The Financial Reporting of Pensions

TUC response to the PAAinE discussion document

Introduction

The TUC welcomes the opportunity to submit a response to the Accounting Standards Board's discussion paper The Financial Reporting of Pensions.

As Britain's national trade union centre, the TUC represents 6.5 million working people through its 59 affiliated trade unions but touches the lives of many more. The TUC is Britain's largest voluntary organisation. As well as working to raise the quality of working life, one of our main objectives is to promote social justice. This includes a direct interest in pensions policy in the round, where our priorities have been:

- ensuring today's workers are supported in saving for their pensions through compulsory employer contributions to good quality occupational schemes;
- to see today's poorest pensioners lifted out of poverty with a level income reflecting their contribution to society;
- indexing of the basic state pension to earnings;
- achieving recognition in the state system of the contribution made to society by women and carers with interrupted employment patterns.

In the national debate on pensions arising from Lord Turner's Pension Commission we stated that workplace pensions are one of the best ways of saving for retirement, building on a strong basic state pension. Ensuring the long-term sustainability of existing workplace arrangements is a key priority for the trade union movement. The TUC has been a key player shaping the post-Turner pensions landscape and are concerned about proposals in the discussion paper which could undermine confidence in schemes at the very time when the government is aiming to increase private and occupational pension savings.

The TUC response to the discussion paper is based on the feedback received from both pension scheme trustees and trade unions negotiating on pensions. Pension scheme trustees have an interest both from the point of view of the pressures on their scheme and their role in investing in companies and therefore it is necessary for them to understand company accounts.

We have limited our comments to the elements of the consultation on the measurement of liabilities. We have serious concerns that the requirement to place very high measures of liabilities onto employer balance sheets is a significant catalyst behind the flight of many employers from high quality defined benefit pension provision. Whilst we do not consider that accounting standards have been the driving force behind the majority of scheme closures, they have certainly been a contributory factor and are often cited as such by Finance Directors. We are in general opposed to changes being made which will add to these problems for employers. In addition to our concerns about the effect on members, we are concerned that some of the proposals will not be helpful to the users of company accounts - whether these users be investors (including other pension schemes), credit risk assessors or other Stakeholders. We believe that a best estimate approach should be used in assessing pensions disclosures as under or over estimation is unhelpful in placing a fair value on the organisation overall.

We hope these broad comments will assist in situating the responses below.

Should a liability to pay benefits that is recognised be based on expectations of employees' pensionable salaries when they leave service or on current salaries (including non-discretionary increases)?

In a company balance sheet, the aim is to place a value of the benefits accrued to date. This is quite different to the exercise of a funding valuation where we need to assess the amount which needs to be saved to provide security for member benefits. So in accounting terms, the cost of pension benefits earned in the year should be based on the current pensionable salaries. For a final salary pension scheme, as future pay increases are granted, an additional liability would arise in respect of past service. This would then be reflected in the P&L account for the year in question.

For deferred members, the employee's pensionable salary should be increased by statutory revaluation to retirement (a non discretionary increase).

There is an argument that in assessing the liabilities for accounting purposes, this approach of using accrued benefits plus future non discretionary increases assuming the member left immediately should also be applied to members currently accruing benefits (active members).However, in the UK, statutory revaluation reflects increases in line with the Retail Price Index, whereas employers often grant salary increases lower than this. Indeed many employers now base salary negotiations on a baseline linked to the Government's measure of inflation, Consumer Price Index. Allowing for RPI increases may overstate the liability in respect of current active members.

Do you agree that changes in assets and liabilities relating to pension plans should be recognised immediately, rather than deferred and recognised over a number of accounting periods or left unrecognised provided they are within certain limits (a 'corridor') approach?

We do support immediate recognition of all changes in both assets and liabilities as a way of ensuring accounts are transparent. Whilst spreading gains and losses might appear attractive, we believe it can obscure the position.

Do you agree with the paper's views in the measurement of liabilities to pay benefits?

No. The ASB state that "A company's financial statements should provide full and transparent information on the company's exposure to pensions, including any deficit." In our opinion, this objective is not met by the proposals put forward. In fact for many schemes using a risk free rate of return would dramatically increase the liabilities and the proposals would result in overstating the potential liability to the employer of the pension scheme.

In particular, do you agree that:

Regulatory measures should not replace measures derived from general accounting principles?

The requirements of the Statutory Funding Objective regime are to use prudent assumptions to assess the level of technical provisions required to meet the benefits of the defined benefit scheme. This should therefore overstate the cost to the employer of providing pension benefits. On this premise, the SFO measure of liabilities would not be appropriate.

The discount rate should reflect the time value of money only, and therefore should be a risk-free rate?

We totally oppose this proposal. The resulting liabilities in many cases would be higher than the technical provisions held for the SFO regime and, at the current time, for some schemes may actually be higher than the cost of buying out the benefits with an insurance company. On the grounds that accounting principles reflect a true and fair value, assumptions should reflect a best estimate basis, with the discount rate reflecting future investment returns on the actual assets held by the scheme. This approach would result in a scheme specific accounting basis, but the reality is that the actual cost of providing pensions is scheme specific and does reflect the actual investment strategy adopted by the trustees of the scheme.

Such an approach did exist, prior to FRS17, but was criticised for a lack of transparency. Surely the answer is in the level of disclosure required. Full disclosure of assumptions, together with sensitivity analyses, would provide analysts with sufficient information to interpret and compare pension accounting figures across companies.

Whilst a scheme specific rate might be preferable, we are conscious of the current basis for accounting which includes an objective (in so much as it does not differ from scheme to scheme) margin over a risk free rate of return in the form of the use of corporate bond rates. Unless a scheme is wholly invested in risk free investments, we do not believe there is any justification for removing this margin over risk free rates in calculating liabilities under the accounting standard.

We also have some concerns about a focus only on the discount rate in accounting figures. Our belief is that the basis as a whole should reflect a best estimate approach. Concentration only on the discount rate without considering elements such as mortality and member options, can produce accounting figures which whilst compliant, are inconsistent with the principle of best estimate.

Information about the riskiness of a liability (ie the risk that the amount of pension benefits will differ from today's expectations) is best conveyed by disclosure rather than adjusting the amount of the reported liability?

As mentioned above, we support further disclosure of sensitivity of the key assumptions including mortality.

Expenses of administering the plan's accrued benefits should be reflected in the liability?

We would support the separate disclosure of these expenses on the grounds of transparency.

Where employees have options to receive benefits in different ways, should the liability be reported at the highest amount or at an amount that reflects the probability of different outcomes?

Realistic assumptions should be adopted, which will not necessarily mean assuming that 100% of members choose to exercise the option to maximise or minimise the value of their benefits. For example, many schemes adopt cash commutation factors that do not provide actuarial equivalence to the value of pension given up. Despite this fact, many members choose to commute pension for cash. Assuming that no members commute pension for cash would overstate the employer's liability to the scheme, resulting in actuarial gains arising each time a member commuted pension for cash. Similarly many schemes offer members some choice over the age at which they can first take some or all of their benefits on an unreduced basis. As an example a member may be able to take their benefits unreduced at any age from 60 to 65. If the actual experience of the scheme is that members retire on average at 62 say, assuming that all members took the most valuable option and choose to receive benefit at 60 would overstate the liabilities.