Investor view

Insight from the investment community

Improving pensions disclosures

Peter Elwin

How are entities presenting their pensions information – is it useful, could it be improved? Peter Elwin, Head of European Pensions, Valuation, and Accounting Research at JP Morgan, gives his personal view about current pension disclosures and those areas in which there might be some scope for improvement.

What the investment community looks for in pension disclosures

Pension obligations and the risks to which they expose companies can be very material, so the disclosure in the financial statements is important. In simple terms, investors need to understand both the amounts recognised in the financial statements and the means by which they have been calculated. This will involve gathering as much information as possible about the underlying assumptions and the sensitivity of those assumptions to, for example, changes in inflation and interest rates. Investors are also very keen to be able to predict future cash flows relating to the pension scheme, so anything that helps with that is welcome.

Disclosures that could be improved

On the whole, the quality of disclosure has improved in recent years. However, there are still some areas where disclosure could be improved further. For example:

- Contribution levels: accounting standards require little disclosure of the expected level of cash payments (only expected levels of contribution in the next period). But where entities have this information (for example, in the form of an agreed contribution schedule or deficit recovery plan), it would be very helpful in determining how much of the deficit is expected to be contributed as opposed to recovered by investment returns.

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- Funding deficit: while the accounting standards give investors information measured on a consistent basis, there is also value in the information provided by the plan's valuation for funding purposes. Ideally, companies would provide the information from the most recent actuarial valuation alongside the accounting disclosures, so users can compare the two different valuation bases.

- Assumptions: as mentioned above, disclosure has improved in recent years, but there are still some entities that describe only the assumptions listed for disclosure in the accounting standards. Information about any material assumption is useful.

- Detail about asset class: more granularity in the disclosure of plan assets, such as whether investments are held in corporate or government bonds, nominal or index-linked, in addition to the usual equities, bonds, etc, enables analysts to understand better the investment risks being taken.

Future of pensions accounting

What does the proposed pensions standard intend companies to disclose?

It seems to seek more clarification as to whether a company is following a liability-driven investment strategy or not – such as what the philosophy is behind the asset allocation; what the path is to eliminating the deficit; and what's the way forward.

The risk is that this turns into boilerplate disclosure. 'We manage our investments in line with our liabilities and aim to pay off the deficit over 10 years and then maintain a fully funded scheme.' That doesn't tell us much at all. As always, the best disclosure is clear, unambiguous and specific to the reporting entity.

The views in this publication are expressed in Peter Elwin's individual capacity and not as a representative of an organisation. The views expressed do not necessarily reflect the views of the respective organisation where he is employed.

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