NAPF
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CONSULTATION ON THE POSSIBLE INCLUSION OF INVESTMENT RISK AS A RISK FACTOR IN THE RISK BASED LEVY

This response is from the National Association of Pension Funds (NAPF). The NAPF is the leading voice of workplace pension provision in the UK. Some 10 million working people are currently in NAPF Member schemes, while around 5 million pensioners are receiving valuable retirement income from such schemes. NAPF Member schemes hold assets of some £800bn, and account for around one fifth of investment in the UK stock market.

The NAPF welcomes the opportunity to comment on the possible inclusion of investment risk as a risk factor in the risk based levy. We accept the theoretical case for including asset allocation as a risk factor although we feel there is a fine line to be drawn between discouraging the injudicious assumption of risk on the one hand and inhibiting efficient portfolio allocation on the other.

However notwithstanding the theoretical case for including investment risk as a risk factor in the risk based levy calculation, the NAPF accepts the case made in the PPF's consultation document that the balance of argument - especially that of proportionality – currently favours the status quo - that is, that asset allocation should not be included as a risk factor. We would add further that both the deficit size and sponsor risk factors are impacted by realised investment risk, suggesting to us that the existing arrangements already, indirectly, factor in past investment risk. However, since the decision is made on proportionality grounds, the PPF should consider from time to time whether scheme behaviour generally has increased future risk to a point where proportionality is prejudiced.

The NAPF also emphasises that a simple division of portfolios into bonds and equities is in no way adequate to assess the risk to the PPF presented by the portfolio of a scheme. At a minimum, bonds need to be subdivided into government bonds, investment grade corporate bonds and sub-investment grade corporate bonds. Account also needs to be taken of the risk presented by other assets such as private equity and hedge funds, as well as by property. The PPF's risk metric also needs to factor in the risk presented by foreign currency positions.

In order to properly take account of risk across multiple asset classes, the NAPF sees no alternative but to use a Value-at-Risk approach. The consultation document observes that this would add to scheme administration costs. However many schemes have VAR analyses carried out by their consultants and these could be used for the purpose of assessing the risk posed by the asset arrangements to the PPF, enabling costs to be contained.

Yours faithfully

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