation is a formal 'health check' of the scheme which must happen at least every three years. The trustees' actuary compares the value of the scheme's assets with its liabilities to work out the funding level.

In a valuation, the actuary looks at all the information about the scheme at a certain date. He works out the value of the assets on that date. Then he looks at the liabilities, including:

- the pensions the scheme is currently paying;
- the benefits which have built up to the date of the valuation (the 'past service' benefits); and
- the benefits which are likely to build up in future.

To do this, he needs to make assumptions about certain things.

These include:

- how many scheme members will work for the company until they retire and how many will leave;
- how long members will live after they retire, which is the length of time the scheme must pay them a pension; and
- how much inflation will be in future, which can affect how much pay rises and pension increases will be.

Different assumptions are used for valuations done for different purposes (see 'Different purposes, different results' above right).

The assets are everything the scheme holds, including investments and bank balances.

The liabilities are everything the scheme needs to pay out. Almost all the liabilities are your benefits, but they also include things like administration fees.

The funding level is the ratio of assets to liabilities.

April 2003

9,308 active members

7,380 deferred members

9,790 pensioners

Investment returns for the year (excluding property)

-10.2%

Value of scheme

£936 million

A valuation is a 'snapshot' at one particular date, and based on one set of assumptions. It is based on things that can change regularly – like the number of members, and investment returns. Since April 2003, the scheme's value has gone up again.

December 2003

6,093 active members

9,807 deferred members

10,220 pensioners

Investment returns for the year (excluding property)

17.0%

Value of scheme

£1,023 million

Different purposes, different results

Valuations are done for different purposes, and this can affect the results. It is normal to have a range of views on a scheme's funding level, and no one result is the 'right' result.

Actuary's valuation

This valuation works out the funding level that is shown in the scheme's valuation report. This uses more up-to-date information on the scheme's liabilities and more cautious assumptions than the accounting valuation (see below). This valuation showed that the scheme's assets were worth £936 million with a deficit of £406 million at 5 April 2003.

Accounting valuation

This valuation works out the funding level that is shown in the group accounts. ALSTOM uses an international accounting standard to do this.

On 31 March 2003 (but calculated at 31 December 2002) ALSTOM's group accounts showed the scheme was worth £919 million, with a deficit of £178 million.

Investment returns were higher in the second half of 2003. We will know whether this has improved the funding level when the actuary carries out his yearly check of the scheme, using information current at 5 April 2004.

Minimum Funding Requirement (MFR)

This is currently the Government's standard method of measuring pension scheme funding levels. All schemes must have an MFR valuation. If the funding level measured by the MFR is less than 100%, the trustees and the company must take action to restore it to 100% within 10 years. If it is less than 90%, they must take action to raise it above 90% within three years. Our scheme's MFR level was 101% at 5 April 2003.

Because pension schemes are so different from each other, the Government plans to bring in a more 'scheme-specific' way of measuring funding to replace the MFR.

The Pensions Bill, which is currently going through Parliament, includes a proposal for a 'statement of funding principles' for each scheme. This must be drawn up by the trustees and agreed with the employer. The Government is aiming for the Pensions Bill to become law by the end of this year.

Discontinuance valuation

The actuary works out what the liabilities would be if the scheme closed on the date of the valuation. This means that no new benefits would build up – either for new members or existing members. But, the scheme would carry on paying benefits.

Finding out the funding level

If the actuary finds that the assets are enough to cover the liabilities, the scheme has enough funding. But, if the assets are not enough to cover the liabilities, the scheme has a deficit.

For the previous valuation, the trustees' actuary used information about the scheme which was current on 5 April 2000. He found that the scheme had enough assets to cover its liabilities at that date. In fact, it had more than enough – around £18 million more.

But since then, some things have changed. The biggest change is the fall in the value of the scheme's investments because of the fall in the value of shares. In the three years from April 2000 to April 2003, the scheme's investment returns were lower than the actuary had assumed in the previous valuation. This had an impact of about £400 million on the scheme's value. Many other pension schemes have also suffered in this way.

Also, people are living much longer after they retire. They are drawing their pensions for longer than the actuary has predicted in the past. This has increased the scheme's liability by about £170 million.

These developments have had a large impact on the scheme, and have been taken into account in the current valuation.

A finely tuned **balancing act**

Wind-up valuation

The actuary works out what the liabilities would be if the scheme was wound up on the valuation date. This includes the cost of buying insurance policies to provide the scheme benefits.

At the moment, the trustees have no intention of winding up the scheme, even if ALSTOM no longer existed.

Paying in and paying out

Some people have asked how the scheme can carry on when the contributions it receives are lower than the benefits it pays out. The actuary takes this into account when he is carrying out the valuation. Some important things to remember are:

- As a pension scheme matures (the number of pensioners increases while the number of active members decreases) the scheme expects to pay out more than it receives in contributions.
- Contributions are only one part of the scheme's funding;
- Pensions build up over a long time, giving the scheme's assets time to grow through investment.
- The actuary looks a long way into the future when he is working out how much money the scheme will need to pay benefits.

Building up – how investment plays its part

Pension schemes are funded by contributions by the employer and the scheme members, but this is not the whole story. These contributions (which form part of the scheme's assets) are invested, with the aim of making them grow over a long time. Investment growth is a vital part of the scheme's funding.

There are different kinds of investment, which grow in different ways.

Here are the main ones:

Shares
If you buy shares, you are buying part of a company. Share investments grow by increasing in value and by reinvesting the dividends (profits) the shares pay. Shares can also lose value (sometimes very quickly) and can become worth less than you paid for them. During the last three years, the value of shares has fallen all over the world. But in the past, over a long time, shares have grown more than any other kind of investment.

A scheme with lots of active members a long way from retirement will not have to pay out pensions for many years. This makes shares a suitable investment. The risk of shares losing short-term value can be balanced against their potential for long-term growth.

Bonds
If you buy bonds, you are lending money to a company or the Government for an agreed length of time. Bond investments grow by building up interest. If you invest in bonds you are less likely to lose money than if you invest in shares. But in the past, over a long time, bonds have grown more slowly than shares.

Bonds pay an income which tends to be similar to the cost of paying pensions. This makes bonds a suitable investment for schemes with lots of pensioners, as they replace the assets paid out as pensions.

Property
Property tends to increase in value over a long time, though it can lose value in the short term. One of the most useful things about property is that it can provide regular income from rent. Our fund invests in commercial properties (shops, offices and warehouses, rather than homes).

Cash
Investing in cash is like having a bank or building society account. The cash keeps its original value (called the capital value) and grows by earning interest. But over a long time, inflation can take away some of its value. Cash is usually only used for short-term investments.

Changes to the investment strategy

Short term

- The trustees are switching 5% of the scheme's assets from shares to bonds immediately. By doing this, they aim to reduce the risk of losing money if shares fall in value. The scheme does not invest in ALSTOM shares.
- They will keep at least 47.5% of the scheme's assets invested in shares (ALSTOM Holdings, the parent company, asked for this to be done in return for supporting the scheme. This is because higher long-term investment growth is important to the company's recovery plan).

Longer term

The trustees will carry out an 'asset/liability modelling' study to decide a suitable long-term investment strategy for the scheme. They aim to find the best combination of investments to keep the scheme's funding level topped up, so that it can carry on paying out pensions in future.

To do 'asset/liability modelling' you need to:

- Estimate how the scheme's membership could change in future (for example, that the number of pensioners will increase while the number of active members decreases).
- Look at how different combinations of investments could perform in future.
- See which combination gives the best balance between risks and returns for your scheme members' needs.

The trustees and the company will continue to look at market conditions to see when they are favourable for making further investment changes.

Controlling costs – making sure there's enough to go round

Short term

On 23 March 2004, the trustees and the company decided to stop agreeing to future early retirements for a temporary period, until the results of a wider review are known. This will not affect anyone retiring early because of ill health, or anyone who has a contractual right to retire early.

The trustees have already reduced transfer values from the scheme (last August). They did this to be fair to all members, so that if you transfer your benefits out you don't take more than the minimum amount allowed, leaving less to go round the people who are still in the scheme. These lower transfer values will not change for the time being. If you are considering a transfer, you should remember that it would not currently represent the full value of your benefits.

If you have recently contacted ALSTOM UK Pensions to ask for early retirement, you should receive a letter from us to let you know if any of these changes affect you.

Longer term

Over the next three months, the trustees and the company will look at ways of reducing costs and conserving the scheme's assets.

If you are a pensioner

If you are receiving a pension from the scheme, none of these actions will affect you directly. You will continue to receive your pension as normal.

Do you have funds in the Additional Benefits Scheme (ABS)?

The trustees have agreed that, if you want to, you can move your existing ABS funds to the additional voluntary contribution (AVC) scheme provided by Friends Provident. You will receive a letter telling you how to do this in the next few months.

Protecting **your benefits**

What the law says

Company pension schemes are set up under trust, so that their assets are separate from company finances.

- If a solvent company wanted to wind up its pension scheme, the company would owe the full amount needed to provide benefits.
- If a company became bankrupt, an independent trustee would be appointed. They could decide to carry on running the scheme as a closed scheme (and paying all benefits), or wind it up. If they wound it up, they would have to pay benefits in a certain order (see 'Who gets what if a scheme winds up?')
- If the scheme's funding level were less than 100% of the MFR, by law the company would owe the amount needed to bring the funding level back up to 100%. The independent trustee would claim the money from the company.

Who gets what if a scheme winds up?

Under current rules, schemes must provide benefits in this order:

1 Benefits from additional voluntary contributions (AVCs).

2 Current pensions, including increases.

3 Benefits for active and deferred members

The Government is looking at changing the order so that increases for pensioners come after active and deferred members' benefits. How much active and deferred members receive will depend on how long they have been a member. The Government has not yet announced when the order will change.

The Government is also proposing a Pension Protection Fund (PPF) to compensate members of final salary schemes if the scheme cannot pay their benefits.

What happens next?

In the next issue of 'Dimension' we'll tell you about the progress we are making, including:

- the company's recovery plan; and
- the investment strategy and 'asset-liability modelling' study.

Find out more

We hope this 'Dimension' has given you a clearer picture of the current position of the ALSTOM Pension Scheme. But, we understand that there will be things you want to know more about.

You'll find more information on our website, including 'questions and answers' about the valuation and the joint review. You can get to the website in two ways:

- From the company intranet: **iww.pensions.alstom.com**
- From the internet: **www.pensions.alstom.co.uk**

If you can't find what you want on the website, or you'd prefer to speak to someone, please contact ALSTOM UK Pensions.

Write to: ALSTOM UK Pensions, PO Box 2229, Rugby, Warwickshire CV21 2YP

Or, phone: 01788 557402
01788 557403

You can also contact your ALSTOM Pension Consultative Committee (APCC) representative. If you have any questions or comments for the trustees or the company, please pass them to your APCC representative as there will be an APCC meeting towards the end of April. The last issue of 'Dimension' for active members included a full list of the current APCC representatives.

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