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Consultation Response

Department for Business, Innovation and Skills

Consultation on the Draft Regulations Determining what Companies must Disclose in Pay Reports

28 September 2012

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

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28 September 2012

Dear Barry

Consultation on revised remuneration reporting regulations

The Institute and Faculty of Actuaries welcomes the opportunity to comment on the proposals set out in the above consultation.

In this response we have concentrated on the aspects of the proposals that relate to the calculation of the remuneration disclosures related to pension benefits. Accordingly, the points we wish to make are as follows:

Question 1

The reference in regulation 7(5) to regulation 7(4)(a) does not appear to be correct.

The legislative reference to the HMRC calculation method is to the calculations underpinning the "annual allowance" test; as part of this calculation the pension entitlement at the start of a reporting period is uprated by inflation before comparison with the end year entitlement. Whilst we do not disagree with this approach (and it is consistent with existing reporting requirements) the consultation paper is silent on this point and refers to the "lifetime allowance" method.

The HMRC methodology which is cross-referenced relates to the increase in accrued benefits over the pension input period (as defined for each pension arrangement) ending in the relevant tax year. There may be different pension input periods for the various pension arrangements for a particular individual; if pension input period end dates are amended, one tax year can pick up the pension input from more than one pension input period from an arrangement. This does not seem appropriate for inclusion in a comprehensive remuneration figure in respect of the company's financial year.

We would also question whether the cross-reference to the HMRC method sufficiently well defines the calculation required in all cases, as problems have arisen with application of the HMRC regime (for instance where members are promised a 2/3rds pension if active at retirement).

The proposed regulations do not cater for cash balance plans or hybrid schemes – we note that the sections in Part 4 of FA2004 dealing with these types of arrangement are separate from the HMRC method (for defined benefit schemes) that is cross-referenced by these regulations.

Question 2

We do not believe that the reporting costs in relation to the pension components of the disclosures will be significantly different to those incurred for companies subject to the Listing Rules. However costs may increase for those companies currently subject only to Companies Act requirements.

Questions 3 and 11

We believe that disclosure of the pension accrued during the year (net of inflation) as well as the accrued pension at the end of the year would aid understanding (and should apply to all defined benefit arrangements, not just final salary schemes).

In terms of early retirement, the reference to the *additional* pension payable may not capture the full picture. In general, payment of a reduced pension on early retirement would be expected to provide the same value to the director as the accrued pension payable at normal retirement age. Disclosure should therefore be required of any entitlement or practice of paying early retirement pensions before normal retirement age with no reduction for early payment or a reduction that is lower than the cost-neutral reduction, as well as of any additional pension payable on early retirement.

Question 8

We agree with the 3 possible approaches as set out in paragraph 67, namely the “HMRC method”, IAS19 and transfer values.

Both of the IAS19 and transfer value methods could be argued for, on grounds of consistency with the reported costs to the company and the amount the member could take as an immediate settlement from the scheme respectively. Whilst these measures will lead to different valuation factors from year to year reflecting market conditions, the degree of volatility would be reduced if it is the value of the increase in benefit each year (net of inflation) that is disclosed (as in the Listing Rules) rather than the difference between the values of the total benefit at the beginning and end of the year (as in the current Companies Act requirement). A further relevant point is that both methods rely on actuarial assumptions which (although subject in both cases to guidance) are set by the company (in the case of IAS19) or the Trustees of the scheme (in the case of transfer values). In the context of company reporting the use of IAS19 assumptions would therefore seem more relevant; whilst these assumptions do vary between companies the differences are less pronounced than for transfer values and the assumptions do not depend on factors such as the scheme’s investment strategy.

The proposed “HMRC method” with a fixed valuation factor of 20 would certainly be more straightforward to calculate from a valuation perspective (but see our comments under Question 1 above); however the use of a fixed factor ignores elements of actuarial value such as different levels of pension increases, spouse’s pensions, retirement age – as well as the age (and therefore true funding costs) of the member concerned. These drawbacks of the fixed factor approach may actually impair (rather than enhance) comparability between different companies and individuals.

Finally, we note the comment in paragraph 36 to the effect that the Government will work with the UK Listing Authority to consider whether the requirements of the Listing Rules need to be reviewed. We would further ask whether the general Companies Act reporting requirements should also be brought into a general review in an attempt to achieve consistency in pensions reporting across all UK companies.

We hope that the above will be helpful but if you have any questions, or would like to discuss any aspect of our response further, then please do not hesitate to contact us.

Yours sincerely,

Martin Lowes
Chair of the Pensions Consultations Sub-Committee
The Institute and Faculty of Actuaries