



## **NAPF Conference Speech : Pensions Accounting**

I congratulate the NAPF for putting this issue on the public agenda. The NAPF is particularly well placed to help lead the debate. As well as being pension fund trustees responsible for the retirement income of millions, you are major investors in the UK's capital markets. I encourage the NAPF to bring the investment community together and ensure that IASB and other standard setters have the best possible understanding of the full range of investor opinion.

The UK Accounting Standards Board has played a leading role in promoting the debate. It has produced both an initial discussion paper and, after extensive consultation, a feedback report that I commend to you. It reports and takes account of the views of over 100 respondents. It is an important milestone in the debate. But not the end of the road. The FRC itself will continue to follow the issue and contribute as the IASB produces its exposure draft on defined benefit plans and as Solvency II and insurance accounting are further developed.

The challenge before IASB and ourselves is to find the point of balance between different objectives.

We need to ensure that investors in UK companies have confidence in accounts. Confidence that there are no nasty lurking surprises that should have been foreseen and disclosed. We put great weight on transparency and disclosure of events when they arise.



Investors also need to compare one company against another. To that end it makes sense that the principles of accounting are applied consistently across the market as far as possible including to pension fund liabilities.

At the same time we cannot be blind to the economic reality that pension funds have illiquid liabilities and invest for the very long term. Short term movement in markets are of less significance to them than to most business and investment vehicles.

We also cannot ignore the political reality that policy makers will bring other issues to the debate as accounting proposals are assessed. That is their responsibility. And there certainly are major policy issues at stake. Pension funds are major investors in the equity markets. They drive enterprise by providing equity capital. And they hold the security of our retirement in their hands. So whilst the first duty to standard setters is to investors of all kinds and to sound capital markets we must work hard to find solutions that meet these needs without jeopardising the particular interests and welfare of the growing population of future pensioners who are often investing a very high proportion of their savings and hopes in their occupational pensions.

How have we tried to walk this tightrope: essentially through careful testing of all proposals and holding true to a few key principles?

Firstly we do not believe in rushing into recognition of possible but uncertain liabilities. Accounting standards should be based on the principle that only present obligations are reflected as liabilities. So, for example, the ASB has rejected the proposition that liabilities should take account of the projected final salaries of scheme members rather than current earnings.



Second, the accounts should not be based on regulatory capital requirements rather than accounting principles. Regulators may require higher levels of prudence and safety than is dictated by best estimates of likely outcomes. Using these requirements for accounting purposes would distort reporting and make comparisons between companies hard to make.

Third, we should avoid unintended consequences that will confuse markets. A fierce debate has ranged around the appropriate rate for discounting liabilities. The ASB has proposed a rate reflecting the time value of money. Others have recommended that the credit risk of the company is taken into account. More work on discount rules is being done. But one point is clear. If credit risk is put in the mix there would counter intuitive results. It cannot be right that riskier enterprises would be able to report lower liabilities.

Fourth, mark to market must be applied pragmatically. Contrary to some commentators' assertions, we do not advocate a full fair value approach. Where assets and liabilities are illiquid and where a true market does not exist, different approaches are needed for valuation purposes. Some way of recognising an illiquidity premium is needed. This is being debated in the context of Solvency II and we need to follow that debate carefully.

We need to understand uncertainty pragmatically and encourage companies to avoid publishing hard numbers that in reality are very soft. Instead we must encourage full disclosure of assumptions and sensitivities.



Retirement income is a crucial issue for us all. Investors should expect standards to pin down the financial impact of all that is certain. But let's not fabricate certainty.

And let's find ways to ensure the long term nature of funds – their special economic reality – is properly reflected. I welcome the NAPF's interest in promoting a rounded debate and look forward to further discussions.