PRAG
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27 April 2023

The Pensions Research Accountants Group's ('PRAG') response to the Financial Reporting Council's ('FRC') invitation to comment on Financial Reporting Exposure Draft ('FRED') 82 - draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland

PRAG is an independent research and discussion group for the development and exchange of ideas in the pensions field. PRAG's efforts are mainly in the areas of reporting and accounting by pension schemes, but PRAG also produces reports on other related matters. PRAG is a non-profit making organisation. PRAG's membership is drawn from the auditing profession, specialist accountants working for third party administrators and for in-house pension scheme entities and pensions specialists from other professions and disciplines.

Aligned to the FRC's Policy on Developing Statements of Recommended Practice (SORPs), PRAG is the FRC's accredited SORP making body for pensions schemes.

PRAG has in place a SORP Working Party to address all direct and indirect matters as they impact the Statement of Recommended Practice, Financial Reports of Pension Schemes (the 'Pensions SORP'), under approved terms of reference.

We have considered the proposals set out in FRED 82, with specific focus on the impact on accounting by pension schemes and the Pensions SORP. In this context, we make the following comments:

Question 1: Disclosure

A. The proposed amendment to paragraph 34.43 (the addition of "...and which may impact the ability of the plan to pay the promised retirement benefits to members." with regards to investment risk disclosures) could result in an interpretation where some pension arrangements (for example defined contribution schemes and master trusts) are not considered within the scope of this requirement as they do not contain "promised" benefits.

   We would request clarification on this matter. We would suggest an amended wording (thus allowing the to-be reviewed Pension SORP to then elaborate and provide guidance as it applies to pension arrangements of each type) as to: "...and which may impact the ability of the plan to pay benefits to members."

B. However, there is a strong view held in the pensions sector, that investment risk disclosures should not form part of the financial statements for pension plans, but that it should form part of the Trustee's report (investment section).

   The view is that such disclosures in the financial statements have become boiler-plate in nature with little if no relevance to the investment strategy of the pension plan, the way investment risk is managed, and is of almost no benefit or insight to the relevant stakeholders either quantitatively or qualitatively.

   However, relevant disclosures would be appropriate to sit alongside the investment strategy and discussion of the implementation thereof within the investment section of the Trustee's report, where a balanced narrative can be formed, sitting alongside a discussion around the actuarial liability side of the equation (such liabilities not forming part of the financial statements of a pension plan). That was clearly evidenced at the time of the recent market volatility, whereby asset values declined considerably, but so did actuarial liabilities; and it was (and is) important for trustees to give that balanced and transparent viewpoint to stakeholders.

   A pension plan's investment strategy is predicated on the value of the plan's actuarial liabilities and the strength of the sponsor's covenant; and so the direct linkage in the Trustee's report is considered to be the most effective place to then describe investment risks and how those risks may be mitigated.

   We would encourage the FRC to consider the above.

C. That said, and if the FRC is not minded to remove paragraph 34.43 (which we would still encourage), we would still seek clarification/amendment as detailed in point A above, and further seek the FRC's opinion on whether, in light of recent market volatility, it would be appropriate to incorporate 'liquidity risk' in the pension plan investment risk disclosures, such that, "...of credit risk, <u>liquidity risk</u> and market risk…." is added.

   Our view, on balance, is that this is now appropriate for pension plans; and guidance as to how this is applied to the differing pension arrangements can be elaborated in the to-be reviewed Pensions SORP.

   As pension plan strategies develop, the inextricable move to risk reduction investment portfolios, including the use of hedging arrangements, will lead trustees to ensure that there is sufficient liquidity to support such strategies alongside meeting member benefits as they fall due. It is for these reasons that a form of liquidity risk disclosure would, in our view, be appropriate.

Question 3: Fair value

We generally agree with the proposal for Section 2A Fair Value Measurement to align the definition of fair value, and the guidance on fair value measurement, with that in IFRS 13 Fair Value Measurement.

We would seek further clarification and enhancement in FRS 102 on the intention of paragraph 2A.17, specifically the final sentence "The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required."

Is the use of bid/ask prices now considered best practice or have they been referred to only for illustrative purposes and each preparer of financial statements is free to make their own choice?

If the intention is to allow flexibility in valuation methods, we believe that it would be appropriate to also include IFRS 13 paragraph 71 in a revised FRS 102, “This does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread.”

Question 8: Effective date and transitional provisions

We agree with the proposed implementation date of 1 January 2025, with early application permitted provided all amendments are applied at the same time; on the expectation that the FRC will publish the final revised FRS 102 by 31 December 2023.

We currently believe that this should then be sufficient time to complete revisions to the Pensions SORP.

Yours sincerely

[redacted]

Andy Lowe
Chair of the PRAG SORP Working Party