Response from Actuarial Profession

Martin Lowes

ASB – what we don't say

Marking to market is wrong or right

Measuring at risk-free discount rate is wrong or right

ASB – what we do say

Proposals (right or wrong in theory) exacerbate difference of treatment compared with comparable liabilities

"Appropriate presentation" should be judged relative to treatment of comparable liabilities, not as theoretical exercise for pensions in isolation

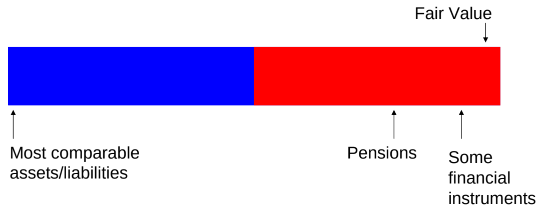
Treating differently makes pensions appear more onerous/volatile

Actually not (and other comparable liabilities generally larger)

This inappropriate presentation (relatively) has behavioural consequences

Defer any further changes to pensions accounting until issues addressed in conceptual framework and being applied consistently to comparable liabilities

Treatment of comparable liabilities



Treatment of Comparable Liabilities

Mark to Market	
Current IAS 19	Yes (with option to amortise)
ASB proposal	Yes
Debt issued by entity	No
Lease arrangements (assets and lease payments)	No (not all on balance sheet or at all)
Bank fixed rate loans/deposits	No
Framework	No preference for one measurement model over others
Conceptual framework (draft)	Not addressed yet

Treatment of Comparable Liabilities

With impact reflected in P&L	
Current IAS 19	An option (which few adopt)
ASB proposal	Yes
Debt issued by entity	No
Lease arrangements (assets and lease payments)	No
Bank fixed rate loans/deposits	No
Framework	No stated preference for P&L vs SoRIE
Conceptual framework (draft)	Not addressed yet

Treatment of Comparable Liabilities

Allowance for credit risk	
Current IAS 19	Yes – independent of entity risk
ASB proposal	No – risk free
Debt issued by entity	Yes – as at issue
Lease arrangements (assets and lease payments)	Yes - implicitly
Bank fixed rate loans/deposits	Yes – implicitly (interest rate reflects risk)
Framework	Not addressed
Conceptual framework (draft)	Not addressed yet

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Treatment of Comparable Liabilities

Disclosure of "contractual" terms	
Current IAS 19	No
ASB proposal	Yes
Debt issued by entity	No
Lease arrangements (assets and lease payments)	No
Bank fixed rate loans/deposits	No
Framework	Not addressed
Conceptual framework (draft)	Not addressed yet

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Treatment of Comparable Liabilities

Disclosure of impact if interest rates etc change	
Current IAS 19	If IAS 1 requires because material
ASB proposal	Yes – even if not material
Debt issued by entity	No (because impact is nil if not marked to market)
Lease arrangements (assets and lease payments)	No (because impact is nil if not marked to market)
Bank fixed rate loans/deposits	No (because impact is nil if not marked to market)
Framework	Not addressed
Conceptual framework (draft)	Not addressed yet

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Allowance for pay increases

Is there a constructive obligation to give pay increases

OR

Is there a constructive obligation to increase accrued benefits with pay increases

Fallback to inflation increases as deferred pension:

- mixes models
- UK centric

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Reflect only present obligations as liabilities

Needs further work (consider back-loaded scales – eg terminal vesting such as post-retirement medical).

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Immediate recognition?

Yes

But treat all assets/liabilities on same basis

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Risk free?

Defer question (in pensions context) until addressed by conceptual framework and being applied consistently to comparable liabilities

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Actual return

Re-define expected return in P&L as (average) asset value x discount rate

Gain/loss relative to this in SoRIE

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Disclosures

Apply principles consistently across comparable assets/liabilities

Marking pensions to market
⇒onerous/volatile
⇒requests for more disclosures

Absence of requests for comparable disclosures for comparable liabilities is because not marked to market

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IASB – Overall comment

As ASB

Presentation of Defined Benefits

Consistency – with comparable assets/liabilities (not just IAS 32/39)

Expected return – average asset value x discount rate

P&L
- service cost
- interest cost
- expected return

Other comprehensive income – Gains/losses (aka SoRIE)

Contribution based

Proposed boundary indefensible

Nonsense answers

Defer review of measurement (all DB) until
- mark to fair value
- treatment of credit-risk
- project on performance statements

have all been addressed in conceptual framework and being applied to comparable liabilities

Inconsistencies

Straight line for contribution based/DB

Deferred benefits from contribution based/DB

Consider final salary based on last 40 year pay

Consider accrual for current year service based on 50% (or 90% or 99%) of current year pay and 50% (or 10% or 1%) of next year pay

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"Higher of" options - Example

Employee age 50 promised lump sum of greater:

- 1000 at age 60
- DC pot in government zero coupon bond paying 1000 in 10 years

10 year AA yield is 5%

Value DB = 1000 / 1.05^10 = 614

MV pot = 1000 / 1.04^10 = 676

Current approach = Max (614, 676) = 676

Proposed approach = 614 + option value = 614

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