ASSOCIATION OF CONSULTING ACTUARIES

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Financial Reporting Council
By email to: ukfrsreview@frc.org.uk

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Dear Sir

ACA FEEDBACK ON FRS 102

I am writing on behalf of the Association of Consulting Actuaries (ACA), in response to your public invitation to provide feedback on FRS 102.

Members of the ACA provide advice to thousands of pension schemes, including most of the UK's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given by members is subject to The Actuaries' Code issued by the UK actuarial professional body. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes in the UK.

The ACA is the representative body of consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

We welcome the opportunity to provide feedback on FRS 102. As actuaries it is only a few sections of FRS 102 that interact with the advice we provide to clients. Our feedback therefore relates to only a narrow section of FRS 102, namely paragraphs 34.34 to 34.48 which affect the financial reports of pension schemes.

The move from the previous UK GAAP to FRS 102 has introduced the requirement for additional disclosures in the annual accounts of pension schemes. In particular the requirement to place a value on annuity policies held by the scheme, analyse financial instruments using the fair value hierarchy and disclose the nature and extent of credit risk and market risk on those financial instruments. Each of these is addressed in turn below.

Valuation of annuity policies

The requirement to include a value of annuity policies held by pension schemes comes from paragraph 34.36 through its reference to paragraph 28.15(b). In our view the benefits to users of the accounts from including this information is usually very minor relative to the cost to schemes of obtaining valuations of annuity policies.

As actuaries we find ourselves as both assisting pension scheme trustees in the preparation of their accounts (for example, by providing an annuity valuation) and also as user of the accounts in carrying out our statutory duties as scheme actuaries (for example, in providing advice to trustees on funding of technical provisions in actuarial valuations). When acting as a user, actuaries are expressly permitted by pension scheme funding regulations to exclude the value of obligations that are matched by annuity policies (as well as the value of the annuity itself) or place a different value on the annuity policies to that shown in the pension scheme accounts (see SI 2005/3377, regulations 3(1)(c), 3(4) and 4(2)).

We are not aware of any practical issues caused in practice by not including the value of annuities in pension scheme accounts prior to the introduction of FRS 102

We appreciate that it is appropriate to include a valuation method for annuities in paragraph 28.15(b) insofar as it relates to the reporting the financial position of post-employment benefit plans in the accounts of employers. In that case the employer is recognising both the obligation covered by the annuity as a liability and the annuity itself as an offsetting asset. However for pension schemes the obligation to pay future benefits is excluded from the accounts by virtue of paragraph 34.47. Therefore we believe that a key reason for valuing annuities for the purpose of Section 28 of FRS 102 is not applicable for the accounts of pension schemes themselves.

Furthermore as there is no measure of the value of future benefits in pension scheme accounts, the cross-reference to paragraph 28.15(b) in paragraph 34.36 has a shortcoming since there is no "present value of the related obligation" in pension scheme accounts. We note that the Pensions SORP (2015) consequently provides further guidance on this (SORP paragraphs 3.12.20 – 3.12.24) and provides a degree of flexibility over how the annuities are valued.

For the avoidance of doubt, we are not suggesting any amendment to paragraph 34.47.

Fair value hierarchy for pension scheme assets

In our view the requirements of paragraph 34.42 strike a reasonable balance between the cost of disclosure and the benefits to users; particularly so given the amendment to this paragraph made in March 2016. Users of the accounts may find it helpful to understand the extent to which the disclosed value of the assets of a pension scheme has been based on judgement rather than observable inputs.

Disclosure of credit risk and market risk

We question the value of the disclosures required by paragraphs 34.43 – 34.46 given that generally:

(a) Most assets will be held by pension schemes to pay for defined benefit promises. As such the risks inherent in asset values only makes sense when considered in relation to how the values of those defined benefit promises move. For example, a scheme with more assets exposed to interest rate risk would generally subject its actuarial funding level to less risk (all other things being equal) than a scheme with less asset exposure to interest rate risk.

(b) Most of the remaining assets will be held by pension schemes to match the assets shown in scheme members' money purchase "personal accounts". In which case it is not the scheme but rather the individual members that are exposed to credit risk and market risk based on their choice of investments from the range offered by the pension scheme. These risks are better explained to members in pension scheme literature (for example, investment fund factsheets) rather than the scheme accounts.

In addition, UK pension schemes will commonly invest in certain types of investments for similar purposes. The disclosure of credit risk and market risk is therefore leading to the emergence of 'boilerplate' wording as schemes produce their first sets of accounts under FRS 102.

Therefore we suggest that the objective of paragraphs 34.43 – 34.46 be reassessed, possibly with a view to these requirements being removed. If the FRC is of the view that it is useful for these risks to be disclosed we would question whether the scheme accounts are the correct home for that disclosure. An actuarial valuation report, which contains information on both scheme assets and the value of future benefit payments, may be a better location to report this information for defined benefit schemes. The actuarial valuation report is available to scheme members in the same way that scheme accounts are available. This would also be more consistent with the guidance from the Pensions Regulator that pension scheme trustees should considers risks in an integrated manner: taking liability funding risks, investment risk and employer covenant risk together.

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We would be pleased to answer any questions you may have on our response.

Yours faithfully

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