

# ELECTRICITY PENSIONS SERVICES LIMITED

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Dear Sirs

## **Discussion Paper – The Financial Reporting of Pensions**

1. We welcome the opportunity to respond to the ASB's discussion paper on the financial reporting of pensions.
2. This response is made by Electricity Pensions Services Limited (EPSL), the central administrator for the Electricity Supply Pension Scheme (ESPS), and should be attributed to EPSL rather than to the ESPS.
3. The ESPS is a top five UK occupational pension scheme by value of assets under management and has some 232,000 members (including DC and EPB only members). It is primarily a DB two-tier scheme, currently comprising 21 actuarially independent sections (Groups) each with its own Group Trustees and Principal Employer.
4. Because of the diversified structure of the ESPS, different views may be taken on the various elements of the ASB's proposals by different sponsoring employers and trustee bodies, some of which may take the opportunity to respond to you directly.
5. In this response we first comment on what we consider to be the six main proposals in the discussion paper, and then add some general remarks.

## **Proposal – Consideration should be given to the Exclusion of Discretionary salary increases when calculating Scheme Liabilities (Chapter 2, Question 1)**

6. We agree with this proposal. Employers often have considerable discretion to make future salary increases non-pensionable.

## **Proposal – Pension Liabilities should be Discounted at the Risk-Free Rate (Chapter 5, Question 6)**

7. We disagree with this proposal. The effects would be to increase reported liabilities in an unjustified way. The lesson of history is that over the long term a risk-free discount rate is unwarranted, and pension schemes have very long term liabilities.

8. We acknowledge that the current use of the AA corporate bond rate may be unsatisfactory because of market distortions, even though this equates to the rate the sponsor would pay if it wished to raise money to fully fund the pension scheme. Use of a swap rate plus 1 to 2 percentage points would be a more appropriate long term solution.

**Proposal – Actual rather than Estimated Returns should be reported in the Income Statement (Chapter 8, Question 11)**

9. We disagree with this proposal. The effects would be too volatile because of market sentiment and short term variations. For example, the share price of Marks & Spencer plc recently dropped by 20% in a single day because of poor quarterly sales figures. Snapshot point in time figures are misleading rather than informative where pensions assets and liabilities are concerned. In reality, pension scheme deficits/surpluses are relatively stable year on year unless large deficit repair payments are made. Estimated returns do however need to be assessed in a realistic way.

**Proposal – Employers in Multi-Employer Schemes should account for their share of the Scheme Liabilities (Chapter 10, Question 13)**

10. The ESPS is divided into sections or Groups which are separately accounted for and have ringfenced liabilities, and we obviously apply and support separate accounting for liabilities where this is the case.
11. Otherwise, we do not consider that a general rule can be applied. Multi-employer schemes may choose to operate on a risk sharing basis, and it may simply be impracticable to apportion liabilities accurately to particular sponsors.
12. We disagree with the proposal that contribution levels might be used as the basis for apportioning liabilities. This may be appropriate in some multi-employer schemes, but in other cases the proportions of active, deferred, and pensioner members between different participating employers may differ markedly.

**Proposal – Pension Schemes should account annually for the Liabilities on the same basis as the Scheme sponsor (Chapter 11, Question 14)**

13. We disagree with this proposal. Pension scheme accounts are an annual statement of transactions and assets, and are prepared for the benefit of trustees and members. Their primary purpose is as a stewardship document. Liabilities are separately calculated, usually triennially, and separately made available to trustees and members. The accounts are not like company accounts which are designed to reveal an annual profit or loss. The proposal has significant cost, confidentiality implications, would blur the boundaries between accountants'/auditors' and actuaries' responsibilities, and any added value in producing general purpose financial reports would not justify the effort involved. The inclusion of pension liabilities would require some form of actuarial valuation to be undertaken on an annual basis and result in a significant increase to the cost of preparing statements for members.

**Proposal – Pension Scheme financial statements should reflect an asset in respect of amounts potentially receivable under an Employer’s covenant and this should reflect the Employer’s credit risk (Chapter 11, Question 15)**

14. We do not believe that financial statements should include liabilities to pay pensions. If any deficit repair payment plan to match these liabilities was shown as an asset of the scheme, there would be major practical implications for trustees in reflecting credit risk and for auditors in having to confirm the reasonableness of estimates.

**General Remarks**

15. We believe that the ASB’s proposals would provide an unsound basis for decision making whether by investors, scheme sponsors, or trustees. It is not helpful to account for pension schemes as if they were just about to be wound up, when in most cases this is not so.
16. We consider that the proposals would unjustifiably increase the perception of scheme liabilities and deficits and would not result in increased usefulness for members.
17. We fear that adoption of the proposals would be yet another “nail in the coffin” of quality defined benefit pension schemes like the ESPS which have provided excellent and reasonably secure benefits for tens of thousands of members for many years. The behavioural impact of FRS 17 contributed greatly to the reduced use of defined benefit schemes with many employers closing schemes to new entrants.
18. We cannot support the adoption of accounting standards for pension schemes which, together with changes already made and other proposals currently under consideration, are likely to mean that in due course there are no pension schemes to account for.

**Conclusion**

19. We hope that you will find these comments helpful in your continuing consideration of your proposals.
20. Please regard these comments as confidential and do not make them available to third parties without our consent.
21. Please acknowledge receipt.

Yours sincerely

Richard Barlow  
**Managing Director**