KVB RAB

September 23, 2008

Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

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26 SEP 2008

Dear Sir David,

COMMENTS ON PROPOSED AMENDMENTS TO IAS 19

We welcome the opportunity to comment on your Discussion Paper – Preliminary Views on Amendments to IAS 19 Employee Benefits (the "Discussion Paper").

This letter has been drafted by the Royal Association of Belgian Actuaries and represents a majority view of the actuaries of the IAS19 taskforce.

We did not cover all your questions but focussed on the areas of main concern.

The need for immediate gain and loss recognition in the short term

We support the IASB's longer term aim of improving the accounting for employee benefits in conjunction with the FASB as part of the on-going global convergence of accounting standards.

However, we would question whether it is most effective, from conceptual and practical points of view, to implement an interim solution at this stage with respect to the immediate recognition of gains and losses.

The proposed changes in the recognition of actuarial gains and losses are likely to result in significant practical difficulties for companies who have grown accustomed to current IAS 19 requirements.
Furthermore, the likelihood of subsequent changes to the defined benefit measurement model in the next stage of the Employee Benefits project would be expected to result in further changes to systems and other practical implications for companies.
There would be clear benefits in addressing these issues at the same time and therefore we suggest that no changes are made to the current treatment of actuarial gains and losses in the short term.
Otherwise there is too much risk of creating new inconsistencies. A combination of the current measurement method (in particular: mark-to-market discount rate) with approach 1, for example, may be against the "faithful representation" principle set by the Framework.

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Equally, when the discount rate definition will be revised (and is not mark-to-market any more), than the corridor should be abandoned.

In addition, we note that the IASB are currently carrying out a number of significant projects which will require detailed consideration of many of the issues underlying the proposals in this Discussion Paper. These projects include Fair Value Measurement, Insurance Contracts, the Conceptual Framework and Financial Statement Presentation. We believe that there is a danger that fundamental decisions underlying those projects may be taken as part of this interim Employee Benefits project. Equally, decisions taken at this stage as part of this project may require subsequent amendment depending on the outcome of other projects.

For the reasons above, we prefer that no changes are made to the current treatment of actuarial gains and losses in the short term.

Presentation of defined benefit promises

As explained above, we prefer that no changes are made to the current treatment of actuarial gains and losses in the short term.

If we compare nonetheless the 3 approaches, we prefer the third approach for the following reasons:

- Although we believe the first approach is compliant with the framework, is very transparent and easy to use, the impact on the profit and loss of the company and on its balance sheet is extremely volatile. The volatility in the profit and loss can be a multiple of the normal pension expense. We believe that such an approach does not give a better view on the financial situation of a company. If approach 1 should be applied, then a different presentation of the profit and loss is needed, with a clear split between normal and exceptional expenses or profits, especially because they do not relate to the core business. In addition, given the long-term nature of post-employment benefit promises, pension expense has to be considered from a long term perspective, allowing compensations between good years and bad years. Approach 1 only considers the short term.
- Approach 2 starts from the idea that interest cost is on average equal to the expected return. This is not the case if the value of the assets is far below or far above the value of the pension liability or if the return exceeds the discount rate (investment portfolio with a high equity exposure) and especially in the case of unfunded pension plans. In the latest case, the interest cost is accumulated in the other comprehensive income. It is unclear how this value will impact profit and loss in the end. If approach 2 should be chosen, then at least a recycling mechanism for the accumulated other comprehensive income should be foreseen (cfr. FAS).
- Approach 3 seems the most appropriate, in the assumption that only market linked trends and inflation are considered as remeasurement. Changes in mortality, salary increase and turnover are considered as corrective changes that never will be compensated in the future by an adverse move. Changes in the value of plan assets and discount rates are only temporary and are expected to be compensated.
  The expected return should be calculated in the same way as it the case currently (first option).

Classification of benefits

We do acknowledge that the current classification of pension arrangements between defined benefit and defined contribution in IAS 19 is unsatisfactory and can produce non-economic outcomes.

Especially defined contribution plans with interest guarantees (straightforward or with a higher of option) and cash balance plans should not be treated as defined benefit plans.

We believe that the concept of significance of risk of further contributions being required by an employer, building on the similar concept of significant risk transfer in IFRS 4 for the definition of an insurance contract, should not be abandoned. The current definition of defined contribution plans (post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods) is perfect.

The real problem is that within the defined benefit pension plans, a distinction should be made between classical defined benefit plans and interest or inflation linked pension plans such as defined contribution plans with interest guarantees (the famous Belgian and Swiss issues) and cash balance plans.
The measurement of defined contribution plans with interest guarantees and cash balance plans should not be based on the "service matching principle" (see Objective of IAS 19 – page 19-9 of the standard).
From an economical viewpoint, the benefit should be split in two parts: one part is the pure defined contribution benefit, which should be measured as defined contribution, and the remaining part is the interest linked or inflation linked benefit, which should be measured in an appropriate way. This is actually the de-construction method as described in previous discussions of the IAS Board.
We propose to measure defined contributions with guaranteed interest in an adequate risk-based way, using put option pricing models (the fair value of the embedded derivative should be measured).
However, if the guarantee provided is settled through an insurance contract and if there is no risk of further contributions, than the plan will fall under the defined contribution definition.
Also the cash balance plans should be measured with de-construction method.

Average Salary benefits should always be considered as defined benefit plan, as the average could be calculated over the total career but also over the last 5 years.

Finally also the phase (accumulation phase vs. pay-out phase) should not have an impact on the classification, as it is our general preference to work only around the concept of significance of risk of further contributions being required by an employer.

In conclusion: the current classification should be refined in order to avoid non-economic outcomes. The introduction of a new classification "the contribution based promises" will not help and will even create more inconsistencies and divergences and should therefore be dissuaded.

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Need for more/better disclosures

We believe that an indication of the adequateness of the mortality table used should improve the financial statements.
This could be obtained by separating in the gain/loss the effect of the mortality from the other sources. However such a disclosure is only useful for annuity based pension plans, for which there is an important longevity risk.

More generally, we suggest to disclose some information about the sensitivity of the DBO with respect to all relevant key assumptions (mortality tables, discount rate, …).

Problem about unqualifying plan assets of insurance companies insuring themselves

Finally we have a problem with the definition of plan assets and especially with the definition of qualifying insurance policies.

The current definition mentions: an insurance policy issued by an insurer that is not a related party (as defined in IAS 24 Related Party Disclosures) of the reporting entity, if the proceeds of the policy:

(a) can be used only to pay or fund employee benefits under a defined benefit plan; and (b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity ...

In our opinion the indication "not a related party" is not relevant.
What really matters is the guarantee that the assets are "not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity".

So, we propose to omit the condition that the insurer may not be a related party.

This current condition causes a lot of problems for insurance companies that insure their own employees as well as employees of other companies. Local legislation gives all clients/companies the same protection in case of bankruptcy. And finally, also a pension fund is a related party.

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We appreciate the opportunity to comment and hope our contribution may support the decisions that will be taken in respect of the interim solution and even the global improvement project of the accounting for employee benefits.

Sincerely yours,

Stefaan Boom

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