The LIAJ's Comments on the IASB Discussion Paper "Preliminary Views on Amendments to IAS 19 Employee Benefits"

1. We would like to extend our gratitude to the International Accounting Standards Board (IASB) for providing us with an opportunity to submit our comments on the discussions about financial reporting for employee benefits.

2. The Life Insurance Association of Japan (LIAJ) is a trade association which was established to promote sound development of the life insurance industry in Japan and maintain its reliability. The association is comprised of all (45) life insurance companies operating in Japanese markets including corporate pensions.

1 General Opinions

3. In response to calls to review the accounting for post-employment benefit promises, this Discussion Paper addresses specific issues for short-term improvements. It is understandable to tackle complex issues step by step; however we have a deep concern that a limited scope could impair the reliability and comparability of financial statements and may hinder providing financial information which is truly useful to the users.

4. The Discussion Paper can be divided into two parts: Chapter 2 and Chapter 3 propose immediate recognition of defined benefit promises, while latter parts of the Discussion Paper propose accounting for contribution-based promises. Regarding Immediate recognition in the statement of financial position, we have some understanding of its direction based on post-retirement cost presented in the other comprehensive income, but not presented in profit or loss. However, we think that there are still some outstanding issues to discuss about the measurement method of defined benefit promises before a final decision. We also oppose the classification of defined benefit promises and contribution-based promises as proposed in the Discussion Paper, and we hope that the Board will give careful consideration to this issue.

5. The Discussion Paper proposes that all changes in the value of liabilities and in the fair value of plan assets arising from a contribution-based plan should be presented in profit or loss, while also proposing three approaches for the presentation of defined benefit promises. Even if the immediate recognition in the statement of financial position is adopted, we propose that actuarial gains or losses and past service costs or credits, which arise during the period but are not recognized as components of net periodic benefit costs under the current IAS 19, be presented in the other comprehensive income separately from profit or loss. As a result, actuarial gains or losses and past service costs or credits can be subsequently recycled as they are recognized as components of net periodic benefit cost.

2 Responses to Questions in the Discussion Paper

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?

【Response】

6. It is understandable to address complex issues step by step; however we have a deep concern that a limited scope could impair the reliability and comparability of financial statements and may hinder providing financial information which is truly useful to the users. We have doubt about and are opposed to the Board's proposal of "contribution-based promises" and measurement methods described in the Discussion Paper for the following reasons:
   - The definitions of defined benefit plans and defined contribution plans under the current IAS 19 are simple and clear;
   - The Board proposes contribution-based promises to overcome measurement defect of cash balance plan and shows its preliminary view that entities should use fair value as a measurement attribute for the liability of a contribution-based promise. However, the Discussion Paper only states in Paragraph 7.23 that "the effect of asset-based risk can be determined by reference to observable market prices of similar assets", and it does not provide sufficient explanations for asset-based risks, which seem to be the most difficult to measure in practice. It is not clear how to calculate the measurement amount of the fair value; and
   - Contribution-based promises include those which promise a specified return on contributions, other than cash balance plans. There is not sufficient reason for using a different measurement method in those promises, which are almost equivalent to defined benefit promises except salary risk.

7. If immediate recognition is introduced, the presentation methods implemented by Statement of Financial Accounting Standards (SFAS) 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* should be referred to.

Question 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?

【Response】

8. The preliminary views propose immediate recognition, or the abolishing of deferred recognition of post-employment benefit obligation and the Corridor Approach which have been permitted under the current IAS 19. Against the current standard permitting deferred recognition, there may be wide criticism that the information about surplus or deficit of plans is not appropriately recognized in the

financial statements and, thereby, users of the financial statements have difficulty in evaluating the entity's financial position and ability to meet its post-employment benefit obligation. On the other hand, we find some difficulties judging whether or not the accounting requirement should be changed without sufficient discussion about the measurement model of defined benefit promises. We are afraid that the accounting requirement could be changed again, due to the result of subsequent reviews of the measurement model. It is highly probable that such a change would make users of financial statements be confused. Even if post-employment benefit obligation is immediately recognized in the statement of financial position, we suggest that actuarial gains or losses and past service costs or credits, which have been deferred for later recognition under the current standard, be presented in other comprehensive income. Actuarial gains or losses and past service costs or credits should then be subsequently recycled as they are recognized as components of net periodic benefit cost.

9. If immediate recognition is introduced, it would be useful to refer to Statement of Financial Accounting Standards (SFAS) 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. The Statement has already implemented methods for immediate recognition in the statement of financial position and methods to present the items, which have been deferred for later recognition under the current standard, in other comprehensive income in the statement of comprehensive income.

10. The Board has shown preliminary views that entities should not divide the return on plan assets into an expected return and an actuarial gain or loss because the subjectivity inherent in determining the expected rate of return may not be eliminated completely. However, even if immediate recognition in the statement of financial position is adopted, an expected return and an actuarial gain or loss should be separately presented in the statement of comprehensive income. We insist that further discussions should be made before the Board makes this conclusion. More specifically, we believe that entities should divide the return on assets into an expected return and an actuarial gain or loss, as required under the current IAS 19, and should present an expected return in profit or loss, while presenting an actuarial gain or loss in other comprehensive income. Actuarial gain or loss will then be subsequently recycled as they are recognized as components of net periodic benefit cost. Also, unvested past service costs or credits should be presented in other comprehensive income and then be subsequently recycled.

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?

【Response】

11. The Discussion Paper proposes the following three approaches: Approach 1: Entities present all changes in profit or loss; Approach 2: Entities present only the costs of service (both costs arising during the period and any past service costs) and changes in service costs caused by changes in assumptions other than the discount rate in profit or loss, and present all other costs in other comprehensive income; and Approach 3: Entities also present interest cost (representing increases in the amount of the defined benefit obligation because of the passage of time) and interest income on plan assets in profit or loss in addition to the costs of service and changes in service costs caused by changes in assumptions other than the discount rate. The Discussion Paper also states that "the Board was persuaded that it would be a sufficient short-term improvement to require entities to recognize all components of post-employment benefit costs in comprehensive income" in Paragraph 3.8.

12. Measuring all financial instruments at fair value and presenting the changes in profit or loss remains a long-term target of the financial instruments projects. Taking this into account, it is too early to decide the adoption of Approach 1.

13. For this reason, Approach 1 is not appropriate, especially in the limited scope of the proposals. We also believe that it is not sufficient to attach disaggregation of information about fair value, and that it is necessary to present some components of defined benefit cost in other comprehensive income.

14. The differences between Approach 2 and Approach 3 are the presentations of interest cost (representing increases in the amount of the defined benefit obligation because of the passage of time) and interest income (on the corresponding plan assets). These items are presented in other comprehensive income in Approach 2, while they are presented in profit or loss in Approach 3. Even if immediate recognition in the statement of financial position is adopted, we believe that actuarial gains or losses and past service costs or credits, which arise during the period but are not recognized as components of net periodic benefit costs under the current IAS 19, be presented in other comprehensive income separately from profit or loss. Actuarial gains or losses and past service costs or credits should then be subsequently recycled as they are recognized as components of net periodic benefit cost, regardless of the classification of defined benefit promises and contribution-based promises. As a result, we support neither Approach 2 nor Approach 3.

15. SFAS No. 158 requires presentation in other comprehensive income as follows:

- Recognize the funded status of a benefit plan in the statement of financial position;
- Recognize as a component of other comprehensive income, net of tax, the gains or losses[1] and prior service costs or credits that arise during the period, but are not recognized as components of net periodic benefit cost pursuant to FASB Statement No. 87, Employers' Accounting for Pensions or No. 106 Employers' Accounting for Postretirement Benefits Other Than Pensions; and

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[1] Changes in the amount of either the projected benefit obligation or plan assets resulting from experience different from that assumed and from changes in assumptions (Paragraph 29 of SFAS No.87)

- Amounts recognized in accumulated other comprehensive income are adjusted as they are subsequently recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of Statements 87 and 106

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?

【Response】

16. As we stated in Paragraph 14, even if immediate recognition in the statement of financial position is adopted, we believe that actuarial gains or losses and past service costs or credits, which arise during the period but are not recognized as components of net periodic benefit costs under the current IAS 19, should be presented in other comprehensive income separately from profit or loss. Actuarial gains or losses and past service costs or credits should then be subsequently recycled as they are recognized as components of net periodic benefit cost, regardless of the classification of defined benefit promises and contribution-based promises.

17. In Paragraph 3.29, the Discussion Paper states three ways to estimate interest income on plan assets to be presented in profit or loss when Approach 3 is adopted. From our viewpoint, using dividends received on equity plan assets and interest earned on debt plan assets (we regard it as using the current rate market participants required for equivalent assets) and using market yields at the reporting date on high corporate bonds to input interest income are similar in their use of expected return(s) on plan assets. Although the Discussion Paper holds a negative view on using an expected return, as shown in Paragraph 2.15, we think it is appropriate to use an expected return. In SFAS 87, an expected return on plan assets is used to determine the net periodic pension cost to be presented in profit or loss. If there are predetermined rules for an expected return linked to the actual return on plan assets (for example, using an actual average yield on plan asset during a five-year period, or adding 15 percent of unrealized gain/loss to actual dividends received on equity plan assets and interest earned on debt plan assets), subjectivity of the reporting entity can be eliminated. Thus, our view is that there are other ways to eliminate subjectivity.

18. Approach 2 and Approach 3 propose that the amount presented in other comprehensive income should not be recycled. We believe that it is desirable to maintain a clean surplus relation and, therefore, the full amount presented in other comprehensive income should be eventually presented in profit or loss, although they are deferred. Under Approach 2, interest income and interest cost are presented in other comprehensive income and will not be recycled. We do not support this approach because the clean surplus relation is not maintained. Under Approach 3, interest income and interest cost are presented in profit or loss, while changes in fair value of plan assets as well as changes in post-employment benefit obligation included in actuarial gain or loss arising from changes of

discount rate are presented in other comprehensive income and will not be recycled. However, we propose that an entity should present remeasurements that arise from changes in assumptions other than the discount rate in other comprehensive income. If an expected return linked to the actual return on plan assets is used for interest income presented in profit or loss as we have suggested, and the unrealized gain/loss included in the expected return is deducted from the difference between fair value and book value of plan assets presented in accumulated other comprehensive income, changes in fair value of plan assets presented in other comprehensive income will eventually be presented in profit or loss in full amount, whether this is called recycling or not. This idea is similar to one in IAS 39, under which the difference between fair value and book value of available-for-sale securities (financial assets) is presented in other comprehensive income and then is subsequently released to profit or loss using the effective interest rate if those instruments are held to maturity. It should be noted, however, that such treatment is not called reclassification in IAS 39. We also think that changes in the measurement amount arising from changes of actuarial assumptions, which are presented in other comprehensive income, can be eventually recycled and presented in profit or loss in full, by amortizing the impact of changes of such assumptions in service cost and by deducting the amortization amount from transition asset or obligations, which is presented in accumulated other comprehensive income. This idea is similar to one in SFAS 158.

19. The Discussion Paper proposes the abolishment of the Corridor Approach without sufficient discussions. We are opposed to this proposal. As discussed in Paragraph 2.5 in the Discussion Paper, the long periods for which plan assets are held gives the opportunity for some gains or losses on plan assets to reverse or offset each other and, similarly, the long periods before settlement of post-employment benefit obligations could give changes in market interest rate being applied as a discount rate that arise in any period an opportunity to reverse. This is what we call “return reversal effect” in asset management, and it is based on the experiences in the market economy that market prices often diverge from theoretical prices temporarily, but converge in a long term. The Corridor Approach is a simplified method that does not require changes of amortization rate for recycling transition assets or obligations caused by such temporary divergence from accumulated other comprehensive income to profit or loss. Considering the characteristics of post-employment benefit obligations as ultra-long term liabilities, we believe that the Corridor Approach is an effective method to maintain.

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?

【Response】

20. If we apply the proposed definition in the preliminary views to post-employment benefit plans in Japan, not only defined contribution plans, but also some defined benefit plans, such as accumulated point plans (where an employer credits points to its employees based on their job grade for each year of service and pays benefits calculated at retirement by multiplying the accumulated points by the unit price), that promise a specified return as well as cash balance plans are classified as

contribution-based promises. On the contrary, defined benefit promises are limited to final salary promises with salary risk etc.

21. Compared to the simple and clear definitions of defined benefit plans and defined contribution plans under the current IAS 19, which focus on whether an entity bears the risk to pay further contribution or not, the proposed definition of contribution-based promises is very broad, complex and hard to understand due to its intent to cover a wide variety of post-employment benefit plans in the world, including hybrid type schemes.

22. Our understanding is that the Discussion Paper proposes the new category “contribution-based promises” to address the issue of measurement of the liability in some contribution-based promises, including cash balance plans. Therefore, the discussions should focus on these contribution-based promises.

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?

【Response】

23. In Japan, many companies have adopted accumulated point plans, while the number of companies that adopt cash balance plans is increasing. Therefore, we suppose that many pension plans in Japan would be reclassified from defined benefit to contribution-based.

24. As stated in Paragraph 21, the definition of contribution-based promises is very complex and hard to understand. In practice, companies must confront difficulties in classifying defined benefit promises and contribution-based promises, and they must find difficulties when measuring fair value of contribution-based promises as deliberated in Chapter 7. We have a particular concern for contribution-based promises that promise a specified return because the contribution-based promises will be required to change the measurement method unnecessarily.

Question 7
Do the proposals achieve that goal? If not, why not?

【Response】

25. Under the current IAS 19, defined contribution plans are clearly defined and classified by focusing on risks that a company bears. We think that there is little need to change this classification. If any amendment is necessary for defined contribution plans, it should be made within the current classification.

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

【Response】
（No comments）

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?

【Response】

26. The Discussion Paper proposes that entities should measure the liability of a defined benefit promise by disaggregation of the components of defined benefit obligations, and that entities should measure the liability of a contribution-based promise at fair value. However, it is not clear what the similarities and differences are between these two measurement approaches. Therefore, we believe that the Board should focus on developing a method to measure the liability in some contribution-based promises, including cash balance plans.

27. Even though there is no active secondary market for post-employment benefit liabilities, the preliminary views proposes to adopt fair value as a measurement attribute for the liability of a contribution-based promise. However, the Discussion Paper does not provide clear explanations for asset-based risks, which seem to be most difficult to measure in practice, as it only describes that the effect of asset-based risks can be determined by reference to observable market prices of similar assets in Paragraph 7.23.

28. The Board also proposes that an estimate of future cash flows should be used in measurement of the liability of contribution-based promises at fair value, and that such an estimate should be the probability-weighted average of the present value of the cash flows. Considering that measurement at fair value will impose a substantial burden in practice, we believe that a deterministic approach, which uses a single estimate of the cash flows, should be permitted in measurement of the liability in contribution-based promises other than cash balance plans.

29. The Board basically thinks that credit risk should be included in measurement of the liability of contribution-based promises. It should be noted, however, that net assets of an entity will increase as its credit deteriorates, while net assets of the entity will decrease as its credit improves. It is doubtful whether such changes in net assets consistently reflect the entity's overall risk profile. Therefore, we are opposed to the reflection of credit risk in measurement of the post-employment benefit liabilities.

30. Also, it is doubtful whether it is appropriate to call the measurement amount proposed for contribution-based promises "fair value" because the term "fair value" is not used for measurement of insurance liabilities in the Insurance Contracts Project, which is also considering a measurement method employing three building blocks. The Board's assumption – to exclude the risk that the terms of the benefit promise change – does not incorporate part of the risks that are possibly included in a

current exit value proposed as a measurement attribute of insurance liabilities. As a result, it would be less appropriate to call the proposed measurement of liabilities for a contribution-based promise as fair value than the measurement of insurance liabilities.

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 the benefit promise do not change?

【Response】

31. The liability for benefits in the payout and deferment phases is economically the same in both defined benefit promises and contribution-based promises. Therefore, it will be problematic to apply different measurement methods and have different measurements amount to the liability in payout and deferment phases. Thus, we take the view that a separate measurement method should be developed, but only for cash balance plans during the accumulation phase.

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?

【Response】

32. As stated above, we take the view that a separate measurement method for cash balance plans during the accumulation phase should be developed. To address the issues on measurement of benefits that depend on future returns on assets, exceptions could be made, such as permitting higher discount rates in hedge accounting where the asset liability management is in place. We think it is possible to disaggregate the changes in liabilities of cash balance plans into components, such as required in defined benefit promises.

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)? Why?

【Response】

33. We believe that changes in liability for contribution-based promises should mirror the presentation of changes in the liability of defined benefit promises; this is based on the same reasoning for defined

benefit promises. We see no reason for requiring different presentations for contribution-based promises and defined benefit promises.

Question 13

(a) What are the practical difficulties, if any, in identifying and measuring the ‘higher of’ option that an entity recognizes 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?

【Response】

34. The preliminary views propose that entities should recognize benefit promises with a ‘higher of’ option as the “host” defined benefit promise plus the ‘higher of’ option. However, we do not understand how to measure the ‘higher of’ option in practice.

Question 14

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

【Response】
（No comments）

Question 15

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

【Response】
（No comments）