21 February 2013

Our ref: ICAEW Rep 35/13

The Pensions Regulator Policy Team
Pensions Protection and Stewardship Division
Department for Work and Pensions
Caxton House
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By email: pensionsregulator.dwpconsultation@dwp.gsi.gov.uk

Dear Sirs

Pensions and Growth: Whether to smooth assets and liabilities in scheme funding valuations and whether to introduce a new statutory objective for the Pensions Regulator

ICAEW is pleased to respond to your request for comments on *Pensions and Growth: Whether to smooth assets and liabilities in scheme funding valuations and whether to introduce a new statutory objective for the Pensions Regulator*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REP 35/13

ICAEW REPRESENTATION

PENSIONS AND GROWTH: WHETHER TO SMOOTH ASSETS AND LIABILITIES IN SCHEME FUNDING VALUATIONS AND WHETHER TO INTRODUCE A NEW STATUTORY OBJECTIVE FOR THE PENSIONS REGULATOR

Memorandum of comment submitted in February 2013 by ICAEW, in response to Department for Work and Pensions call for evidence Pensions and Growth: Whether to smooth assets and liabilities in scheme funding valuations and whether to introduce a new statutory objective for the Pensions Regulator published in January 2013

Contents **Paragraph**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the call for evidence Pensions and Growth: Whether to smooth assets and liabilities in scheme funding valuations and whether to introduce a new statutory objective for the Pensions Regulator published by Department for Work and Pensions on 25 January 2013, a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. This response reflects consultation with the ICAEW Business Law Committee which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

MAJOR POINTS

5. We see some benefit in the introduction of an additional statutory objective as this will give the Pensions Regulator explicit authority to continue to balance the competing interests of members and the employer, which will provide certainty and give industry more confidence that the Regulator will continue with its current approach. However, it is important that any new statutory objective is not perceived as requiring a new approach and/or a substantial change in practice by the Regulator.

6. From both a conceptual and practical perspective, we do not support the introduction of smoothing into funding valuations. We believe that the current system already contains enough flexibility around the use of discount rates to enable the recovery plan to include an appropriate level and timescale for deficit repair contributions taking account of cashflow considerations (ie affordability for the sponsor).

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1. What would be the effect of smoothing assets and liabilities in schemes undertaking valuations in 2013 and going forward? Would it materially improve the sponsoring employers' ability to attract investment or to invest in short term? If so, what evidence is there of this?

7. We have not answered the questions relating to smoothing in detail, but we make some more general comments at paragraph 6 above.

Q2. Given that there is no one defined method for calculating scheme liabilities, how would you implement smoothing?

• How should schemes calculate liabilities on a smoothed basis?

• Over what period of time should the smoothing occur?

• Would smoothing be a voluntary or mandatory requirement? Should there be any other restrictions applied to schemes if smoothing is used?

• Should schemes be locked into smoothing (if they choose to smooth) for more than one valuation cycle or permanently? Would this make deficit repair contributions more counter cyclical to the wider economy in the longer term?

• How would you apply smoothing to assets?

• Would smoothing enable the breadth of differing scheme circumstances to be appropriately accounted for (e.g. schemes that have hedging/risk management strategies in place)??

• Should this be a permanent or temporary change?

8. See above.

Q3. What are the advantages and disadvantages of smoothing for sponsoring employers, scheme members and the Pension Protection Fund?

9. See above.

Q4. Is the current regime flexible enough to ensure that defined-benefit pensions regulation does not act as a material brake on investment and growth for the UK economy?

10. We are aware that there are differing views on whether the current regime acts as a brake on investment and growth for the UK economy, and we hope this call for evidence will establish whether or not this is the case.

Q5. Should a specific model of smoothing be introduced, the Government would welcome views as to what schemes, in terms of their valuation date, should be able to take advantage of the change.

11. No comment/not applicable - see above.

Q6. What would be the advantages of a new statutory objective for the Pensions Regulator to consider the long term affordability of deficit recovery plans to sponsoring employers?

12. In our view, it is appropriate for the Pensions Regulator to exercise judgement in balancing potentially competing statutory objectives (it already does this in relation to its duties to protect scheme members and to reduce calls on the PPF), and we believe the introduction of this additional objective could assist tPR to balance the competing interests of members and the employer, a task the regulator already carries out but with implied rather than explicit authority. The statutory duty will provide certainty, enabling the Regulator to continue to take a robust approach when balancing these interests and giving industry more confidence that the Regulator will continue with its current approach.

13. However, whilst we can see the benefit of introducing a statutory objective, we have concerns about whether the proposed wording would be workable. The issue of affordability relates to cashflow, and it is not clear from the call for evidence why the proposed objective would be to consider *long term* affordability (our emphasis). We therefore think the words "long term" should be removed, so that the wording of the statutory objective is more consistent with the requirements for trustees (to consider what is reasonably affordable) under the scheme funding code of practice, which we understand is widely interpreted as requiring trustees to modulate short term funding requirements in the interest of the long term stability of the sponsor and its long term ability to support the pension scheme.

Q7. What would be the disadvantages in creating this further statutory objective for the Pensions Regulator?

14. We believe the introduction of the new statutory objective is effectively a codification of current practice, and should provide an acceptable framework within which the Regulator can continue to balance these competing interests. However, there is a risk that this could be perceived by the Pensions Regulator as requiring a new approach and/or a substantial change in practice (for instance, in order to demonstrate that the additional statutory objective has been taken into account), which could result in increased bureaucracy and/or difficulty when dealing with the Regulator. We hope the statutory objective is introduced in a manner that avoids this potential adverse outcome.

15. See also our concerns over the detailed wording of the proposed new objective at paragraph 14 above.

Q8. Is the consideration of the long term affordability of deficit recovery plans to sponsoring employers already implicit in the existing objectives and requirements for the Pensions Regulator? If so, is this sufficient?

16. We believe consideration of the affordability of deficit recovery plans to sponsoring employers is already implicit in the existing objectives and requirements for the Pensions Regulator but, as we mention above, we do not believe the objective is to consider 'long term' affordability. As we mention at Q6 above, we believe that codifying the existing implicit duty into a statutory objective will provide increased certainty for the Regulator and confidence for industry.

Q9. Are there other options (including legislation) which would ensure that the Pensions Regulator carries out its functions in a way which appropriately balances protection of members, the Pension Protection Fund and sponsoring employers?

17. We are not aware of any alternative options.

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