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S&P: How Asset-Backed Contribution Arrangements Can Muddle Pension Deficit Reporting.

(Editor's note: The opinions stated herein represent Standard & Poor's Ratings Services' views on the analytical consequences of financial reporting of asset-backed contribution schemes. Our comments in this article do not affect our current ratings criteria.)

Postretirement plans with asset-backed contribution (ABC) arrangements have come under various criticisms in the U.K. Last year, the U.K. Pensions Regulator warned trustees to "critically and carefully" evaluate the risks attached to these increasingly popular arrangements, which are essentially securitizations of assets that provide annual income stream to the pension plan (see the Appendix for an overview of ABC arrangements and the related accounting). And in a recent public announcement, the U.K.'s Financial Reporting Council (FRC) promised a crackdown on arrangements that resulted in companies removing their postretirement obligations from their balance sheets (or "derecognizing" them) while retaining the ultimate responsibility for the unfunded deficit.

The FRC investigated the accounting and financial reporting of a number of ABC arrangements. While acknowledging the existence of the arrangements in general, noting the commercial reason behind them, it criticized structures that introduced additional features with the sole purpose of transforming the pension obligations into equity instruments in the sponsoring entity's consolidated financial statements. Standard & Poor's Ratings Services agrees with the FRC that the economic substance of these arrangements is that of a debtlike liability rather than an equity instrument, because the companies would eventually need to contribute to the pension plan's deficit if the ABC structure fails to do so.

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