



The Actuarial Profession

making financial sense of the future

discussion paper response

**International Accounting
Standards Board**

**Preliminary Views on
Amendments to IAS 19
Employee Benefits**

September 2008

www.iasb.org

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Dear Sir/Madam

Preliminary Views on Amendments to IAS 19 Employee Benefits - IASB

Thank you for offering The Actuarial Profession the opportunity to comment on this discussion paper. Our detailed comments on the paper and on the specific consultation questions are set out in the appendix to this letter.

Our key points are summarised below.

- We agree that:
 - it is difficult to justify deferred recognition of gains and losses, and acknowledge that the balance sheet items that result from deferred recognition are both complicated and potentially confusing
 - it is difficult to justify inclusion in P&L of the expected asset return as currently derived, but would support replacing this by applying the discount rate used to measure liabilities to the asset value, giving an amount that is consistent with the interest cost on liabilities and avoiding the subjectivity with the current definition.
- We can see no pressing reason to address the presentation of the change in defined benefit liabilities. We believe that this is an issue that should be addressed after the completion of the current comprehensive project on the presentation of financial performance, and this issue should therefore be removed from the scope of the current project.
- We are not aware of any major issues that require the Board's attention in relation to the definition of defined contribution promises or in relation to promises that would be categorised under the proposals in the discussion paper as contribution based promises. Since the proposals in the paper are themselves problematic – far more so than the current requirements as we explain in our detailed comments – we do not believe that these issues

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should be considered in this project. Instead, they should be addressed as part of the planned phase 2 project considering a comprehensive review of pension accounting.

- Similarly, due to the magnitude of the extra costs that would in practice result from implementing the proposals for “higher of” promises – as explained in our detailed comments - we believe this issue also should be deferred and considered as part of the planned phase 2 project considering a comprehensive review of pensions accounting.
- We believe that this comprehensive review of pension accounting should itself be deferred until the various issues considered in relation to the proposals for contribution based promises (fair value, allowance for credit risk, allowance for other risk, both diversifiable and non-diversifiable, marking to market, recognition of gains and losses, presentation of financial performance) have all been addressed in comprehensive projects at the conceptual framework level with the conclusions being applied consistently to all assets and liabilities. Making changes to pensions accounting in advance of this will move the treatment of pension assets and liabilities further away than it is already from the approach to comparable liabilities, with inappropriate real world consequences.

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via martin.hewitt@actuaries.org.uk.

Yours sincerely,

Robert Hails

Chairman, Consultations Group of the Pensions Practice Executive Committee

Attached: Appendix

Please reply to Staple Inn

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Preliminary Views on Amendments to IAS 19 Employee Benefits

Appendix

Question 1: *Given the objective of the IASB project to address specific issues in a limited time frame, are there additional issues which you think should be addressed by the Board as part of this project? If so, why do you regard these issues as a matter of priority?*

No, we do not believe there are additional issues in relation to IAS 19 which we think should be addressed by the Board as part of this project due to their urgency.

In fact, we believe that IASB's proposed Phase 2 project to conduct a wider review of pensions accounting in conjunction with FASB should be deferred until mark to market accounting is being implemented for all comparable assets and liabilities – see question 2 below.

Further, we are not aware of any major issues that require the Board's attention in relation to the definition of defined contribution promises or in relation to plans that would be categorised under the proposals in the discussion paper as contribution based promises. Since the proposals in the paper are themselves problematic – far more so than the current requirements – we do not believe that these issues should be considered in this project. This is discussed further in our response to question 5 below.

The proposed treatment of “higher of” promises appears at first sight to be straightforward (albeit as explained below in our response to question 13(b) we believe that they would not have the impact that the Board expects). However, the calculations involved, while in theory possible, would in practice be complex, time consuming, and would substantially increase costs. This is explained further below in our response to question 13(a). We believe this issue should be deferred and considered as part of the planned phase 2 project considering a comprehensive review of pensions accounting.

Finally, we can see no pressing reason to address the presentation of the change in defined benefit liabilities, and believe that this is an issue that should be addressed after the completion of the current comprehensive project on the presentation of financial performance. We therefore support the removal of this issue from the scope of the current project. This is discussed further in our response to question 3 below.

Question 2: *Are there factors that the Board has not considered in arriving at its preliminary views [on the recognition of defined benefit promises]? If so, what are those factors? Do those factors provide sufficient reason for the Board to reconsider its preliminary views? If so, why?*

Some of the proposals in both Chapter 2 and later in the paper appear to follow logically from the arguments presented in the paper. However, those arguments are based on premises that are not applied in other areas of accounting.

	Current IAS19	ASB Proposal	Debt issued by the entity	Lease arrangements (asset and deposits)	Bank loans/deposits	Framework	Conceptual framework
Mark to market	Yes (with option to amortise)	Yes	No	No (not all on balance sheet at all)	No	No preference for one measurement model over others	Not addressed yet
With impact reflected in P&L	An option (which few adopt)	Yes	No	No	No	No stated preference for P&L vs SoRIE	Not addressed yet
Allowance for credit risk	Yes – independent of entity risk	No – risk free	Yes – as at issue	Yes - implicitly	Yes – implicitly (interest rate reflects risk)	Not addressed	Not addressed yet
Disclosure of “contractual” terms	No	Yes	No	No	No	Not addressed	Not addressed yet
Disclosure of impact if interest rates etc change	If IAS 1 requires because material	Yes – even if not material	No (because impact is nil if not marked to market)	No (because impact is nil if not marked to market)	No (because impact is nil if not marked to market)	Not addressed	Not addressed yet

The above table shows that many similar long term assets and liabilities:

- are not marked to market at all
- so without early recognition of gains or losses anywhere in the financial statements
- are measured including allowance for credit risk (normally implicitly) –but not for changes in credit risk
- have far more limited disclosure requirements

In particular, it is hard to distinguish in nature between the commitment made by a company to its bondholders and the commitment made in the form of pensions for former employees. (The dependence of pensions on life expectancy, whilst recently in the news a lot, has a relatively small impact compared to the effect of movements in interest rates.)

The different treatment of pension assets and liabilities is important. It makes pension obligations appear riskier than other corporate obligations. This can mislead management and investors, guiding them to sub-optimal decisions.

The IASB has stated that it is concerned with appropriate representation of the underlying financial position, and that it cannot be swayed by the behavioural consequences. However, the behavioural consequences that affect pension plans do not result from the “fair” representation of pension plans.

Instead, they result from the different treatment of pension assets and liabilities compared to other comparable long term assets and liabilities. As things stand, pension plans seem risky against a background of a generally non-volatile balance sheet. If the accounting was consistent, pension plans would seem just as volatile as now, but against a background where large parts of the balance sheet (generally larger than the pension plan) are equally volatile. Accounting would no longer present pension plans as being more risky than the rest of the business, and quite possibly different decisions would be, and would have been, made. Indeed, real people may not have borne the real losses that they have on closure of schemes.

We do not suggest ending the marking to market of pension plan assets and liabilities, even though this would be more consistent with the treatment of many other similar assets and liabilities. However, we would suggest that (apart from the immediate recognition of gains and losses) there should be no further changes to the accounting for pension plans until the issues addressed in the paper (fair value, allowance for credit risk, allowance for other risk, both diversifiable and non-diversifiable, marking to market, recognition of gains and losses, presentation of financial performance etc) have all been addressed in comprehensive projects at the conceptual framework level with the conclusions being applied consistently to all assets and liabilities. We believe that the presentation of changes in defined benefit costs should be consistent with that for other similar liabilities – otherwise there are behavioural implications.

Despite the arguments above, we agree that:

- it is difficult to justify deferred recognition of gains and losses, and acknowledge that the balance sheet items that result from deferred recognition are both complicated and potentially confusing
- it is difficult to justify inclusion in P&L of the expected asset return as currently derived, but we support replacing this by applying the discount rate used to measure liabilities to the asset value, giving an amount that is consistent with the interest cost on liabilities and avoiding the subjectivity that is of concern with the current definition.

Although this will continue to be inconsistent with the treatment of similar liabilities that are not marked to market, we nonetheless support immediate recognition of pension gains and losses on the balance sheet.

Question 3:

- (a) *Which approach to the presentation of changes in defined benefit costs provides the most useful information to users of financial statements? Why?*
- (b) *In assessing the usefulness of information to users, what importance do you attach to each of the following factors, and why:*
 - (i) *presentation of some components of defined benefit cost in other comprehensive income; and*
 - (ii) *disaggregation of information about fair value?*
- (c) *What would be the difficulties in applying each of the presentation approaches?*

We agree with the Board that decisions about a long term approach to the presentation of changes in defined benefit liabilities should await completion of the comprehensive project on reporting financial performance.

Regarding the three approaches put forward for comment, we believe they are likely to be inconsistent with the conclusions of the comprehensive project, and all are inconsistent with the current treatment of changes to comparable liabilities.

- Comparable liabilities are not marked to market, so changes in those liabilities are not recognised in either P&L or in other comprehensive income. We therefore do not believe that Approach 1 is consistent with other IFRS.
- Similarly, we do not believe that Approach 2 is consistent with other IFRS. We also do not recognise as meaningful the split proposed in Approach 2 between liability gains/losses relating to changes in the discount rate and other changes. For liabilities linked to inflation (or a linked parameter such as inflation to a cap, or wage increases), future inflation is just as much a financial assumption as the discount rate (and breakeven inflation can be derived from financial markets just as directly as market yields) – what matters for real liabilities is the real discount rate. If this Approach is to be taken further, the impact of changes in inflation as well as changes in the (nominal) discount rate should be recognised in other comprehensive income.
- We agree that the potential ways to define interest income on plan assets considered in the discussion paper in connection with Approach 3 are not meaningful and should not be taken further. We do however support the economic argument that (expected) interest on liabilities should be offset in the financial statements by an (expected) return on the assets. As noted in Questions 2 and 4, we favour a pragmatic unbiased approach setting the expected return on plan assets to be that using the discount rate (however derived) used in measuring the plan liabilities.

We therefore set out below in our response to question 4 our preferred Approach to presenting information on changes in pension cost.

Question 4:

- (a) *How could the Board improve the approaches discussed in this paper to provide more useful information to users of financial statements?*
- (b) *Please explain any alternative approach to presentation that provides more useful information to users of financial statements. In what way does your approach provide more useful information to users of financial statements?*

Since comparable liabilities are not marked to market, it would be misleading to include the actual return on pension assets and other pension gains/losses in P&L unless and until accounting generally moves to marking to market all long term assets and liabilities.

Nevertheless, we agree with the argument in the discussion paper that interest on pension liabilities should for consistency with other IFRS be recognised within P&L. However, it would be misleading to recognise interest cost within P&L but not to offset this with any asset return item. (Doing so would result in showing higher profits for a company with an unfunded pension scheme than for one with a funded scheme: a company with an unfunded scheme would include in P&L higher interest on cash or lower interest on borrowings than the equivalent company with a funded scheme, but without any balancing item in respect of the return on pension assets.)

We support including in P&L a notional expected investment return calculated as the asset value multiplied by the discount rate used to measure the liabilities. This is a more objective amount. It treats assets and liabilities consistently. It also avoids increasing the discrepancy between the treatment of pension assets and that of the many types of long term assets and liabilities measured at amortised cost using the effective interest method. Gains and losses, including the difference between this expected return and actual return, would be recognised through other comprehensive income.

Further, this approach ensures consistency between P&L for entities with funded and unfunded schemes. (A company with an unfunded scheme would include in P&L higher interest on cash or lower interest on borrowings than the equivalent company with a funded scheme, but the company with a funded scheme would instead include an equivalent amount in respect of the notional expected return on pension assets.)

Question 5: *Do you agree that the Board has identified the appropriate promises to be addressed in the scope of this project? If not, which promises should be included or excluded from the scope of the project, and why?*

No.

We acknowledge that the current accounting for DC and DB benefit plans is inconsistent.

However, the difference arises from the fundamental issue that DC plans are accounted for on a cash basis as and when the liability passes out of the company, and DB plans are accounted for on an accruals basis allowing for a standard (AA) level of credit risk for as long as the liability remains in the company. As long as this remains the case, it is necessary to define a boundary between which plans get accounted for in which way. The current boundary is between pure funded (and perfectly matched) DC plans and all other plans. We suspect that it will be very difficult and may be impossible to define any other defensible boundary. Any attempt to draw another boundary will almost certainly lead to treating very differently two plans which are almost identical (in some cases economically identical but presented differently).

IASB staff have wrestled with this problem for several years now, and it is unlikely to be soluble as long as the accounting for pure DC and final salary plans remain as they are. Drawing further lines between categories of pension benefits will not resolve the problem.

Accordingly, IASB should give up any attempt to fundamentally change the accounting for any category of pension benefits until a comprehensive review of pensions accounting as a whole has been completed, and this review itself should be deferred until:

- The definition of “fair value” has been addressed for assets and liabilities that are not traded, including the treatment of risk (both diversifiable and non-diversifiable), and is being applied consistently to comparable assets and liabilities
- mark to market accounting is being implemented for comparable assets and liabilities
- the treatment of credit risk has been resolved as a matter of principle and is being implemented in a consistent way across accounting for comparable liabilities
- the recommendations of the project on presenting financial performance (including the treatment of gains and losses) are known

Pensions has suffered from being a test bed for the introduction of new accounting methods, with real impacts on real people derived from the inconsistent and tougher presentation of pension commitments relative to comparable liabilities.

On a more detailed level, paragraph 4.9 of the Discussion Paper notes that IFRIC was informed that attribution of benefits to periods of service generated questions in relation to some plans that promise benefits related to current year salary (or contributions derived from current salary) with subsequent revaluation or returns in line with some index or asset value. Some question whether future salary increases should be allowed for in assessing whether the plan formula attributes higher benefits to later periods of service. We agree this is a live issue.

However, we can see no connection between this issue and the proposals in the Discussion Paper to introduce a definition of contribution based promises with a completely new accounting treatment. Exactly the same issue would arise in relation to contribution based promises as defined in the Discussion Paper – except that IASB has simply omitted in relation to contribution based promises the requirement to allocate benefits on a straight line basis where the plan formula would allocate materially higher benefits to later periods.

The paper gives little justification for this omission except that it would change the accounting treatment for plans that would currently be classed as defined contribution. IASB has given no reason why it is more important to maintain the allocation in relation to plans that are currently classed as defined contribution than in relation to plans that are currently classed as defined benefit, and has not discussed the arguments for and against such a requirement. We believe that the existing requirement in relation to defined benefit plans is targeted at plans where there is step change in the plan benefit formula (for example where the accrual rate is 1% of final pay for each of the first 10 years of service, increasing to 2% of final pay thereafter), rather than at the impact of salary increases on plans with a flat benefit formula. The reasons for straight line allocation of benefits for plans with such a step change in the benefit formula apply just as much to plans that are currently defined benefit but would be re-categorised as contributions based as to plans that will remain categorised as defined benefit.

We believe that the issue could be resolved in a straightforward way by IFRIC clarifying that the existing requirement does not require allowance for future salary increases in assessing whether a plan formula allocates a materially higher benefit to later periods of service. We do not believe that it has any relevance in motivating the creation of a new category of benefit promises with novel accounting treatment as suggested in this Discussion Paper.

Question 6: *Would many promises be reclassified from defined benefit to contribution-based under the Board's proposals? What are the practical difficulties, if any, facing entities affected by these proposals?*

Yes.

As explained above, the proposals create an artificial distinction between categories of pension benefit that are almost identical (in some cases economically identical but presented differently). We have given examples in our response to question 15.

The proposed approach to recognising plans that will now be re-categorised as contribution based will

make them look more onerous and volatile than comparable liabilities. This will mislead management and investors, guiding them to sub-optimal decisions, with real world impacts on employees.

Question 7: *Do the proposals achieve that goal [of limited impact on plans currently classed as defined contribution]? If not, why not?*

We have not yet identified any such impacts.

Question 8: *Do you have any comments on those preliminary views [regarding the recognition for contribution based promises]? If so, what are they?*

We note that the proposal to require attribution in accordance with the plan benefit formula, without consideration as to whether this leads to allocating materially higher benefits to later periods, will mean differences in treatment between categories of pension benefit that are almost identical (in some cases economically identical but presented differently). We do not believe this can be justified on the fundamentals.

We also note that for any plan that meets the definition of a contribution based plan, but is back loaded in any way, requiring straight line amortisation would make the benefit attributed to past service salary related (by including a pro-rata part of what the plan benefit formula regards as benefits in respect of a future year based on that year's salary), thereby meaning the plan wouldn't count as contribution based after all. This demonstrates how fragile the proposed definitions would seem to be.

However, by adopting this approach the paper ignores important issues relating to the treatment of plan benefit formulas that are inherently back loaded. Although insignificant in the UK because of UK specific legislation, the issues are important elsewhere.

Question 9: (a) *Are there alternative measurement approaches that better meet the measurement objectives described in this paper? Please describe the approaches and explain how they better meet the measurement objectives?*
(b) *To what extent should the effect of risk be included as a component of the measurement approach at this stage of the Board's post-employment benefit promises project? How should this be done?*

The measurement objectives presented in the discussion paper are not justified. They are not derived from the Conceptual Framework; they are not justified in the discussion paper itself; and they are not applied in the measurement of comparable liabilities (not even final salary pension liabilities). We do not therefore believe that it is appropriate to measure the proposed measurement approach against those objectives.

In particular, the question as to how risk should be allowed for in relation to pension liabilities should be considered once allowance for risk (including credit risk) has been resolved at a conceptual level and is being implemented for the measurement of comparable liabilities (including those identified in the response to question 2 above) and in the same way as for those liabilities. Reflecting risk in the annual re-measurement of pension liabilities in advance of doing so for comparable liabilities will

make pension liabilities look more onerous and volatile than comparable liabilities. This will mislead management and investors, guiding them to sub-optimal decisions, with real world impacts on employees.

- Question 10:**
- (a) *Do you agree that the liability for benefits in the payout and deferment phases should be measured in the same way as they are in the accumulation phase? If not, why?*
 - (b) *What are the practical difficulties, if any, of measuring the liability for a contribution-based promise during the payout phase at fair value assuming the terms of benefit promise do not change?*

We agree that there should not be a change in the measurement approach as beneficiaries pass from employment to deferred status or from deferred to payment. Indeed, we do not see how it can be justified to measure identical liabilities differently because of past history that is no longer relevant. The thought process should not require either a change in measurement approach on a change in status, or require identical liabilities to be measured differently.

Further, many benefit plans have been formed from mergers of, or transfers from, predecessor benefit plans. Whilst the managers know the benefits to which members are entitled, they do not always know how those benefits were built up, making an approach based on phase (accumulation, deferment, payout) impractical if not impossible to apply in practice.

- Question 11:**
- (a) *What level of disaggregation of information about changes in the liability for contribution-based promises is useful to users of financial statements? Why?*
 - (b) *Do you agree that it is difficult to disaggregate changes in the contribution-based promise liability into components similar to those required for defined benefit promises? If not, why not?*

For plans that are not money purchase plans (under the current definition) the same level of detail as for defined benefit plans is both useful and possible (it is being provided now).

For plans that are money purchase plans (under the current definition) many of the items provided for defined benefit plans are redundant (because the company no longer has liability after payment of the money purchase contributions).

Seeking to classify two fundamentally different types of plan as contribution based makes some of the disaggregation difficult for some plans, i.e. the problem is with the categorisation of benefit plans not with the disclosure requirements.

- Question 12:**
- Should changes in the liability for contribution-based promises:*
- (a) *be presented in profit or loss, along with all changes in the value of any plan assets; or*
 - (b) *mirror the presentation of changes in the liability for defined benefit promises (see Chapter 3)?*

For plans that are not money purchase plans (under the current definition) the (measurement and) presentation of changes in the liability should be the same as for defined benefit plans – because such plans are defined benefit.

Question 13: (a) *What are the practical difficulties, if any, in identifying and measuring the 'higher of' option that an entity recognises separately from a host defined benefit promise?*

We understand that IASB staff have commented that pension actuaries already use option pricing and stochastic approaches for example in connection with the measurement of pension promises subject to guaranteed increases in line with inflation but with a minimum and/or maximum increase (a collar and/or cap) or in connection with asset liability studies. This is indeed the case. However, we note that:

- pension promises subject to pension increases with caps or collars can be measured using a closed form solution – there is no need to run stochastic projections; instead a simple formula can be used to derive the mean level of annual pension increases for such a promise from breakeven inflation and inflation volatility (which can both be backed out of market prices on swaps)
- asset liability studies are carried out at the level of the whole scheme, not for individual members.

In contrast we note that measurement of “higher of” promises would in general:

- have to be carried out for each individual member not at the aggregate scheme level
- require stochastic simulation for each member (there will not always be a closed form solution)
- require full calculations starting from individual member data at each balance sheet date (at interim reporting dates as well as at the financial year end); while defined benefit liabilities for the plan as a whole can readily be approximately rolled forward to each balance sheet date and compared with the asset value at that date, it will not be possible to roll forward the aggregate for the plan of the option value of “higher of” guarantees, which are very sensitive to the relative size for each individual member of the two liability measures at the balance sheet date.

To judge what would be involved if the suggested approach was implemented, we suggest considering the calculations implied by projecting forward the assets and two different pension promises for 40 years for say 1000 stochastic runs for each of the tens of thousands of members of a pension plan. And gathering the data required for each of these members at the balance sheet date from the plan administrator and performing (and checking) the required calculations all before the accounts are finalised.

All this means that while the approach set out in the paper is possible in theory, in practice the costs of pension cost calculations will be (literally) several orders of magnitude higher than now, and are unlikely to be possible within the timescale available from the year end to the date on which the accounts are finalised.

Question 13: (b) *Do you have any other comments on the proposals for benefit promises with a 'higher of' option? If so, what are they?*

We note that the statement in the discussion paper that the Board believes that measurement of "higher of" options at intrinsic value – as is normal under the current requirements of IAS 19 – may understate the value of the option.

We agree that this is possible – but note that the measurement of pension liabilities is already several steps further towards marking to market at fair value than for comparable liabilities such as those considered above in the response to question 2. This difference in the treatment of comparable liabilities is already making them look far more onerous and volatile than comparable liabilities. This is already misleading management and investors, guiding them to sub-optimal decisions, with real world impacts on employees.

It is therefore inappropriate to further increase the difference in treatment between pension liabilities and other comparable liabilities. Instead, attention should be directed at narrowing the difference. Once marking to market at fair value, allowing for any embedded options, is being implemented for comparable liabilities, a similar approach can be adopted for pension liabilities.

We note further that in many cases the proposed change will reduce rather than increase the value placed on the liabilities, as explained in the following example.

Example

A plan promises an employee age 50 a lump sum of the greater of:

- 1,000 on retirement at age 60
- the accumulation of a money purchase account invested in a government zero coupon bond which will mature in 10 years time with proceeds of £1,000.

The 10 year AA discount rate is 5%.

So the value of liabilities on a defined benefit basis is £614 (= $1000/1.05^{10}$).

With a government bond yield of 4% pa, the market value of the zero coupon bond is £676 (= $1000/1.04^{10}$).

On the approach generally adopted now taking a higher of option at intrinsic value, the value of liabilities is taken at the greater of £614 and £676, i.e. at £676.

On the proposed approach, the value would be the defined benefit value (£614) plus the option value of the excess of the money purchase maturity proceeds over the defined benefit promise (nil) i.e. £614.

This example is of a degenerate option for simplicity. However, the same principles will apply for "real" cases. In effect, by starting with the DB value, and then looking at the option value of the DC excess, the approach is applying a reduction in respect of non-existent credit risk to the first tranche (of an amount equal to the DB value) of the money purchase account. If this reduction in value exceeds the option value of the excess (which it often will), the approach will give a smaller overall value than the current intrinsic approach.

Question 14:

What disclosures should the Board consider as part of that review?

Disclosure principles should be applied consistently across all significant long term assets and liabilities. The demand from some investors for more disclosure relating to pensions has arguably been generated by the inconsistent treatment of pensions compared to other long term assets and liabilities, that makes pension liabilities seem more risky (relative to those other assets and liabilities) than in reality they are. If those other assets and liabilities were treated consistently, and similarly marked to market, we believe there would be a more balanced assessment of the need for, and extent of, disclosure relating to different assets and liabilities.

There are many assets and liabilities where different measures would give different values. It would therefore be inconsistent to require disclosure of more than one measure of pension liabilities (such as the suggestion that has been mooted of requiring disclosure of the buy-out cost for an ongoing plan).

The UK ASB has suggested extensive disclosure in corporate accounts of the powers of the trustees or managers of the entities pension plans. Contractual arrangements between the entity and its suppliers, customers and banks are not disclosed in the accounts, and confidential provisions within such agreements are often of far more significance than the provisions governing pension plans. Requiring disclosure of the “contract” between the entity and the trustees/managers would therefore be inappropriate. (Just the fact of disclosing powers that plan trustees have in extreme situations can - inappropriately and with adverse behavioural consequences - make a pension plan seem relatively risky compared to other long term assets and liabilities where there is no disclosure of similar provisions.) Further, such disclosures would be impractical (within any reasonable length of financial statements) for a group with multiple plans across different countries, where there can be no objective measure of what plan provisions would be “usual” (across country borders) and since little aggregation of the disclosures across plans would be possible because of different local law.

Similarly, there is no requirement to disclose expected cashflows for other long term assets and liabilities, so it would be unduly onerous to require disclosure of a pension plan’s expected cashflows (but see below in respect of aggregated data over the short term). In any case, it is the expected funding (not accounting) cashflows from the entity to the plan that matter most to users of the accounts, rather than the cashflows within the plan itself, and these cashflows are generally easier for the entity to adjust in the light of the entity’s financial state than is the case for other long term liabilities.

Requiring disclosure of aggregate contributions to the group’s pension plans over the next year or two is sensible. Beyond this period, actual employer contributions are so uncertain that disclosure would be misleading. Disclosure of funding agreements would be simply impractical (within any reasonable length of financial statements) for a group with multiple plans across different countries.

The disclosures about risk exposures and management should be required – where material – by general accounting standards (such as IAS 1) rather than setting out extra requirements for pensions.

In relation to the specific issue raised by the discussion paper, we note that IAS 19 already requires disclosure of significant assumptions, which would include the post-retirement mortality assumption (where relevant). However, we agree that it would be helpful to require disclosure of standard metrics (such as for example life expectancy for a 65 year old retiring now or in 10, 20 30 years time) rather than references to actuarial tables that may not be meaningful except to other actuaries.

Question 15: *Do you have any other comments on this paper? If so, what are they?*

Over recent years, IASB staff have made a number of attempts to draw an arbitrary line separating what are currently all defined as defined benefit plans. The proposed definition of contribution based promises in the discussion paper seems consistent with that history. For the reasons noted in Question 5, the only workable place to draw the line is where it currently is – between pure defined contribution plans and the rest.

The table below shows just a few examples illustrating why the proposed bright line is unworkable.

Contribution based	Defined benefit
Promise of 1000 at retirement for a deferred pensioner who participated in an average salary plan	Promise of 1000 at retirement for a deferred pensioner who participated in a final salary plan
Plan which defines pension based on average of all years' salary	Plan which defines pension based on average of up to 40 years' salary
This year's accrual under plan formula based on this year's salary	This year's accrual under plan formula based 50% (or 90% or 99%) on this year's salary and 50% (or 10% or 1%) on next year's salary

As explained above, a mixed model measuring contribution based promises (other than promises that would currently be treated as defined contribution) cannot be justified.

Applying option valuation to the excess of a "higher of" defined contribution promise over a defined benefit promise can give smaller rather than larger values than the intrinsic value approach which is commonly adopted now, due to the allowance for credit risk on defined benefit promises.

Of course, some of the difficulties with the half way house fudge proposed in the discussion paper would fall away if the measurement of defined benefit plans was also reviewed, and this may be the direction to go in the long term. However, for now pension plans already seem risky against a background of a generally non-volatile balance sheet. If the accounting was consistent, pension plans would seem just as volatile as now, but against a background where large parts of the balance sheet (generally larger than the pension plan) are equally volatile. Accounting would no longer present pension plans as being more risky than the rest of the business, and quite possibly different decisions would be (and have been) made. Indeed, real people may not have borne the real losses that they have on closure of schemes.

We do not suggest ending the marking to market of pension plan assets and liabilities, even though this would be more consistent with the current treatment of many other similar assets and liabilities. However, we would suggest that there should be no further changes to the accounting for pension plans until the issues addressed in the paper (fair value, marking to market, recognition of gains and losses, allowance for credit risk etc) have been addressed at the conceptual framework level and the conclusions applied consistently to all assets and liabilities.

The IASB has stated that it is concerned with appropriate representation of the underlying financial position, and that it cannot be swayed by the behavioural consequences. However, the behavioural consequences that affect pension plans do not result from the "fair" representation of pension plans.

Instead, they result from the different treatment of pension assets and liabilities compared to other comparable long term assets and liabilities. “Appropriate representation” must be considered relative to the treatment of comparable assets and liabilities, not in isolation, and not against selective comparison with the approach adopted for some (not all) categories of financial instruments under IAS 32/IAS 39 – which have only a limited impact for most entities, and do not apply to the categories of significant liabilities that are most similar to pension liabilities.