Swedish Bankers´ Association
Svenska Bankföreningen

POSITION PAPER
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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Discussion Paper – Preliminary Views on Amendments to IAS 19 Employee Benefits

Dear Sirs,

We appreciate the opportunity to respond to the International Accounting Standards Board's Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits*. This letter represents the views of the Swedish Bankers' Association.

General remarks

We share the view of the Board that the present standard for pension obligations has too many alternatives for the presentation of defined benefit obligations. However we believe that the present note information makes it possibly to create comparable information between different entities. However, we object to all of the three suggested approaches in the Discussion Paper to presentation of defined benefit promises. We believe that the two methods to present actuarial gains and losses immediately either in SoRIE or income statement, that is currently available under IAS 19, should not be changed. We further more believe that the "corridor" approach in the current version of IAS 19 should be maintained.

We believe that no quick fixes should be made. Before fundamental changes are made of the valuation of defined benefit obligations in the financial statements a deep analysis should be made of the reasons why the present methodologies exists as a basis for reconsidering the financial reporting for both pension assets and liabilities. When the IASB recently added an additional option for the recognition of actuarial gains and losses in 2004, the IASB expressed that "the IASB accepts that requiring actuarial gains and losses to be recognized in full in profit or loss in the period in which they occur is not appropriate at this time because the IASB has yet to develop fully the appropriate presentation of profit or loss and other items of recognized income and expense." E.g. a more fundamental analysis of why not the present pension obligation should be presented instead of a non contractual future obligation is needed. Why not using amortised cost, normal financial liabilities are measured at amortised cost, why should pensions liabilities be measured differently? Should not the measurement of similar assets and liabilities be measured similarly even though different standards apply? We believe that there is a link between using expected return on plan assets and using expected future salary increases as basis for measuring the present pension liabilities. Therefore, the measurement of one side of the balance sheet should not be amended before also changing the

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other. The current value of plan assets should not be reported in the income statement or in the balance sheet before the present, instead of the future salary, is used as the measurement basis for the pension liabilities. Such change should also have the advantage of reducing the unnecessary difference between pension liabilities and life insurance liabilities.

We believe that the purpose of the present standard is to display an accrued net pension cost that is taken to earnings as the employee performs its services to the company. As long as we have a mixed measurement model, we believe that convincing arguments have to be presented why changes in fair value of pension liabilities should be presented in earnings or in the balance sheet instead of in the notes and why the fair value of assets in another entity which may not be controlled by the employer should be presented in earnings or in the balance sheet of the employer. Amortised cost is presently the basic measurement basis for long dated liabilities, before changing that for pension obligations other standards should be amended at the same time.

When reconsidering the presentation of defined pension promises we believe that it is important to in dept reconsider why non contractual future salary increases should form the basis for the measurement of defined benefit promises liabilities while that is not the case for defined contribution promises. That difference also creates an unnecessary difference in the financial reports between different entities. When reading the DP it seems that the Board may have found that future non contractual pension obligation should not be presented in the financial reports (page 75 paragraph 4): ”the Board’s view was that to do so would misrepresent the nature of the entity’s obligation. The Board thought that the unit of account should be the benefit promise that has been made, not a benefit promise that might exist in the future”. And page 65 paragraph 6.8 has the following wording: ”For example, if a defined contribution plan promises a benefit of contributions of 5 per cent for the next ten years, the fact that the benefits earned in later periods are higher than the benefits earned in early periods would not affect the accounting. Entities would not make an accrual in the early periods for the higher benefits to be earned in the later periods.” Other arguments are found in paragraph 6.9: “The Board’s preliminary views is that entities should measure a contribution-based promise at fair value assuming the terms of the benefit promise do not change. It is not meaningful to calculate the fair value of an allocated amount”. We believe that the last quote is especially relevant for defined benefit schemes since a calculation of the current value of a defined benefit obligation is presently based on a non contractual expected future salary.

We have focused our comments on the questions concerning recognition and presentation of defined benefit promises since they are more relevant for Swedish banks than the contribution-based promises that are discussed in the DP.

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?

The Discussion Paper proposes that all changes in the present value of the defined benefit obligation are recognised in the financial statements in the period in which they occur. Since the present value of the defined benefit obligation always will be reflected in the statement of financial position without any deferral mechanism, the issue of measurement of the defined benefit obligation becomes even more important. One issue that the Discussion Paper does not address is whether the liability for defined benefit promises should be based on expectations of employees' pensionable salaries when they leave service or whether the liability should be based on current salaries at each reporting date.

We believe that the liability for past service (and the pension expense for each period) should be based on the benefits that the employer is presently committed to provide – this would usually be benefits based on current salaries. Under this view, the pension expense of each period will reflect the extra pension liability incurred by giving increases in pensionable salaries. We disagree with the requirement in the present standard to anticipate expected future salary increases. We believe that only benefits that the entity is presently committed (by legal or constructive obligation) to pay should be reported as liabilities, not benefits to which the entity might become committed in the future. In our view, that principle should apply also to increases in pension benefits that result from salary increases because we believe it provides the clearest view to users of an entity's obligations. Employees typically become more expensive as they progress through their careers. In addition to paying higher current benefits as they progress, in a final salary plan the employer also makes the original pension promise more valuable with each increase in pensionable salary. We believe that the current approach is inconsistent with the treatment of expected increases in other elements of remuneration – such as salaries and bonuses – which are accounted for in the periods in which they occur. We believe that the increase in value of an employee's pension benefits is in economic terms not distinguishable from the rest of the remuneration for each year of service – in effect it is a bonus in the form of additional pension benefits. Under this view the cost of promoting an employee includes an increase in the value of the employee's pension benefits (that is usually larger the longer the employee's service). That cost should be reflected as an expense of the period in which the decision to promote the employee is made, together with increases in other components of the employee's remuneration.

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?

We do not agree that entities should not continue using an expected return on assets. As long as the expected future salary forms the measurement basis for defined benefit obligations it is relevant to use the expected return on assets. The Board states in paragraph 2.15 of the Discussion Paper that it is concerned that the subjectivity inherent in determining the expected rate of return provides entities with an opportunity to choose a rate with a view to manipulating profit or loss. Accordingly, the Board states that its preliminary view is that entities should not divide the return on assets into an expected return and an actuarial gain or loss. We believe that such a statement by the Board is not consistent with an objective to develop principles-based standards. There is no more subjectivity involved in estimating the expected return on plan assets than it is in estimating other actuarial assumptions such as future salary increases, rates of employee turnover, and discount rates and so on. The Board has also accepted a high degree of subjectivity in other recent amendments of standards, such as valuation of intangible assets and contingent liabilities in a business combination at the benefit of providing more decision-useful information to users of financial statements. We must assume that the entities are doing their best when estimating different variables. It would be inconsistent to recognise the interest cost in the income statement if not recognising some kind of long-term return on the plan assets that exist to secure the benefit obligation.

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?

We believe that the two methods to present actuarial gains and losses immediately either in SoRIE or income statement, that is currently available under IAS 19, should not be changed until a fundamental analysis is made of both plan assets and pension liabilities. Such analysis should strive at conforming the financial reporting of pension obligations with other similar items like financial liabilities and life insurance liabilities. An amendment of one should be made at the same time as the others.

We do not believe that any of the proposed approaches for presentation in the Discussion Paper provides more useful information to users of financial statements for the following reasons:

- It is not feasible to use the immediate recognition approach through P&L for actuarial gains and losses (Approach 1) until the Board resolves substantial issues about performance reporting. There is little point in fixing something in IAS 19 now that might be out of line with the final presentation standard.

- Approaches 2 and 3 suggest splitting actuarial gains and losses into one portion that should be part of service costs and therefore recognized immediately in the income statement and one portion that should be recognized immediately in other comprehensive income. There is no conceptual basis for treating actuarial gains and losses in different ways as proposed under those approaches. We therefore question on what conceptual basis Approaches 2 and 3 operate in order for those approaches to bifurcate actuarial gains and losses into two different portions that are accounted for differently:
    - It is arbitrary to divide actuarial gains and losses into one portion that is recognized in earnings and the other portion in other comprehensive income.
    - Financial statements will be more complex to understand when some actuarial gains are found in the income statement and others in other comprehensive income.

- The approaches proposed by the IASB lead to divergence from US GAAP. We fail to see the merit in creating a new divergence from US GAAP when the present IAS 19 is more similar to the amended US GAAP standard than the proposed approaches.

- Approach 2, which requires interest cost to be presented in other comprehensive income, would be inconsistent with most other IFRSs, which require interest cost to be recognized in profit or loss (e.g. interest on available for sale classified interest bearing securities).

(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?

See our comments on question a) above and our general remarks. We do not see the merit in presenting some costs in equity and some in earnings, especially actuarial gains and losses. Until a deep analysis has been performed of the whole financial reporting for pensions, no changes should be made. As mentioned above we are not convinced that there are reasons for amended the cost model presently used for pensions in a mixed-models approach. Instead information of some kind of current value could continue to be presented in as supplementary information outside the income statement and the balance sheet.

We do not see the merit in giving more disaggregated information of fair value of pension liabilities. For plan assets there are merits in giving information about the composition of the assets in different main categories (e.g. equities, interest bearing instruments, real estate). However if that information should be given separately for pension assets or as part of risk information in general has to be decided by the entity depending on the circumstances. E.g. it might be natural for a bank to present the risks in the pension system together with its Basel 2, pillar 3 disclosures or IFRS 7 disclosures.

(c) What would be the difficulties in applying each of the presentation approaches?

Approach 1 does not entail any difficulties to apply, but we question the information content as discussed above.

Approaches 2 and 3 are difficult to apply due to the difficulties in explaining the numbers due to the split presentation of actuarial gain and losses.

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?

See our general remarks above.

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?

See our general remarks above regarding the present pension liabilities classified as defined benefits pension liabilities. For the defined contribution based promises we have no opinion since the once described in the DP is uncommon in Sweden.

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?

We do not believe this is the case in Sweden, where a majority of plans are so called final salary plans.

Question 7

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

We have no specific comments on this question.

Question 8

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

We have no specific comments on this question.

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.

We have no specific comments on this question than the once given as general remarks.

(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?

We have no specific comments on this question than the once given as general remarks.

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?

We foresee great difficulties in establishing a fair value as there is no practical guidance or illustrative examples in the Discussion Paper on how to establish such a fair value.

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?

We believe that the same level of disaggregation of information about changes in the liability for contribution-based promises should be used as for defined benefit obligations. We are not aware of the difficulties involved in disaggregating changes in contribution-based promises due to the fact that such plans are quite rare in Sweden.

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?

From a conceptual basis, we believe that the same treatment should be offered as for 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?

We believe that there are severe difficulties in identifying the appropriate option pricing model for higher of options and we believe that any results from such model will be subjective and that such model probably will generate different results for different entities since the model will have to be adjusted based on the entity's expected behavior when future value changes occur. The difficulties are especially severe since it will not be possible to back test the model against any market prices since no market exists for such promises.

Question 14

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

We have no specific comments on this question.

Question 15

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

We have no specific comments on this question.

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