The voice of banking & financial services

International Accounting Standards Board
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26 September 2008

Dear Sirs,

Preliminary Views on Amendments to IAS 19 Employee Benefits

This is the British Bankers' Association's response to the above discussion paper. The BBA is the leading association for the UK banking and financial services sector, speaking for 223 banking members from 60 countries on the full range of UK or international banking issues and engaging with 37 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts and contributing £50 billion annually to the UK economy. We welcome the opportunity to comment.

General comments

Although we accept that there may be a short term need to amend IAS 19 to address aspects of the standard which result in the provision of less than optimal information to users (namely the corridor approach to the recognition of changes in the value of pension scheme assets) we do not agree that such a broad review of IAS 19 as set out in the discussion paper is required at this time. In particular, we do not believe changes should be made to the existing requirements on the presentation of changes in the value of assets and post-employment benefit obligations in the performance statement at this time nor that defined contribution schemes should be included. These are not immediate priorities and in our view the risks of pursuing hasty solutions outweigh any benefits which might be derived in the short term.

Rather we suggest that the Board conducts a more focused short term project to require assets and post-employment benefit obligations to be recognised immediately, and in full, with a consequential elimination of the corridor. It would be realistic to expect that a limited review such as this could be completed in a shorter timeframe than is envisaged by the Board. Any change in presentation of actuarial gains and losses in the income statement and the issues raised by cash balance schemes, including alignment of any changes in measurement with defined benefit schemes, can then be subject to later projects which can take into account cross cutting issues such as presentation and fair value measurement. Ideally, we would wish to see pension plan assets and liabilities being measured on a consistent basis and presented together.

A thorough review of IAS 19 should be undertaken after the completion of other related projects; particularly the financial statement presentation project, the conceptual framework and the review of IAS 37. Ideally, this longer-term review should be conducted jointly with the FASB to enable the development of the common standard envisaged by paragraph 1.15 of the discussion paper. We would also suggest that the Boards should review the outcome of the European Financial Reporting Advisory Group's project on the financial reporting for pensions.

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Below we offer our views on the questions posed. These should, however, be read through the lens of our above comments: we do not believe the majority of the issues raised in the discussion paper should be included within the scope of the project at this stage. They should instead be part of a fundamental review at a later date.

Specific comments

Chapter 1: *Introduction*

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?**

In our view the discussion paper fails to make a case for such broad reform in the short term. Stating that ‘anecdotal evidence and academic research’ (paragraph 1.2) points to the fact that users of financial statements ‘agree that post-employment benefit promises pose a significant risk, many of them do not understand the information that entities provide about pension benefit promises’ is not adequate justification. The discussion paper needs to, at a minimum, cite the relevant ‘academic research’ and preferably should be based on the conclusions of research conducted by the staff to ascertain users’ views. It would also be helpful to receive a summary of the issues debated by the Employee Benefits Working Group.

Notwithstanding our points above, we accept that there is a desire on the part of both users and preparers to review IAS 19. We recognise that a full review of IAS 19 would take some time and there are issues that could be resolved in the short term. In principle this is a logical approach. However, in our view, the discussion paper attempts to address too many issues and in effect amounts to a major review of IAS 19. We suggest that the Board refocuses the paper on amendments which can be made in the short term, such as the elimination of the corridor and the immediate recognition of plan assets and liabilities.

We note that the FASB is conducting a parallel project. If, as is stated in paragraph 1.15, both Boards view the development of a common standard as the ‘ultimate goal’ we suggest that a new project should be conducted following the finalisation of the conceptual framework, the revision of IAS 37, financial statement presentation and the outcome of any short term amendment to IAS 19 and US GAAP. Also, as noted in paragraph 1.3, the European Financial Reporting Advisory Group is currently conducting a major project in this area. We suggest this project has the potential to usefully inform the Board’s work.

In conclusion, we cannot agree with the scope of the project or its objectives.

Chapter 2: *Deferred Recognition of Changes in the Liability for Defined Benefit Promises*

2. **Are there factors that the Board has not considered in arriving at its preliminary views? If so, what are those factors? Do those factors provide sufficient reason for the Board to reconsider its preliminary views? If so, why?**

The discussion in paragraphs 2.3 to 2.12 should, in our view, form the sum of any amendment to IAS 19 in the short term. We agree with the conclusion that entities should recognise all changes in the value of plan assets and defined benefit obligations in the financial statements in the period they occur and that they should not be smoothed over a period of time. Those elements recognised in the statement of recognised income and expense should continue to be so recognised.

However, we would highlight the volatility that this would introduce to the income statement unless the statement of recognised income and expense was used as at present. Relatively small changes in assumptions can lead to considerable changes in the value of what are by their nature long-term liabilities. Therefore, any change will need to be made in the context of the development of meaningful performance reporting. The measurement of a pension scheme's assets and liabilities will have to reflect their long term nature.

We disagree with the views reached in paragraphs 2.13 to 2.15. We believe that a differentiation between the components of changes in liabilities and assets (the expected returns and actuarial gains or losses) should be presented separately including the use of the statement of recognised income and expense as at present. This is the key to developing appropriate performance reporting that reflects the different nature and predictive value of the different components of the changes.

We agree with the Board's preliminary decision to retain the general requirement for unvested past service costs to be recognised in full in the period in which they arise (paragraphs 2.16 to 2.21).

Chapter 3: *Presentation Approaches for Defined Benefit Promises*

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?

As noted above, we do not believe it is appropriate for this project to consider issues of presentation. To us, there is little value in the Board pre-empting the Financial Statement Presentation project, which is developing a long term solution to the issue of the presentation of gains and losses in the performance statement. Only once this project is completed do we believe the Board should return to the issue of how actuarial gains and losses are presented within the context of IAS 19. Therefore, in the interim, we believe the two presentation approaches currently permitted by IAS 19 should continue to be permitted, i.e. the presentation of all actuarial gains or losses in other comprehensive income or the presentation of all changes in the value of assets and liabilities in profit or loss.

Notwithstanding this, of the three options listed, our preference would be for approach 2, as it minimises volatility in the income statement.

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?

Again, we do not believe that two approaches set out in the paper should be adopted at this time. The current arrangements should be maintained until such time as a fundamental review of IAS 19 is conducted and a thorough assessment of the strengths and weaknesses of different presentation approaches made.

Chapter 5: *Definitions*

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?

We do not believe that it is appropriate for the project to focus on issues such as this in the short term or that the discussion paper makes a convincing case for the need for change. Rather we believe this should be addressed as part of a longer-term review of IAS 19 conducted following the completion of the conceptual framework and other related projects.

Further we believe the proposals raise two fundamental inconsistencies which, in our view, make the proposed approach illogical and likely to lead to confusion. The first is the treatment of career average schemes and how they compare with final salary schemes or career average revalued schemes. Each of these can essentially be considered as a scheme that promises a pension of a defined fraction of current pay for the current year of service. The difference is that:

a) in a career average scheme there is no further increase;
b) in a career average revalued scheme the pension is increased in line with (typically) price inflation;
c) in a final salary scheme the pension is increased in line with the employees own rate of pay increase; and
d) in a further variant, the increase could be in line with the return on an equity index.

Under these proposals, a) and d) would be classified as contribution based, c) would be defined benefit and b) would believe would be defined benefit. In our view, there is little logic in treating these four differently – in each case there is a future uncertainty (other than arguably a)), it is just the nature of that uncertainty which is different.

The second is the treatment of pensions in payment. Paragraphs 8.5 onwards acknowledge that once a pension is in payment, the way in which it was derived is irrelevant. However, the proposals later suggest that the way the promise is accounted for should depend on whether it is derived from a promise treated as defined benefit or one treated as contribution based. We cannot see the logic in this. In trying to resolve one perceived inconsistency, the proposals merely create another.

We believe that one implication of this proposal is that a promise which includes a pension that is index-linked would not be a contribution based promise, whereas a fixed one (or one increasing at a fixed rate) would be. This again is inconsistent – a fixed pension is not intrinsically any more certain than an index linked one – they both carry demographic risk and both have an investment risk; one is nominal, one is real.

As well as leading to a major change in the way certain post-employment benefits are accounted for, we believe the proposals would introduce real measurement difficulties. For example, it is not unusual for a single trust to contain both a defined benefit and contribution based promise section, with a pool of assets that are available to both sections. If the proposals were applied to such a scheme, it would be difficult for preparers to disaggregate changes in the value of the plan assets and benefit liabilities in different ways for the two types of promise. Arbitrary decisions would then be required to determine the change in value of the plan assets attributable to different sections when some are reported in income and others in other comprehensive income. In addition, it would be necessary to determine the assets available to the contribution based promise section in order to measure credit risk. This would involve calculating a value consistent with the measurement attribute of the contribution based promise section and then determining the priority of the two sections for the plan assets. The proposals would therefore require preparers to not only determine a fair value assuming the terms of the benefit promise do not change for the contribution based promise section but also for the defined benefit promise section. We doubt whether this could be done on a consistent basis between different entities without much additional guidance and complexity.

In summary, we believe these proposals should be withdrawn and a proposal developed which avoids these problems.

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?

We fear that the proposals may lead to many promises being reclassified; particularly those which are based on career average earnings or are associated with a specific return on contributions or those with a 'higher of' option.

Please see our answer to question 5, where we discuss the possible practical difficulties of the proposals.

7. Contribution-based promises, as defined in this paper, include promises that IAS 19 classifies as defined contribution plans. The Board does not intend this proposal to lead to significant changes in the accounting of defined contribution plans in IAS 19. Do the proposals achieve that goal? If not, why not?

We are concerned that the proposed definition of 'contribution-based promises' includes some schemes which are currently classed as defined benefit schemes. We would highlight defined-benefit schemes with a guaranteed return on contributions in IAS 19.26 as an example of a scheme which would be scoped into the new category. We do not believe this category raises major measurement difficulties under the existing IAS 19 requirements and therefore question why it has been included.

Chapter 6: *Recognition Issues relating to Contribution-Based Promises*

8. Do you have any comments on those preliminary views? If so, what are they?

We agree with the decision to exclude these issues from the scope of the short term project. Our, in principle, thoughts on the preliminary views recorded in the discussion paper are that we:

- agree unvested contribution-based promises should be recognised as a liability;
- agree that benefits from a contribution-based promise should be allocated and recognised in accordance with the benefit formula; and
- agree that there should be no requirement to recognise an additional liability to reflect the amount that an employer would have to pay an employee who leaves service immediately after the reporting date.

Chapter 7: *Measurement of Contribution-Based Promises-Core issues*

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 promises project? How should this be done?

We do not believe that measurement is an issue which should be considered as part of a short term project to review IAS 19. It should instead be part of a long term project which considers all the relevant aspects of accounting for benefits.

We agree that defined contribution promises do not expose employers to the same risks as do defined benefit schemes and agree that the Board has identified the main risks that employers are exposed to in paragraph 7.22. We believe that the measurement approach should include all the risks identified, other than the risk that the terms of the benefit will change (as concluded by the Board).

Chapter 8: *Measurement of Benefits after the Accumulation Phase*

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 the benefit promise do not change?

We agree with the Board's preliminary view that the liability to pay benefits in the deferment phase should be measured on the same basis as in the accumulation phase. It would not be helpful to have a change in the measurement basis when employees move from one category to another. However, as noted above, we do not believe that measurement should be considered at this time.

With regard to b) we do not see that there are any additional practical difficulties to measuring the liability for a contribution based promise during the payout phase at fair value which do not exist for the accumulation phase. The measurement approach should reflect what the liability is and not how it was accumulated.

Chapter 9: *Disaggregation, Presentation and Disclosure of Contribution-Based Promises*

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?

A defined contribution scheme will have a liability only to the extent of any unpaid contributions. As such, we do not believe that disaggregation is necessary. A cash balance scheme measured as a defined benefit scheme can have the same level of disaggregation as other defined benefit schemes (regular cost, expected return, interest and actuarial gains). We believe that a cash balance scheme measured at fair value (assuming the benefit promise does not change) could be disaggregated into components but only on a fairly arbitrary basis.

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)? Why?

Option A has the advantage that it looks relatively simple to implement, although B may prove more useful as it might lead to defined benefit and defined contribution based liabilities that are currently treated as defined benefit liabilities being presented in a more consistent way.

Chapter 10: *Benefit Promises with a 'Higher of' Option*

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?
B) Do you have any other comments on the proposals for benefit promises with a 'higher of' option? If so, what are they?

Instinctively, the proposed accounting makes sense and looks to be consistent with the treatment of financial options in IAS 39. There may, however, be legitimate questions about the ease with which such options can be valued.

14. The Board intends to review the disclosures required about post-employment benefit promises in a later stage of this project. As part of that review, the Board intends to consider best practice disclosures in various jurisdictions. For example, explicit requirements to disclose information about the mortality rates used to measure post-employment benefit liabilities could be introduced to allow users to understand the

inherent uncertainties affecting the measurement of those liabilities. What disclosure should the Board consider as part of that review?

We agree that the disclosures made under IAS 19 are useful. We suggest the starting point for any review should be an assessment of the current requirements usefulness. Each disclosure which is judged to provide useful and relevant information should be maintained. Examples of further disclosures we believe it may be useful to consider include: measurement assumptions, the sensitivity of measurement assumptions, alternative measurements of liabilities (for instance buyout amounts) and a description of investment strategies.

We would also add that many large institutions operate a number of different, often small, pension schemes throughout their groups. We believe it is important that disclosures focus only upon those schemes which are material to the entity and request that the Board considers this point as part of its review.

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

Other than reiterating that we do not support the proposed scope of the project and urging a more focussed short term amendment, we have no further comments.

Yours sincerely,

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