

March 13, 2012 3:54 am

Regulation should be NAPF's target

From Prof Dennis Leech.

Sir, The National Association of Pension Funds blames quantitative easing for amplifying the ballooning pension scheme deficits, creating a need for companies to provide massive additional funding (report, March 8). It is wrong. It should be calling for reform of how pensions are regulated. QE is a necessary policy for an economy in depression and if pension schemes cannot cope as a result then how they are regulated needs reforming.

The fundamental problem is that legislation now requires every pension scheme to be valued as if it is to close to new members immediately, and its assets must cover its future pension liabilities accordingly. But what is truly bizarre is that liabilities have to be valued as a discounted present value, using gilt or market interest rates. When interest rates are as low as they are now, liabilities go through the roof, even though the real pension liabilities have not changed! The pension entitlements of defined benefit schemes are whatever they are and they are not in any way affected by interest rates. So the deficits that emerge under QE are an artefact of the accounting and regulation system.

How pension schemes are regulated probably makes sense under conditions of universal perfect markets and general economic equilibrium, assumed by financial economists. But it is quite inappropriate to present conditions, where the economy is far from full-employment equilibrium and interest rates are as low as they can go. There is an urgent need for government action.

Dennis Leech, Professor of Economics, University of Warwick, UK

Printed from: <http://www.ft.com/cms/s/0/49235b7a-6c3c-11e1-b00f-00144feab49a.html>

Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

© THE FINANCIAL TIMES LTD 2012 FT and 'Financial Times' are trademarks of The Financial Times Ltd.