LIVERPOOL VICTORIA

Accounting Standards Board
Aldwych House
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7 July 2008

Dear Sirs

THE FINANCIAL REPORTING OF PENSIONS

You asked for comments on the PAAinE discussion paper on the financial reporting of pensions and we are pleased to make a contribution to the debate as trustees of a £750m defined benefits scheme operating in the UK.

Firstly, we are greatly in favour of any initiative to make the reporting of pensions more transparent to both the members of pension schemes and shareholders of companies sponsoring such schemes. It is our view that the reporting should be symmetrical between both sides; that is to say that both sides should have the same view of the financial position of the scheme. Having said that, there may be valid differences of opinion between the view of both sides on, for example, issues such as mortality which could be regarded as (and disclosed as) reconciling items between the two positions.

Where we do have difficulty with the discussion paper is on the treatment of a pension deficit (at least in part) as an asset representing the employer's covenant. We do agree that the employer has a liability to the scheme to fund a deficit and should therefore include that liability in its accounts at the current value. It is therefore tempting to take the line that this liability of the employer is reflected via an asset in the scheme itself, but it is not at all obvious how trustees could place a reliable value on this asset, even though they will, of course, concern themselves with the security of payments due from the employer. Indeed this will be a key consideration in any arrangement with the employer on contributions, whether the scheme is in surplus or deficit.

It is normal for deficits, particularly large ones, to be funded over time periods of 10 years or longer. Even with a high quality employer, there is some risk of insolvency over that time, so it may not be safe to value such an asset at 100% unless the deficit is immaterial or had subsequently been funded. There have been too many high profile corporate failures to allow trustees to make heroic assumptions about the funding of deficits without having done

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the appropriate work to satisfy themselves that the employer is indeed 'good for the money' and remains so while the deficit persists.

The question that trustees need to answer to be able to value the employer's covenant is, 'Can the employer afford to fund the deficit as it develops over time?' rather than, 'Can the employer afford to fund the current deficit?' It would be normal in the insurance world to value such an asset using a stochastic model running multiple scenarios of the employer's and pension scheme's balance sheets over appropriate time periods under various economic assumptions, and assuming relevant management actions by both the employer and the trustees, to establish a best estimate loss position. This would not only model the ability of the employer to pay but also the size of the deficit that needed funding. This is impractical not only for the obvious cost implications but also because a pension scheme is very unlikely to have access to the employer's detailed business plans, while any model of the employer defined by the scheme would not be auditable. In addition the additional complexity involved if there were to be multiple employers would be very significant.

Apart from the general point that any valuation based on a model is only as good as the model itself, the key issue is that it is only with the active (and auditable) participation of the employer that the value of their covenant can be calculated. That participation is unlikely to be forthcoming for sound commercial and ethical reasons. In other words, the value of the covenant is not capable of accurate assessment by the pension scheme.

Accordingly, we do not support the statement in Chapter 11, paragraph 7.9 and would urge that any deficit is left as just that, with any future contributions being ignored on the balance sheet. The promise of future contributions would be a useful disclosure in relation to the deficit but should not be taken as having a present value.

We hope this contribution to the debate is useful and please feel free to contact us for clarification of our views.

Yours faithfully

Michael Allen
Trustee
Liverpool Victoria (1994) Staff Pension Scheme