Institute and Faculty of Actuaries

Proposed amendments to IAS 19 and IFRIC 14

IFoA response to IASB

6 November 2015

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

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.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

Mr Hans Hoogervorst
International Accounting Standards Board
IFRS Foundation
30 Cannon Street
London
EC4M 6XH

6 November 2015

Dear Mr Hoogervorst

IFoA response to IASB consultation paper - Remeasurement on a Plan Amendment, Curtailment or Settlement/Availability of a Refund from a Defined Benefit Plan: Proposed amendments to IAS 19 and IFRIC 14

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the IASB consultation paper on the proposed amendments to IAS 19 and IFRIC 14. The IFoA's Pensions Consultations Subcommittee has led the drafting of this response.

2. The IFoA is in general agreement with the IASB's concern over the issues addressed. We also agree with much of the IASB's approach in addressing those issues. However, we have a number of concerns with specific aspects of the proposals, which we have noted in our response. In particular, we would highlight the following main points:
   - in certain parts of the paper, there is inconsistent treatment of similar issues, to which we have referred in our response
   - it is likely that the cost of applying the changes would be much higher than the IASB envisages. This would cast doubt on whether the changes could be justified on cost/benefit grounds;
   - in certain parts of the paper, the proposals, we believe will worsen, rather than improve, comparability; and
   - specific drafting points are likely to lead to more uncertainty around interpretation and could increase, rather than reduce, divergence in practice in comparison to the current IAS 19.

3. Consequently, we would strongly encourage the IASB to revisit the issues in detail before developing revised proposals. We would happily meet representatives of the IASB to discuss in greater detail our current concerns with the proposals.

Question 1 – Accounting when other parties can wind up a plan or affect benefits without an entity's consent

The IASB proposes amending IFRIC 14 to require that, when an entity determines the availability of a refund from a defined benefit plan:

a) the amount of the surplus that an entity recognises as an asset on the basis of a future refund should not include amounts that other parties (for example, the plan trustees) can use for other purposes (for example, to enhance benefits for plan members) without the entity's consent

b) ***an entity should not assume a gradual settlement of the plan as the justification for the recognition of an asset, if other parties can wind up the plan without the entity's consent***

c) ***other parties' power to buy annuities as plan assets or make other investment decisions without changing the benefits for plan members does not affect the availability of a refund.***

4. Under the current version of IAS 19, our understanding is an entity is required to ignore third party powers and actions which might prevent the entity reaching the position of taking a refund of surplus. We agree this is inappropriate and that IAS 19 should be amended to require consideration of third party powers and actions. If that approach is taken, it should be consistent across IAS 19 and also across different scenarios. However, we do not believe that the ED achieves this. We also think that it is appropriate to consider what actions any such third party is likely to take; rather than assume that the third party will necessarily take the potential action (or alternatively, not assume that the action would occur at the first opportunity and/or in a way that absorbs the whole plan surplus). Illustrations of alternative courses of action include:
   - the plan trustee may have powers under the plan documentation to augment member benefits. However, agreements between the plan sponsor and the trustee on other matters may mean that using the power might have consequences elsewhere, which the trustee would want to avoid (for example a guarantee of parent support might drop away if the trustee uses specified powers under the plan documentation);
   - the trustee powers may be restricted to augment member benefits to the extent of the surplus on the funding basis, which may be smaller than that on the accounting surplus;
   - the trustee may have a policy to retain some, or all, of the surplus as a risk margin;
   - they may have agreed policies as to how they will exercise their powers and it would be appropriate to consider those policies as well as the trustee powers; and
   - particularly in the UK, which we believe is where third party powers are most likely to be present, the trustee will have a Statement of Investment Principles (SIP) setting out how it intends to invest the plan assets. The SIP can be changed, but only following due consideration, appropriate advice and formal consultation with the employer. If consideration is to be given to trustee powers to invest the plan assets (see below) then it would also be appropriate to take into account the trustee intentions as set out in the SIP.

5. Paragraph 64 of IAS 19 limits the measurement of a defined benefit asset to the lower of the plan surplus and the asset ceiling. IFRIC 14 addresses the assessment of the asset ceiling (rather than the plan surplus). We would strongly encourage re-drafting of Paragraph 12B of the ED to refer to the assessment of the asset ceiling rather than to the assessment of the surplus.

6. Under the ED, paragraph 12B states that surplus that could be used to enhance the amount of the benefits shall be excluded from the asset limit. Paragraph 12C states that there is no adjustment to the asset limit in respect of surplus that could be used to enhance the security of the benefits (by buying annuities as plan assets). The Basis for Conclusions provides little justification for this distinction. BC6 explains that buying annuities affects the future amount of plan assets, presumably rather than the future value of the Defined Benefit Obligation (DBO), although this is implied rather than stated. This does not relate to the right to the refund of a surplus, but neither does augmenting benefits. Both of these just affect the future surplus available to be refunded.

7. While it may be that an investment power would not impact the availability of a refund, an investment action could automatically prevent the realisation of such a refund (eg buying an insurance policy that could not be cancelled). In practice, there would be a regular charge to actuarial experience through comprehensive income, which would reduce any surplus recognized and ultimately deliver no economic benefit.

8. Although the arguments have not been included in the ED, IFRIC papers during the development of the ED attempted to draw a distinction by arguing that the:
   - power to buy annuities is not a power to use the surplus. However, since buying annuities will reduce the surplus it is challenging to consider how it could be regarded as anything other than a power that will reduce (i.e. "use") the surplus. In addition, it is also challenging to distinguish between a power that reduces surplus by augmenting the amount of the benefit and a power that reduces surplus by enhancing the security of the benefit.
   - difference in relation to the use of an investment power is that under paragraph 8 of IAS 19, the fair value of assets should be the price at the measurement date. Any future change in the value of the assets should be recognised at the future date when it occurs. While not disagreeing with the statement,we are unclear as to its relevance for the following reasons:
     - The defined benefit asset is taken as the lower of the plan surplus and the asset ceiling;
     - The asset value reflected in the plan surplus should indeed be the value at the measurement date and should ignore any potential future change; and
     - IFRIC 14 considers the assessment of the asset ceiling (rather than the plan surplus). The asset ceiling is considering the surplus available for a future refund which will reflect future changes.

9. This statement, if applied to changes in the asset value, would apply equally to changes in the DBO. The DBO reflects the benefits at the measurement date, and any augmentation of the benefits should be recognised at the future date when it occurs. Applying the same logic to a power to augment benefits would suggest that this too should be ignored in assessing the asset ceiling.

10. More fundamentally from the perspective of the entity, a buy-in and a buy-out are economically equivalent (ignoring the risk of insurer default), so the accounting for them should be consistent. If the existing wording of IAS 19 does not facilitate this, the wording should be revised to reflect this. The economic reality would not change to reflect the proposed wording of IFRIC 14.

11. Overall, we consider that:
    - powers that affect the asset value are economically equivalent to powers that affect the liability value and should be accounted for in an equivalent manner;
    - the IASB has not set out a justification in the ED or its Basis for Conclusions for treating the powers differently; and
    - the arguments used to draw a distinction between the powers in IFRIC papers do not distinguish between assessing the plan surplus and assessing the asset ceiling. For the above reasons, we believe that powers should be applied identically whether they affect the benefits or they affect the assets.

12. We note that the proposal is expected to affect mainly entities with UK pension plans. Until the EU adopted IFRS, UK companies accounted under UK GAAP and, in particular, under FRS17. FRS 17 was drafted in the UK having regard to UK circumstances and permitted recognition of surplus from which benefit could be obtained only through either a:
    - contribution reduction, or
    - refund of surplus that was imminently available and for which consent had already been received.

13. Amending IFRIC 14 to require that the assessment of the asset includes consideration of whether the trustee has power, would therefore be a move back towards the previous UK approach; the trustee is likely to use the power to apply surplus to buying annuities as an asset of the plan.

14. However, as noted above, we believe that, if consideration is to be given to trustee powers (and in particular to trustee powers to invest the plan assets) then it would also be appropriate to take into account any available evidence as to how the trustees are likely to exercise those powers. In particular, the trustee intentions as to how it intends to exercise its investment powers as set out in the SIP. Rather than classifying trustee powers based on assets and liabilities, they should be classified based on expectations on how the trustee will exercise those powers.

15. Including the implications of third party powers in the asset ceiling assessment under IFRIC also creates an apparent inconsistency with the definition of the DBO under paragraphs 87 and 88 of IAS 19. Under these paragraphs, the DBO reflects:
    - a history of *the entity* increasing benefits; or
    - an obligation for *the entity* to use surplus for the benefit of plan participants.

    However, there is nothing to suggest that the DBO should reflect a:

    - history of *a third party* (e.g. a trustee) increasing benefits; or
    - power for *a third party* (e.g. a trustee) to use surplus for the benefit of plan participants.

16. In some circumstances, the accounting will consider a way around the absence of reference to third party powers. For example, if the plan has experienced past surpluses, which have been applied under trustee powers to augment benefits, and the plan has a current surplus, the entity would probably assume the surplus is used in line with the trustee past practice (it may ignore the reference in paragraph 88(a) to the history of increases *by the entity*). However, in other circumstances, the approach may be less clear. If the plan has been in deficit for a number of years, but now has a surplus, and the trustees have the power to use the surplus to augment benefits, Paragraphs 87 and 88 would not appear to provide any justification for assuming that the trustees apply all, or part of, that surplus for the benefit of plan participants.

17. Including explicit reference to trustee powers for the assessment of the asset ceiling under IFRIC 14, while not referring to trustee powers to augment benefits under paragraphs 87 and 88, will strengthen the suggestion that the absence of reference to trustee powers under paragraphs 87 and 88 implies that no allowance for use of these powers should be made for assessing the DBO under paragraphs 87 and 88.

18. We therefore suggest that, if IFRIC 14 is amended to include reference to third party powers, then the IASB should consider whether trustee powers should also be allowed for in assessing the DBO under paragraphs 87 and 88 of IAS 19. We would suggest that paragraphs IN6 and 61 are similarly amended.

Question 2 – Statutory requirements that an entity should consider to determine the economic benefit available

The IASB proposes amending IFRIC 14 to confirm that when an entity determines the availability of a refund and a reduction in future contributions, the entity should take into account the statutory requirements that are substantively enacted, as well as the terms and conditions that are contractually agreed and any constructive obligations.

19. The IFoA supports this proposed amendment.

Question 3 – Interaction between the asset ceiling and past service cost or a gain or loss on a settlement

The IASB proposes amending IAS 19 to clarify that:

a) ***the past service cost or the gain or loss on settlement is measured and recognised in profit or loss in accordance with the existing requirements in IAS 19; and changes in the effect of the asset ceiling are recognised in other comprehensive income as required by paragraph 57(d) (iii) of IAS 19, as a result of the reassessment of the asset ceiling based on the updated surplus, which is itself determined after the recognition of the past service cost or the gain or loss on settlement.***

20. We welcome the intention to clarify the interaction of requirements on past service costs, settlements and on the asset ceiling.

21. We note that, where a plan is in surplus, but recognition of the surplus is restricted (e.g. to nil), and a plan amendment has the effect of increasing (or reducing) the DBO (consequently reducing or increasing the plan surplus), then:
    - the cost (or credit) arising from the plan amendment is recognised in P&L; and
    - an equal and opposite change in the effect on the surplus restriction is recognised in OCI.

22. It seems unusual that a change that has no effect on the asset recognised in respect of the plan surplus should generate a non-zero charge (or credit) in P&L. It also seems unusual that, if the surplus is restricted because the trustee has the power to use the surplus to augment member benefits, and then the trustee (rather than the entity) uses the surplus in exactly the way envisaged by the asset restriction, that the impact of the plan amendment is still recognised in P&L.

23. We acknowledge that there are no easy answers to this issue. It is consistent with the general approach that all movements in the surplus restriction are recognised in OCI and that any other approach would require a comprehensive review of when changes in the surplus restriction (or the corresponding changes in the either the surplus or the recognisable surplus) should be reflected in P&L and when they should be reflected in OCI.

24. We would recommend that the IASB include text in the Basis for Conclusions acknowledging the counter-intuitive outcome of the proposal, and explaining why this outcome is appropriate. Currently, the Basis for Conclusions only considers the technical issue as to whether the proposal is consistent with other requirements in IAS 19, and ignores the more substantive issue as to whether the proposed requirement and its outcome are appropriate.

25. Draft paragraph 64A refers to the treatment of changes in the effect of the asset ceiling based on the updated surplus. For example, we note that a curtailment may change the asset ceiling itself, as well as changing the current plan surplus. The change in the effect of the asset ceiling could arise from either source. It may be helpful to reflect this in the text.

26. For the new paragraph 64A – about the measurement and recognition of past service cost or curtailment gain/loss and the related changes in the effect of the asset ceiling – we would ask the IASB to consider whether it is more appropriate to include this in a section of IAS 19 headed "Statement of financial position". If this is not done, we believe it could confuse users of IAS 19. We would suggest that it would be logival to include this in paragraph 57 or paragraph 122.

Question 4 – Accounting when a plan amendment, curtailment or settlement occurs

The IASB proposes amending IAS 19 to specify that:

a) ***when the net defined benefit liability (asset) is remeasured in accordance with paragraph 99 of IAS 19:***
    (i) ***the current service cost and the net interest after the remeasurement are determined using the assumptions applied to the remeasurement; and***
    (ii) ***an entity determines the net interest after the remeasurement based on the remeasured net defined benefit liability (asset).***

b) ***the current service cost and the net interest in the current reporting period before a plan amendment, curtailment or settlement are not affected by, or included in, the past service cost or the gain or loss on settlement.***

27. Re-calculating the service and interest costs following a re-measurement (driven by a plan amendment, curtailment or settlement) could be seen as moving IAS 19 nearer to US GAAP. However, we note that, under US GAAP, service and interest costs would also be re-calculated following a re-measurement for interim accounts.

28. BC 13 and 14 explain it would not be appropriate to ignore the impact of a plan amendment, curtailment or settlement in the calculation of service and interest costs for the period following the event. However, the IASB does not offer any justification why the impact of the event should be reflected on the updated assumptions, rather than on the beginning year assumptions. BC17 states that the proposals would provide more relevant information, an enhanced understanding and eliminate diversity, but it does not offer supporting evidence.

29. We believe the proposals would reduce comparability, and hence reduce both relevance and understanding. The reduction in divergence only requires clarification that adjustment should be made for the impact of a plan amendment, curtailment or settlement in the calculation of service and interest costs for the period following the event. It does not require switching the calculation onto the re-measurement basis. It is unclear what has changed from the view given in BC 64 of the current IAS 19.

30. We agree that it would not be appropriate to ignore the impact of a plan amendment, curtailment or settlement in the calculation of service and interest costs for the period following the event. We can see no advantage in requiring this allowance to be on the re-measured basis rather than on the beginning year position. However, as set out below, we can see a number of disadvantages in recalculating the service and interest costs for the plan as a whole on the re-measured basis.

31. We have set out our thinking in this area by means of two examples. Entity X and entity Y are identical, have identical plans and the same financial reporting period. In the absence of any plan amendment, curtailment or settlement, you would expect their pension cost accounting to be consistent.

32. Under the current IAS 19, if entity X arranges a settlement for 1% of its liabilities, it would show a small settlement impact, but the pension cost accounting for X and Y would remain consistent and comparable. In both cases, their pension cost accounting would be based on beginning year assumptions for the whole period. If their pension costs are very different, it would be clear that this were due to the entities adopting different assumptions.

33. Under the proposals, entity X would recalculate service and interest costs (in respect of the whole plan, not just the 1% that was settled) for the balance of the financial period on the basis of market conditions at the date of the settlement. Entity X pension cost could therefore be very different from that for entity Y. It would be impossible to tell how much of the difference was due to the impact of the revised market conditions at the re-measurement date, and how much was due to the entities making inconsistent assumptions in the first place. Investors would lose any ability to compare the pension cost accounting for entities X and Y.

34. Another entity Z has two plans. One of the plans arranges a settlement for 1% of its liabilities during a financial period.

35. Under the current IAS 19, the pension cost accounting for both plans would remain on the beginning year assumptions for the whole period. Any investor wanting to investigate the impact of applying revised assumptions would be able to adjust the disclosed numbers.

36. Under the proposals, entity Z would rework service and interest costs for the affected plan (in respect of the whole of the plan, not just the 1% that was settled) for the balance of the financial period on the basis of market conditions at the date of the settlement. It would not rework the service and interest costs for the other plan. The total service and interest costs shown in entity Z's accounts would therefore reflect:

- one plan with the cost wholly on the beginning year assumptions, and
- the other plan with the cost partly reflecting these assumptions and partly on revised assumptions.

37. It would appear that there is no expectation that the entity would disclose the re-measured net defined benefit liability (or the assumptions used to assess it) lying behind the recalculation of service and interest costs. Indeed, disclosing full details for each re-measurement could generate voluminous disclosures and would simply not be practical. The aggregate service and interest costs shown would not reflect the disclosed beginning year assumptions.

38. Investors would lose their current ability to investigate the impact of applying revised assumptions or to project forward the expected costs for the following year, based on changes in market conditions since the beginning of the year. Investors would also find it more challenging to understand the disclosures and their implications for the future.

39. BC17 argues that the expected benefits of requiring recalculation of the service and interest costs for the whole plan would outweigh the additional costs, as the net defined benefit liability or asset already has to be re-measured. We do not agree with the IASB view that there would therefore only be limited additional costs, as explained in the following paragraphs.

40. It would be possible to consider the impact of a settlement affecting a small subset of the liabilities. As at the date of the settlement, the net defined benefit liability and the impact of the settlement are as follows.

	Before settlement	After settlement	Impact of settlement
Impacted liability	A	0	A
Remainder of liability	B	B	n/a
Total liability	A + B	B	A
Plan assets	C	C - payment	payment
Net defined benefit liability	A + B - C	B – C + payment	A - payment

41. Paragraph 99 of IAS 19 refers to re-measuring the net defined liability to derive the impact of the settlement on the basis of market conditions at the date of the settlement. In practice, all the entity requires is the value of the settled liability on the updated assumptions and the value of the amount paid to settle the liability. The entity never needs to know the value of the rest of the liability or the value of the plan assets; so in the absence of the proposed reporting requirement, it would not incur the cost of re-measuring them. The payment made to settle the liabilities is "known" and does not require any calculation.

42. Similarly, for a plan amendment, the entity only needs to know the value of the impacted liabilities before and after the amendment on the updated market conditions. It never needs

to know the value of the rest of the liability or the value of the plan assets and therefore it does not incur the cost of re-measuring them.

43. The impact of re-measuring a small proportion of the liabilities is small, so proportionate methods can be adopted without any material approximations. Re-measuring the entire assets and liabilities would be much more significant, so a more detailed and expensive approach would be required. It would not be just the extension of the calculations to the whole plan which increases costs, but the more onerous approach required because the impact will be material.

44. In particular, measuring the asset value at 'non-standard' dates (not at a month or quarter end) can be onerous, as investment manager and custodian reporting tools are not usually set up to provide this information.

45. Overall, as explained given the absence of any benefit from the proposal, the negative impacts on comparability and on the clarity of the disclosures, combined with the significant additional cost, we remain unconvinced that the proposal can be justified.

46. We would, however, support clarification that service and interest cost for the period from the date of the plan amendment, curtailment or settlement are adjusted to reflect the impact of these developments, but not for the general movement in conditions between the beginning of the financial period and the date of the event. We believe this is in line with the usual current practice.

47. A plan amendment, curtailment or settlement could be so limited that re-measuring the net defined liability at the date of the event (as opposed to using the beginning year position to assess the impact of the event) would not make a material difference. Alternatively, the impact could be so limited that the event is not material at all. In either case, the impact of using the re-measured net defined liability at the date of the event to recalculate the service and interest costs for the balance of the financial period could nonetheless be material. We ask the IASB to consider whether the need to carry out the re-measurement be driven by whether it makes a material difference to the assessment of the impact of the plan amendment, curtailment or settlement (and the recalculation or not of the service cost and interest cost on updated financial conditions follow from this), or alternatively, whether the re-measurement makes a material difference to the pension cost as a whole, including the potential impact on service cost and interest cost in respect of the unaffected liabilities and assets?

48. The ED does not appear to be consistent between whether it is a plan amendment and/or curtailment in itself which drives a re-measurement (and the consequential recalculation of service and interest costs for the whole plan), or whether it is the impact on accrued benefits (with a non-zero past service cost).

49. Many plan amendments and/or curtailments only affect future accrual and do not impact accrued benefits.

50. Under paragraphs 99 and 100 of IAS 19, it is clear that it is only necessary to re-measure the net defined benefit liability to assess the past service cost if a plan amendment or curtailment does actually generate a past service cost. No re-measurement is required if the plan amendment or curtailment only affects future accrual. The heading above paragraph 99 is similarly restricted to past service costs and does not refer to either plan amendments or curtailments directly.

51. However, the ED is not always consistent with this and creates uncertainty as to whether the proposed amendments apply in respect of any plan amendment or curtailment, or only where there is a past service cost. For example:

- the title of the ED implies it applies to all plan amendments and curtailments;
- in part (a) on page 4 of the ED, the text implies that a re-measurement is required for every plan amendment and curtailment;
- the title of Question 4 implies it relates to all plan amendments and curtailments;
- the amended text in paragraph 99 now implies that the entity should re-measure the net defined benefit liability after any plan amendment or curtailment (even if there is no past service cost);
- the heading to BC13 refers to plan amendments and curtailments (rather than to past service costs as for paragraph 99); and
- BC 13 to BC19 generally refer to re-measurements arising from plan amendments, curtailments and settlements, rather than (as in IAS 19) to re-measurements arising from past service costs and settlements.

52. We believe it is important to clarify the intention of the ED; otherwise the amendments will lead to divergence of approach. Such divergence could have a more material impact than the uncertainty that the proposals are intended to address.

Question 5 – Transition requirements

The IASB proposes that these amendments should be applied retrospectively, but proposes providing an exemption that would be similar to that granted in respect of the amendments to IAS 19 in 2011. The exemption is for adjustments of the carrying amount of assets outside the scope of IAS 19 (for example, employee benefit expenses that are included in inventories) (see paragraph 173(a) of IAS 19).

53. We agree this transition approach is appropriate for the changes relating to the asset ceiling.

54. However, as noted above, we are concerned that the IASB has significantly underestimated the additional costs that will result from the proposed changes relating to the accounting following a plan amendment, curtailment or settlement. These costs will be particularly onerous if the requirements are applied to past events, where the calculations required by the new requirements were not planned for at the time of the event, and the calculations already carried out have to be revisited. In particular, the required data may now be difficult to access. If the IASB proceeds with these proposed changes, we are particularly concerned about the higher costs in relation to past events. We therefore suggest that either:
    - the proposed changes relating to the accounting following a plan amendment, curtailment or settlement are adopted prospectively. The restatement only affects the split of movements in the assets and liabilities between P&L and OCI and does not affect the net pension plan asset/liability at the beginning of the year of adoption of the revised standard; or
    - a long transitional period (between issue of the amended standard and when application becomes mandatory) should be available. This would allow entities to build in the significant extra work at the time of the relevant exercises during the comparator year or years for the year the amendment is adopted.

Should you wish to discuss any of the points raised in further detail please contact please contact Philip Doggart, Technical Policy Manager, at **Philip.Doggart@actuaries.org.uk** or on **0131 240 1319**.

Yours sincerely

Fiona Morrison
President, Institute and Faculty of Actuaries