Lane Clark & Peacock LLP
St Paul's House
St Paul's Hill Winchester
Hampshire SO22 5AB
Tel: 01962 870060
Fax: 01962 870086
www.lcp.uk.com

TJM/813170/VIE

26th September 2008

International Accounting Standards Board

SUBMITTED VIA IASB WEBSITE

Dear Sir or Madam,

Preliminary views on amendments to IAS19 Employee Benefits – LCP response

We welcome the opportunity to respond to the above discussion paper.

LCP is a leading actuarial consultancy based across Europe with offices in Belgium, Ireland, the Netherlands, Switzerland and the UK. We have extensive specialist knowledge of accounting for pensions, and for the last 15 years have produced our annual Accounting for Pensions report which is widely recognised as an authoritative survey of how leading global companies report their pension obligations.

We support the IASB's objective of improving the accounting standard to enhance comparability between companies. Most large companies in Europe already recognise gains and losses on the balance sheet in the year in which these occur (Source: LCP Accounting for Pensions Survey 2008), although we note that there are some countries and sectors where most companies defer recognition using the corridor option. Allowing companies the choice makes it more difficult for readers of accounts to compare companies, so in principle we support the removal of the corridor option, but would note that there are valid reasons for certain sectors to adopt the corridor, and these issues need to be addressed as part of any change.

We have significant concerns with the remaining proposals in the discussion paper, which further complicate what is already a complex standard. These problems arise from the limited scope of this first phase of the review. Because of the limited scope, the proposals represent a piecemeal approach to improving the standard, rather than a full examination of all the issues. We therefore support deferring further consideration of these proposals to the second phase of the review, so that a coherent standard can be developed which addresses all types of plan consistently, and treats pensions consistently with the rest of companies' financial performance. Our key concerns are:

- We believe there are serious drawbacks to all three of the alternative approaches set out for determining the pension costs in profit & loss and other comprehensive income. For the reasons set out in our response to question 3 in the appendix, we believe that they do not represent an improvement over the existing standard. Furthermore, in our view it is premature to revise the presentation of defined benefit pension plans before the completion of the financial statement presentation project. We therefore suggest that these fundamental revisions to the determination of pension costs are deferred to the second phase of the project to amend IAS19, and that all gains and losses should continue to be recognised outside profit and loss in other comprehensive income as is currently permitted.

- The proposals on contribution based promises introduce a new and complex set of rules that are fundamentally different to the existing rules for defined benefit plans. The new rules would raise numerous practical difficulties, be difficult for investors to understand, and mean that similar plans could be accounted for in very different ways depending on which category they fall into. We think that while the proposals have some merit, further consideration should be deferred to the second phase of the project as part of a comprehensive reconsideration of pensions accounting, in order to avoid having fundamentally different rules for similar types of plan.

- The proposed rules on "higher of" plans also, in our view, go beyond what is appropriate for the first phase of the review. We recognise that the accounting for these plans raises difficulties. However, we believe these should be considered alongside the accounting for defined benefit promises in the second phase of the review in order to avoid inconsistencies in the rules.

Our responses to the specific questions raised in the consultation are given in the attached appendix. In summary, we believe that the first phase of the review should be restricted to removing the option of delayed recognition through the "corridor", and that the remaining issues should be addressed as part of a comprehensive reconsideration of pensions accounting in the second phase.

I would be happy to discuss any of the points raised in this letter with you.

Yours sincerely

{Sent as an attachment to an e-mail on 26th September 2008 at 16:48}

Tim Marklew FIA
Consultant

Enc: Appendix

Scope of the project

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?*

No, we do not believe that additional issues should be addressed; rather, the scope of the short-term project should be narrowed for the reasons set out above.

Recognition and presentation of defined benefit promises

Question 2

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

We agree that all gains and losses should be recognised in the period in which they occur.

There are arguments both for and against the proposed change to IAS19 to recognise unvested past service cost in the period of the plan amendment. We believe that this change would introduce confusion for readers of accounts who are familiar with the current rules, without a compelling benefit. We therefore suggest that this change is deferred to the second phase of the project.

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?

We do not support any of the three approaches outlined as we have significant concerns with all three. Our comments are:

Approach 1 - recognition of all gains and losses in profit or loss.

> While there are theoretical merits in this approach, the additional volatility introduced into the profit and loss account would hinder, rather than help, readers of accounts in understanding company pension schemes and their effects on companies' financial performance. Readers of accounts will need to be able to understand and correctly adjust accounts to ensure that valuations of companies correctly take into account risks and

projected cash flows. We believe that users of accounts would usually strip out pension gains and losses from profit and loss as the first stage of analysis. It is therefore helpful to have gains and losses shown separately outside profit and loss as at present.

Approach 2 - recognition of service cost in profit and loss, all other changes in assets and obligations outside profit and loss.

Our key concern is the treatment of interest cost as an element of other comprehensive income outside profit and loss, because:

- This is inconsistent with other areas of IFRS, under which interest on liabilities is reported within profit and loss; and

- Companies which do not pre-fund their plans will benefit from reporting the income from the alternative use of capital within profit or loss, whereas companies that do pre-fund their plans will report no income from the assets in the pension plan. As well as distorting comparisons between companies, this is undesirable from a public interest standpoint because it may create an incentive for companies to not fully fund their pension plans in order to artificially improve reported profits.

Under this approach, some gains and losses, such as changes in non-financial assumptions, would be recognised in profit and loss. We do not support this because it would lead to inconsistent treatment of assets and liabilities; we expand on this further in our comments on Approach 3.

Approach 3 – actual return on assets and remeasurement arising from changes in financial assumptions in OCI, other changes reported in the income statement.

Under this approach, some changes in liabilities are recognised within profit and loss (including changes in assumptions other than the discount rate, and experience gains and losses on the liabilities). However, all changes in assets, other than interest income, are recognised outside profit and loss. This creates a fundamental inconsistency between the treatment of assets and liabilities, which leads to profit and loss figures which do not reflect the economic reality of the plan. For example, many plans have assets which are designed to closely match the liabilities, such as derivatives, swaps, or annuities with insurance companies. Where the liabilities vary, these movements would be recognised in profit and loss, but corresponding movements in asset values would be recognised outside profit and loss, leading to volatile profit and loss costs even for plans where the employer is exposed to little or no risk.

Given the above concerns, and given that broader issues of financial statement presentation remain unresolved, we believe that for the purpose of the short term improvement project the approach taken should not represent a radical departure from the current standard. We therefore think that the current presentation of cost in profit and loss, including the expected return on assets, should be retained.

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?

We believe it is premature to address the presentation of defined benefit pension plans while wider issues in presenting the financial performance of companies remain unresolved.

Definition of contribution-based promises

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 this project, and why?

LCP believes that the scope of the short-term project is too broad, and that new rules for contribution-based promises should be excluded entirely from the first phase of the review.

The proposed definition of contribution based promises encompasses many plans – such as career average plans, where there are not significant difficulties in applying the current rules.

We believe it is fundamentally undesirable for there to be two different sets of valuation principles – one for defined benefit plans, and one for the rest. No matter where the line is drawn between these two categories, there will be inconsistencies between the accounting for similar plans that fall on different sides of that line.

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?

Yes, we believe that under the new proposals a very large number of plans around the world would be reclassified from defined benefit to contribution based, including a large proportion of plans in the United States, Canada, Switzerland, Japan, Germany, Italy and the Netherlands.

There are significant practical difficulties in the proposals which will make implementation of the proposals costly for companies and difficult to understand for investors. Key concerns are:

- Measuring the credit risk of the promise is extremely difficult, and there are few established and generally accepted methods for assessing this credit risk. For example, while credit ratings exist for companies, they generally do not exist for pension plans. The risk of default on the pension promise will depend on many interacting factors including the local regulatory regime, the investment and funding strategy, the ranking of the pension scheme relative to other creditors, and the corporate structure of the sponsoring company. In many cases, an entity would not be able to assess the credit risk reliably without constructing a complex model, which would be difficult for investors to understand even with extensive disclosure.

- Some plans have separate sections offering defined benefit and contribution based promises, and in these cases it will be necessary to notionally separate out the defined benefit and contribution-based portions of plans that promise both types of benefits. This matters because it would affect the surplus or deficit in the contribution-based portion and hence the credit-adjusted discount rate to be used.

- For a plan which has, in the past, granted both defined benefit and contribution based benefits, it would be necessary to identify which pensioner members had been granted which type of benefit. Very often this will be difficult to carry out as the necessary records may not be available.

Overall, the practical difficulties are significant, and will lead to increased costs to comply with the standard. We urge the IASB to defer consideration of the accounting model for contribution based plans until the second phase of the project.

Question 7

Do the proposals achieve that goal [to leave the treatment of defined contribution plans unaffected]? If not, why not?

We agree that the treatment of defined contribution plans would remain largely unaffected under the proposals.

Recognition issues related to contribution-based promises

Question 8

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

Our comments on the key principles are:

- We do not agree that benefits should necessarily be attributed according to the benefit formula. Having contribution based plans attributed by benefit formula, whilst defined benefit plans are attributed by the higher of the benefit formula or a "straight line" approach, would introduce a fundamental inconsistency between defined benefit and contribution based plans. In some cases this could lead to very different accounting for plans with very similar structures, where one is classified as defined benefit and the other contribution based.

- We agree that both unvested and vested promises should be recognised as a liability; and

- We agree that the liability should not reflect the "walk away" benefit that the employee would receive on leaving the plan immediately after the reporting date.

However, for the reasons given in our letter, LCP do not support the introduction of these rules as part of the first phase of the project, because they would introduce a fundamental inconsistency with the existing valuation model for defined benefit schemes. Instead, these concepts should be considered as part of a thorough review of IAS19 in the second phase to ensure that different classes of plan are treated consistently.

Measurement of contribution-based promises

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?

We believe that it is of great importance that the measurement approaches of all types of plan should be consistent, and therefore do not support the introduction of a new measurement approach for contribution based plans which is inconsistent with the established approach for defined benefit plans.

We believe that the incorporation of credit risk into the measurement of contribution based promises results in a measurement approach which is fundamentally inconsistent with that used for defined benefit promises, where the discount rate is based on AA rated corporate bonds. While there are theoretical arguments both for and against the incorporation of credit risk, we believe that having two different approaches for similar types of plan is undesirable on both theoretical and practical grounds.

We do not agree that the entity's credit risk should be included in the measurement approach for contribution based promises at this stage, because:

- The valuation model is fundamentally inconsistent with the measurement approach for defined benefit plans;
- We do not believe that the assessment of credit risk provides useful information to the users of accounts; and
- As noted in our answer to question 6 above, there are significant practical problems in assessing this credit risk.

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 share the Board's concern, noted in paragraph 8.6 of the discussion paper, that measuring the liability for benefits in the payout and deferment phases in the same way as they are measured during the accumulation phase could lead to exactly the same obligation being measured differently depending on how it has arisen. Many defined benefit plans which are closed to new accrual would be affected by this inconsistent treatment. This provides further support for the view that it would be undesirable to introduce the new valuation model for contribution based promises as part of Phase 1 of the project.

Disaggregation, presentation and disclosure of contribution-based promises

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 it will be useful to disaggregate information about changes in the liabilities for contribution based promises, but that the level of disaggregation that is possible and desirable will vary significantly between plans. We therefore favour a principles-based requirement for a disagreggation of the movement in assets and liabilities, showing major movements, without prescriptive rules.

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?

Many plans that are classified as contribution based will be, in substance, very similar to plans that are classified as defined benefit. For example, this will be true of mature plans where most benefits are in the deferment or payment phase. We therefore believe that it is very important that the treatment of defined benefit and contribution based plans is consistent, and that the requirements for contribution based plans should mirror those for defined benefit plans as closely as possible.

Benefit promises with a ‘higher of’ option

Question 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?

The proposed rules are likely to lead to inconsistencies in the accounting treatment that could lead to similar promises being valued differently. The proposed rules require the benefit with a “higher of” option to be split into a host defined benefit promise and an additional uplift valued at fair value. The valuation principles for defined benefit plans are different to fair value (for example, a defined benefit promise is valued using a discount rate based on AA rated corporate bonds rather than a suitable risk adjusted rate for a fair value calculation). The difference in valuation principles means that a defined contribution promise with a defined benefit underpin would potentially be valued significantly differently to a pure defined contribution promise, even if the defined benefit underpin is low and rarely expected to bite.

To avoid this inconsistency we believe that a simpler approach, consistent with the valuation principles for defined benefit schemes, would be more appropriate.

Other matters

Question 14 *- What disclosures should the Board consider as part of that review?*

We recommend that the following disclosure requirements should be considered, to codify what is already best practice followed by many companies:

- Disclosure of the mortality assumptions used; and
- Disclosure of key sensitivities to changes in assumptions

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

No.