

**FOR IMMEDIATE RELEASE**

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## **UK PENSION FUND INVESTORS ADVISED TO TAKE PRECAUTIONARY MEASURES**

**LONDON:** 19 September 2008 – Buck Consultants (Buck), an ACS company and one of the world's leading human resource and benefit consulting firms, today issued an advisory note to pension clients recommending key actions that should be considered in the prevailing circumstances. Most UK pension schemes have not suffered significantly from direct exposure to the most extreme result of the turmoil in global financial markets, namely Lehman's bankruptcy. However, Buck believes that pension funds face a heightened level of risk with regard to the health of capital markets, including core equity and fixed income markets.

Steven White, Head of Pensions and Investment – London, of Buck Consultants states:

“Exposure of UK pension funds to date appears to have been small and predominantly within passive equity and bond portfolios, and our primary advice to clients is to maintain existing positions as disinvestment would incur significant transaction costs and may be unnecessary.

“However there are a number of other recommendations for UK pension fund investors.

“We advise that any new net cash contributions be held back in high quality short term cash funds, as opposed to investment in the capital markets.

“Exposure to government debt should be maintained, although we note that the risk associated with these assets is rising as governments take on the financial liabilities of failed private sector institutions.

“Although short-term inflation expectations may be close to peaking, we would maintain strategic allocations to index-linked and other inflation-hedging assets, such as property.

“It is likely that some hedge fund managers will suffer as a result of the recent turmoil; back office functions will be stretched and many have moved to risk-averse positions. Therefore, we would suggest that planned additions to hedge fund allocations should be delayed until market conditions have stabilised.

“There is a stronger case for active management of assets in this environment as managers not constrained by a benchmark have more flexibility to reduce or avoid investment in unstable sectors of the global market.

“It is important to review the expectations of portfolio returns achievable in the long term, although this should be done at a later stage once market conditions have subsided.

“Trustees should monitor particularly carefully the strength of employer covenants as the contagion spreads from the financial sector crisis, and any pending buy-out plans may become harder to implement.

“In summary, our advice is not to over-react to the current crisis but to take the above steps in order to address asset allocation most efficiently, and acknowledge that lasting effects are yet to emerge.”

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**Notes to editors:**

**Buck Consultants**, an ACS company, is a leader in human resource and benefits consulting with more than 1,500 professionals worldwide. Founded in 1916, Buck is an innovator in the areas of retirement benefits, investment advice, health and welfare programmes, human resource management, compensation and employee communication. News and other information about Buck Consultants is available at [www.buckconsultants.co.uk](http://www.buckconsultants.co.uk). Buck is an independent subsidiary of Affiliated Computer Services, Inc (ACS).

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***To accompany their advisory note to clients Buck Consultants has prepared a background briefing document for clients, which is reproduced below:***

**Background**

A prolonged period of low interest rates, an increased appetite for risk and the growth in derivative based structures contributed to the emergence of the so-called “credit crunch“. This was first triggered in July 2007 by burgeoning uncertainty about credit quality, stemming initially from the US “sub-prime” mortgage market. Since then markets have experienced bouts of sharply increased volatility, as equities, property and corporate bonds have fallen in value. Government bonds and index-linked gilts have been favoured in a “flight to quality” as

the era of cheap, plentiful credit and financial engineering began to unwind. Prices of gold, commodities, food and oil continued to rise for a time as an inflationary pressure built up, but these “real” assets are now also in sharp retreat.

As the crisis has developed, confidence in and between financial institutions has eroded sharply and the functioning of the money markets has been severely impaired.

Central Banks have had to intervene repeatedly by pumping liquidity into the money markets, bailing out financial institutions such as Bear Stearns and Northern Rock as well as cutting interest rates, dramatically so in the US. However, their actions have been constrained by the twin fears of increasing exposure to moral hazard and losing control of inflation.

Investors are now facing two linked threats. The first is a crisis of confidence in financial markets, which has reached a critical point this week. The second is the economic downturn: falling house prices, falling consumer confidence, tighter lending conditions, inflation in fuel and food costs, and rising unemployment. This latest round of financial turmoil is likely to delay any economic recovery, and may exacerbate the scale of the economic setback.

In our previous updates for clients, we laid out the background to the crisis in more detail and warned of the potential for a significant bear market with high profile casualties.

Our views communicated in February 2008 still hold good: “the downside risks associated with equity investing have increased. The outlook for banks remains highly uncertain, as exposures to mortgage lending and structured investments continue to unfold. Projections for corporate earnings growth still look optimistic, as falling values of property and other assets affect consumers in the major economies.

“We believe that the double digit returns on equity markets that have supported pension scheme funding levels over the last few years will not be repeated over the next few years. The risk/return balance for equity investment has deteriorated.

“Property is in the throes of a sharp fall in valuations but opportunities for long term investors may emerge from the turmoil.”

### **Recent events**

Financial institutions continue to suffer from severe losses emanating from write-downs of mortgage related debt. Earlier this month Fannie Mae and Freddie Mac, the two companies that back half of the outstanding mortgages in the US, failed to secure funds to cover losses. They were taken over by the US Federal Reserve, in effect nationalised, on the 7 September 2008. This triggered a large scale technical credit default which will take significant effort to unwind and settle.

Just a week later it emerged that Lehman Brothers, once the fourth largest investment bank in the US, was having trouble securing financing. This time however, there was no Fed backing and Lehman Brothers filed for Chapter 11 bankruptcy on 15 September, becoming the largest casualty of the credit crisis to date. The root cause remains the ongoing US mortgage-backed market, where Lehman Brothers was the biggest underwriter. This also represented the largest ever bond default, dwarfing Worldcom, Enron and others. The fate of Lehman emphasised that the authorities were willing to allow even large and important institutions to fail.

The same day it was announced that Merrill Lynch, having suffered \$52.2bn of sub-prime related write-downs, had been acquired by the biggest consumer bank in the US, Bank of America. The final news of the day was that AIG, the US's biggest insurance company, was also desperate to secure short term funding. The Fed announced a takeover of AIG on the morning of 17 September, again using public funds, in order to preventing it from filing for bankruptcy.

The impact of these events has led to sharp falls in global share prices over the past few days and record widening of credit spreads (the additional implied by the price of corporate as opposed to government bonds).

Central banks, in particular the Federal Reserve, the Bank of England and the European Central Bank have added liquidity to the money markets. Ten major global banks, including Bank of America, Barclays and Goldman Sachs have set up a further \$70bn liquidity pool.

The short term impact is clear, risk premia have increased. The prospects of slowing economic growth and recessions in the major regions have not changed fundamentally but interest rates could be cut sooner than expected. Currently, beyond the immediate market reaction it is difficult to foresee exactly what the implications for the global real economy are likely to be. Markets should draw some comfort from the fact that the US Treasury has so far dealt with the problems relatively well.