The Actuarial Profession
making financial sense of the future

Consultation response

IASB Exposure Draft: Defined Benefit Plans
Proposed amendments to IAS 19

September 2010

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Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

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6 September 2010

Dear Sir/Madam

Exposure Draft: Defined Benefit Plans – Proposed amendments to IAS 19

Thank you for the opportunity to comment on this consultation. We support the response from the International Actuarial Association. We do not intend to repeat the points that have been made by the IAA: rather in this letter we expand on matters of particular relevance to the UK.

Recognition

IAS19 has too many reporting options currently to aid decision usefulness. We support

- immediate recognition. Readers of accounts can readily understand both the evolution of cost for the company in question, and such relative to that for like companies. Transparency is necessary for good decision making.

  It is sometimes argued that immediate recognition leads to undesirable levels of volatility in accounting entries. Immediate recognition does not add to volatility – it merely records in real time the volatility inherent in markets (of all types) in particular, and in the real world generally. Volatility is real, it should be recognised and managed.

- service cost and finance cost being included in P&L, and re-measurements in OCI. This provides a practical mechanism to disclose a company's underlying costs separate from impacts from gains and losses arising from market movements and assumption changes.

Preparers of accounts in the UK have successfully operated such a model for some years, FRS17.

Net discount rate

We also support replacing the expected asset return with a net interest cost approach, with actual returns on investments held relative to the discount rate being booked in OCI[1]. We note however that companies accounting under FAS will still be able to take prior credit for expected outperformance on their assets and this could put companies accounting under IFRS at a systemic disadvantage if FASB do not converge in the

[1] The expected asset return approach implicitly targets a 'neutral' P&L position over time. That is, equities are expected to outperform bonds over time and credit for that outperformance is taken directly and in advance into P&L. Gains and losses against the 'neutral' position are taken through P&L (smoothed or unsmoothed depending on whether the corridor applies or not) or through OCI depending which reporting option is chosen under the current IAS19. The ED considerably simplifies the reporting options : the 'neutral' position is redefined to be that relative to the expected liability (through the discount rate) and gains and losses relative to the discount rate reported under OCI

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short term. Across the UK, it is estimated that aggregate profits of UK companies will fall by £10 billion in moving to a net interest cost approach. It may also lead to different behaviours, e.g. better matched investment strategies, as the accounting no longer has an in-built bias for equity over bond investment – whether such would lead to higher or lower economic cost over time for UK p.l.c. will depend on risk-return payoffs in future investment markets.

Other Items

We understand the Board are proposing adding an 'ABO' style disclosure in connection with the FASB convergence project (Question 9c). In the UK, the decision useful measure across all companies would be the liability for vested deferred pension obligations should all employees leave service voluntarily at the accounting date[2]. This is not the same measure as the DBO, but assuming salary growth is zero[3] – that is not a measure that would be decision useful for UK companies in our opinion.

In relation to Question 13c), we would ask the Board to clarify please how to account for the PPF levy. Does the Board consider the levy to be a pensions related item to be accounted for under IAS19 (either a tax or an administration expense) or as a non-pensions tax under general tax accounting rules? Should the PPF levy be recognised on an annual charge basis or capitalised into the DBO?

In relation to Question 13d), we agree with the IAA that although the Board Conclusions promote capitalisation of administrative expenses, the wording of the ED itself does not indicate the required treatment. Further, it is common for many expenses to be met by sponsors (and currently expensed as part of general administrative expenses) rather than through the pension plan (and expensed through pension cost): the ED should define which expenses are in scope if the intention is to ensure consistent treatment between expenses met within and those met outside the pension plan.

Finally, we list in the Appendix to this letter some drafting points for your consideration.

We hope this response is help to your deliberations. Please contact Martin Hewitt, Pensions Practice Manager on 020 7632 2185 or via Martin.Hewitt@actuaries.org.uk if anything is unclear or we can help further.

Yours sincerely

Martin Lowes
Chairman, Consultations Group, Pensions Practice Executive Committee

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[2] Generally, DBO would be higher than the liability for vested deferred pensions.   In recent years, benefit designs that cap pensionable salary growth have become common. Where the cap on pensionable salary growth is below Limited Price Indexation then likely the DBO is lower than the liability for vested deferred pensions.
[3] For back end loaded benefits, should those benefits be re-attributed for nil salary growth?

Appendix

Some drafting points on the Exposure Draft on Defined Benefit Plans

- While BC 82-83 state the decision to require taxes on benefits to be reflected in the DBO, and paragraph 73(b) requires an assumption to be made about the size of the future taxes, the ED itself does not seem to address the recognition of taxes in the measurement of the DBO or service cost.

- We did not follow the Board's thinking in saying in BC85 that "when the ultimate cost of the benefit promise depends on the return on plan assets less asset management costs…." in that the cost of all funded defined benefit plans depends on the return on plan assets.

- The definition of curtailment in paragraph 7 refers to "significant" in relation to both
  a) reduction in employees covered, and
  b) amendment which reduces degree to which future service qualifies for benefits.

  However paragraph 98A only refers to "significant" in relation to the first criteria

- Given that the ED will not permit unrecognised obligations going forward, it is not clear if the second (part (b)) clause in the definition of curtailment is needed going forward? Plan amendments would simply be treated as past service costs.

- On a general note, the ED makes reference in a number of paragraphs to 'best estimate' but the term is not well defined. It would be helpful if the Board could clarify the meaning of the term (either generally or each time it is used) as UK actuaries are required under the Board of Actuarial Standards to define such terms whenever used.

- We did not follow the need for the reference to "Unless paragraph 71A applies" in the examples to paragraph 69.

- In paragraph 73(a)(i), it would be helpful to provide a reference to "allowing for expected changes in mortality rates".

- We agree each of the two clauses in the last sentence in paragraph 98(c), but we do not agree that the first clause is because of the second. We suggest replacing the word "because" by the word "and".