

PRAG

PENSIONS RESEARCH ACCOUNTANTS GROUP

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Dear Jenny

Response to FRED 62 Draft amendments to FRS 102 Fair Value Hierarchy Disclosures

We welcome the opportunity to respond to the Exposure Draft FRED 62 Draft amendments to FRS 102 Fair value hierarchy disclosures.

The Pensions Research Accountants Group (PRAG) is an independent research and discussion group for the development and exchange of ideas in the pension field. Its efforts are concentrated mainly on the areas of reporting and accounting by pension schemes, but it has also produced reports on other matters when appropriate. PRAG's members work for pension funds, administrators, audit firms and other pension related professions. It therefore represents a wide cross-section of pension expertise. PRAG is also the SORP making body which publishes the Financial Reports of Pension Schemes A Statement of Recommended Practice (2015) ('the SORP').

We set out below our response to the questions asked in the Exposure Draft. We also provide further comments on the impact of the amendments on the SORP.

Question 1: Do you agree with the amendments proposed to FRS 102? If not, why not?

PRAG agrees with the proposed amendments. The PRAG SORP working party had requested these amendments at the time the SORP was being revised for FRS 102 (including determination of fair value as well as disclosure). PRAG is aware that a number of organisations such as global custodians, investment managers and pension scheme accounts preparers have already incurred costs preparing for the fair value hierarchy disclosures currently required by FRS 102. Had the FRC acted upon PRAG's request at the time of the SORP revision costs would have been saved by these organisations and the SORP would have been able to deal with the proposed amendments at the time of its revision rather than subsequently.

The proposed amendments are intended, amongst other things, to increase the consistency of required disclosures with EU-adopted International Financial Reporting Standards (IFRS). PRAG notes that whilst the main disclosure requirements are consistent the amendments do not address inconsistencies that may exist in related aspects, for example the definition of active markets. PRAG has not sought to identify all inconsistencies that may exist but suggests this area is considered by the FRC as part of the triennial review.

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PRAG also notes that the SORP included an optional disclosure for fair values determined under Category C to enable pension scheme financial statements to disclose investments whose value is determined by valuation techniques that rely significantly on observable market data (C(i)) and those whose value is determined by valuation techniques that use non-observable data (C(ii)). These align with the proposed amendments in FRED 62 in relation to Level 2 and Level 3 and therefore schemes adopting this optional disclosure will have information to meet the proposed disclosures. Schemes which choose not to adopt these optional disclosures will have to carry out further analyses in order to comply with the proposed disclosures including comparative re-analysis. Schemes reporting under the existing requirements should consider this when deciding whether or not to adopt the optional (C(i)) and (C(ii)) disclosures.

FRED 62 is proposing to amend fair value hierarchy disclosures only. The determination of fair value under FRS 102 is not being amended and will be reviewed as part of the FRS 102 triennial review. There is therefore an inconsistency between fair value determination and fair value disclosure. PRAG would prefer to see both determination and disclosure amended at the same time. However, as commented on further below, the mapping of the current FRS 102 fair value hierarchy to the amended hierarchy is relatively straightforward and therefore whilst consistency between determination and disclosure would be desirable it is not a reason to delay the proposed changes.

Question 2: Do you agree with the proposed effective date for these amendments? If not, what alternative would you propose?

PRAG agrees with the proposed effective date for the amendments and the comments made in FRED 62 regarding early adoption. PRAG notes however that the timing of FRED 62 means that there is some uncertainty for accounts for years ending 31 December 2015 and 31 March 2016 as accounts preparers must decide now whether to prepare fair value hierarchy disclosures in accordance with FRS 102's current or amended requirements. PRAG also notes that there will be a lengthy period where both the current and amended fair value hierarchy disclosures will be permitted which could lead to lack of consistency between accounts and some confusion by users of accounts. However, on balance it would seem preferable to set the timescales as proposed by FRED 62 to enable flexibility for pension schemes in the transition period.

PRAG notes that any delay in implementing the amendments will potentially cause difficulties for pension schemes which have decided to adopt the revised disclosures and would therefore stress the importance of making the amendments in the time frame set out in FRED 62.

Question 3: In relation to the Consultation Stage Impact Assessment do you have any comments on the costs and benefits identified? Please provide evidence to support your views of the quantifiable costs or benefits of these proposals.

PRAG believes that the proposed amendments will have a positive impact on pension scheme financial reporting. The IFRS fair value hierarchy disclosures are well established and global custodians and investment managers are familiar with these disclosure requirements and will have generally have reporting procedures in place for them. Removing the current FRS 102 fair value

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disclosure requirements will also reduce confusion caused by having two different fair value hierarchy disclosure regimes. There will also be increased consistency with local authority pension scheme financial reporting as local authority pension schemes have been required to report under IFRS for several years and with employers who report under IFRS.

In terms of costs of compliance PRAG believes the proposed amendments will have a positive impact on the costs of compliance as many organisations will already have reporting procedures in place for the proposed IFRS fair value hierarchy. However, as noted above, unnecessary costs will have been incurred already in preparing for the current FRS 102 fair value hierarchy disclosures.

Further comments on FRED 62

The SORP and further guidance 'Practical Guidance Investment Disclosures' issued jointly by PRAG and the Investment Association (IA) in June 2015 (Practical Guidance) both cover the current FRS 102 fair value hierarchy determination and disclosures. Pension scheme accounts preparers will still be required to determine fair value under FRS 102's current requirements and it will be permissible to use the current disclosures for accounting periods commencing before 1 January 2017. As noted above there will be a lengthy period when both current and amended disclosures are permissible. PRAG has therefore considered the SORP and the Practical Guidance in formulating its response to FRED 62.

Under FRED 62 the fair value hierarchy disclosures for pension scheme financial statements are brought into line with International Financial Reporting Standards (IFRS) disclosure requirements. This is achieved by amending paragraph 34.42 of FRS 102 to read as follows:

For financial instruments held at fair value in the statement of net assets available for benefits, a retirement benefit plan shall disclose for each class of financial instrument, an analysis of the level in the following fair value hierarchy into which the fair value measurements are categorised. A fair value measurement is categorised in its entirety on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

- *Level 1: The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.*
- *Level 2: Inputs other than quoted prices included within Level 1 that are observable (ie developed using market data) for the asset or liability, either directly or indirectly;*
- *Level 3: Inputs are unobservable (ie for which market data is unavailable for the asset or liability)*

The Practical Guidance includes a high level comparison of IFRS and the current FRS 102/SORP disclosure requirements (paragraphs 2.10 to 2.13). The IFRS disclosures considered by the Practical Guidance are consistent with the proposed amendments to FRS 102 and therefore the Practical Guidance is a useful guide to how the current fair value determination and disclosures

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map to the proposed amendments. A slightly expanded guide, based on the Practical Guidance, is set out below (although it may not cover all possible scenarios).

Existing FRS 102/SORP	Equivalent FRED 62	Comments
Category (a) – quoted price for an identical asset in an active market	Level 1 – unadjusted quoted price in an active market	Category (a) maps to Level 1
Category (b) – price of a recent transaction for an identical asset, adjusted if it is not a good estimate of fair value	Level 2 - inputs other than quoted prices included within Level 1 that are observable (ie developed using market data) Level 3 - Inputs are unobservable (ie for which market data is unavailable for the asset or liability)	Category (b) does not exist under FRED 62. Using a recent price or an adjusted recent price would not meet the Level 1 criteria therefore investments valued using Category (b) will map to Level 2 or 3 depending on whether the valuation uses observable or non-observable inputs.
Category (c(i)) – valuation technique relying significantly on observable market data	Level 2 - inputs other than quoted prices included within Level 1 that are observable (ie developed using market data)	Category c(i) maps to Level 2
Category (c(ii)) – valuation techniques relying significantly on non-observable data	Level 3 - Inputs are unobservable (ie for which market data is unavailable for the asset or liability)	Category c(ii) maps to Level 3

Pooled funds are specifically addressed in both the SORP and the Practical Guidance in relation to how they should be disclosed in the fair value hierarchy. Following the above guide the table below summaries the typical disclosures under current requirements and under the proposed amendments, although this may not cover all possibilities and each case will need to be assessed based on its circumstances.

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Example Fund	Type of Pooled	Existing FRS 102/SORP	Equivalent FRED 62
	Exchange traded	Category (a)	Level 1
	Non-exchange traded daily or weekly priced, redemption without restriction	Category (b)	Level 2
	Non-exchange traded monthly/quarterly priced open ended funds	Category (c(i))	Level 2
	Non-exchange traded monthly/quarterly priced closed funds	Category (c(ii))	Level 3

PRAG's view is that fair value determination and disclosure guidance provided by the SORP and Practical Guidance in relation to categories (a), (b), (c(i)) and (c(ii)) is generally applicable to the disclosures required under Level 1, 2 and 3 using the above tables as a guide. In due course PRAG will revise the SORP to take account of the amendments and any other relevant developments.

Yours sincerely



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Chair of the PRAG SORP Working Party

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