TOWERS
PERRIN

September 5, 2008

Ms. Anne McGeachin
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH, United Kingdom

Dear Ms. McGeachin:

COMMENTS ON PROPOSED AMENDMENTS TO IAS 19

Towers Perrin is a global professional services firm, whose Human Capital Group provides global human resource consulting in areas including the valuation and design of retirement benefits programs. We appreciate the opportunity to comment on the IASB's Preliminary Views on Amendments to IAS 19, *Employee Benefits.*

We thank the IASB for tackling difficult issues concerning the appropriate accounting for employee benefits. This letter presents our comments. We believe that the Preliminary Views document reflects thoughtful and serious efforts to improve on the state of employee benefits accounting. There are a number of areas in which we have comments, which are discussed in this letter.

Our principal concern relates to the scope of the current [limited-scope] project. We strongly recommend that in this initial phase of the Board's reconsideration of IAS 19, the concept of contribution-based promises be limited to plans with a defined contribution or credit for service in the current year and an explicit, guaranteed minimum return linked to an index (i.e., plans that would be defined contribution were it not for a promised return). Our thoughts on this issue are included in the comments that follow.

We have the following comments on the questions raised in the Discussion Paper.

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?

TOWERS PERRIN

Comment: We do not believe additional issues should be addressed in the project, in order to keep to the desired time frame. In fact, as mentioned above and discussed later in our comments, we believe that the scope of the project as it relates to the notion of contribution-based promises should be narrowed from what is suggested in the Discussion Paper.

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 those factors? Do those factors provide sufficient reason for the Board to reconsider its preliminary views? If so, why?

Comment: We believe that the Board has done a thorough job of considering relevant factors in arriving at its preliminary views. However, in deliberating proposed changes to IAS 19, we would encourage the Board to appropriately consider the cost/effort required to implement those decisions as compared with the incremental improvement in transparency and understandability of the resulting measures. As discussed later in our comments, we believe that for some of the changes suggested in the Discussion Paper, the implementation cost would outweigh the perceived improvement in the resulting measures of the employer's liability.

Question 3

(a) Which [alternative] 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?

Comment: We note that each proposed approach has a different objective, which may have merit for different users and differing circumstances. Obviously, any approach should be consistent with the principles and construct underlying the Board's project on financial statement presentation.

We believe Approach 1 is the most transparent and simple approach and the most consistent with the IASB Framework. However, we believe the implications for profit and loss are too dramatic a change at the present time. Retirement promises extend for decades, with experience gains and losses and the effects of assumption changes producing potentially significant variability in comprehensive income from year to year. Often, those gains and losses at least partially offset over time. Generally, reflecting that year-to-year variability in profit and loss would provide relatively little insight with which to predict the level of expected future earnings. Accordingly, the reader of the financial statements may be misled or confused by this volatility, with more informed readers perhaps simply “backing out” the retirement plan gains and losses from profit and loss. On the other hand, a pattern of significant gains or significant losses should be discernible from appropriate disclosure requirements.

We acknowledge, however, that other approaches have components that would be either internally inconsistent or inconsistent with the IASB framework. For example, although inflationary expectations affect other economic assumptions as well as the discount rate, Approaches 2 and 3 would report the effect of a change in discount rate in other comprehensive income and the effect of changes in the other economic assumptions underlying the benefit promise (e.g., salary growth rate, medical trend rate) in profit and loss. As a result, a decrease in the expected inflation rate that causes the salary growth rate to decrease would decrease the benefit obligation. But there would be an offsetting increase in the benefit obligation due to a corresponding decrease in the discount rate. However, because only the effect of the change in the salary growth rate would be reflected in profit and loss, there would be a spike in profit and loss – even though the net change in the benefit obligation is zero.

We applaud the symmetry in all three approaches in reporting changes in the discount rate and unexpected changes in the fair value of plan assets, and in reporting interest cost and expected asset return. We particularly believe that for funded plans, the symmetrical treatment appropriately reflects the financing of the plan and hedging of interest rate risk. We also believe reporting interest cost and asset returns (interest income) in other comprehensive income is more consistent with the Board’s tentative views on financial statement presentation. However, we are troubled by the arbitrariness of the development of interest income, particularly when investment return is disaggregated into interest income and investment return different from interest income. In particular, we believe employers should not be penalized for the manner in which their assets are invested (i.e., income from fixed income investments recognized in profit and loss, but income from equity investments recognized in other comprehensive income).

Ultimately, the choice between Approach 2 and 3 should be driven by the needs of investors and creditors.

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 the project, and why?

Comment: Although the premise of this phase of the project is that it be limited in scope, encompassing benefits that are based on contributions and a promised return, the scope of the changes suggested in the Discussion Paper would apply to virtually all benefit plans that are not based on final pay or uncapped retiree medical costs. The Discussion Paper indicates that the rationale for establishing a new accounting regime for certain types of promises is that IAS 19 "does not result in a faithful representation of the liability" for those promises. While it is not entirely clear which promises are to be considered to be contribution-based, we believe that the liability for many of the benefit promises that appear to be within the unnecessarily broad scope of the definition of contribution-based promises is already measured in a representationally faithful manner under IAS 19.

For example, it is not clear from the Discussion Paper that career-average-pay plans and flat dollar plans would be considered contribution-based promises, yet we understand that to be the case. We struggle to find sufficient rationale that the accounting for these types of plans should change from that currently prescribed by IAS 19, since we believe that the existing accounting standard does result in a faithful representation of the liability for these plans.

How to distinguish between defined benefit and contribution-based promises also appears to be quite subjective. For example, in the Netherlands, career-average plans frequently include provisions that allow the promise to be revalued during active service to reflect pay increases and CPI. It is not clear in this situation whether the potential for salary risk causes the benefit to be a defined benefit promise. As another example, consider a final-pay plan that uses a ten-year averaging period to measure final average pay. Would the promise under this plan for any participant anticipated to be employed fewer than 10 years be considered a defined benefit promise or a contribution-based promise? If the former, it is illogical that the promise would be measured differently than if the promise for the individual were in fact a career-pay benefit, since the promises in this situation are identical.

The lack of specificity also raises concerns about the consistent interpretation and application of the underlying principle. For example, typical promises in different countries vary significantly yet the definition of contribution-based promises, as currently drafted, provides insufficient guidance to ensure comparable promises would be accounted for similarly. It is also unclear how far the notion of contribution-based promises extends. Because the definition is not limited to pension promises, it appears the concept would extend to certain retiree medical promises and long-term benefits, for which the guidance in IAS 19 refers to the accounting for postemployment benefits. Similarly, the implications for employers participating in a multiemployer plan is unclear, but as IAS 19 is currently written, it appears the concept of contribution-based versus defined benefit promises would extend to those arrangements as well.

Because the Board's longer-term project encompasses a comprehensive reconsideration of IAS 19, we believe the focus of the current phase should be limited to areas that are considered problematic. As mentioned earlier, we believe that the accounting for plans such as career-pay plans or flat dollar plans is not "broken". Extending the new measurement approach to broadly-defined contribution-based promises could set a measurement precedent for the more comprehensive project [reconsidering the accounting for employee benefits in its entirety], without appropriately considering more rational and cost effective measurement approaches for defined benefit promises.

Consequently, at least in this initial phase of the Board's reconsideration of IAS 19, we recommend limiting the concept of contribution-based promises to plans that provide a defined contribution or credit for service in the current year and an explicit guaranteed minimum return linked to an index (i.e., plans that would be defined contribution were it not for a promised return). In developing that concept, the Board should provide a more narrow and carefully defined concept of contribution-based promises that would add more clarity to the underlying principle and reduce subjectivity in application.

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?

Comment: We believe the definition of contribution-based promises is much more far-reaching than intended by the Board. The accounting for traditional, funded defined contribution plans, final pay plans and many retiree welfare plans would not change. But for many, if not most, other types of post-employment benefits, the accounting would change dramatically. In many countries – Brazil, Canada, Germany, Japan, Switzerland, and the United States, for example – we believe that more than two-thirds of plans currently classified as defined benefit would be considered fully or partially contribution-based promises.

The proposed measurement approach for contribution-based promises is substantially more complicated and costly to apply than the current measurement approach for defined benefit plans, with no indication that the resulting measure is more reliable or understandable. Because measurement of contribution-based promises would consider "all possible outcomes," actuarial firms would have to utilize stochastic valuation systems, which would significantly increase the cost of valuations for contribution-based promises unless the number and type of stochastic variables were limited. (Currently, the major actuarial firms generally use a deterministic approach for measuring obligations for financial statement reporting, whereby assumptions are developed taking into consideration variability and the range of likely outcomes.) In addition, if the term "all possible outcomes" implies that all possible demographic outcomes would need to be measured, then significant research and development costs would be incurred as actuarial firms incorporated demographic stochastic models that would integrate with their economic stochastic models. Instead, if the scope of contribution-based promises were limited as we recommend, the minimum guarantee could be determined using a stochastic approach (for that limited variable).

The introduction of credit risk into the measurement model would also introduce complexity and subjectivity. The rational and methodical determination of credit risk would raise challenges in many countries, particularly those without an established practice of raising funds through the bond market (which would provide at least one objective, market-based measure of credit risk). Many developing markets, for example, lack the robust market data needed to develop this input.

The IASB has intentionally provided limited guidance on methodologies and stated that it intends to leave to auditors and actuaries the development of practices that meet the objective of measuring the liability for contribution-based promises at fair value. However, the depth of actuarial and auditing experience within Asian markets, for example, is currently a long way from that found, for example, in North America and Western Europe. As a consequence, the development of appropriate valuation methodologies for local plan designs is likely to lead to a wide variation in the methodology and reliability of those measures. For example, countries such as South Korea, Thailand and Japan have limited actuarial experience in valuing pension promises in accordance with other accounting standards covering retirement benefits. The problem would be further exacerbated by the introduction of a potentially complex methodology.

Although we do not advocate the approach proposed in the Discussion Paper to value contribution-based promises on the grounds that it would not be an improvement for most plans that would be affected, there are also practical difficulties in implementing that approach. Among those difficulties are the underlying records that would be used to value contribution-based promises to former employees, which could be substantial. Due to gradual changes from traditional benefit designs to account-based designs, as well as the wide ranging scope of the Discussion Paper, the records for many plans do not currently exist in a format that would enable a plan sponsor to reliably determine (at a reasonable cost) which portions of a former employee's defined benefits arose from promises now classified as contribution-based.

We believe the reclassification of a significant portion of defined benefit plans that are reliably measured using commonly understood methods introduces a level of complexity that is likely to reduce comparability and reliability. We encourage the IASB to seek a simpler, more cost-effective approach.

Question 7: Do the proposals achieve [the] goal [of not significantly changing the accounting for plans currently classified as defined contribution plans]? If not, why not?

Comment: In Germany the employer always bears the residual risk that an externally funded pension plan will not pay the guaranteed promises. Since this risk is very small in the case of direct insurance plans (Direktversicherung) and insurance-like pension funds (Pensionskasse, versicherungsförmiger Pensionsfonds), these plans have traditionally been classified and accounted for as defined contribution plans. Measurement of the benefit obligation for these arrangements, and similar mixed attribute plans that have been accounted for as defined contribution plans in the past, would change.

However, beyond those accepted practices, we believe the proposal does generally achieve the goal of not significantly changing the accounting for plans currently classified as defined contribution. But rather than making a simple concept – defined contribution plans – potentially confusing and complex, we encourage the Board to retain the concept of defined contribution plans, and introduce a third category of promises that would focus on the promises that are considered to be problematic. Again, we emphasize retaining simplicity where warranted.

Recognition issues related to contribution-based promises

Question 8: Do you have any comments on those preliminary views [relating to recognition of contribution-based promises]? If so, what are they?

Comments: We generally agree with the concepts of allocating and recognizing benefits in accordance with the benefit formula, recognizing unvested promises as a liability, and not recognizing a liability based on the "walk away" benefit assuming an employee terminated immediately. However, we would observe there is a disconnect between following the benefit formula for a career-average-pay plan (which is, by definition, backloaded) and attributing the cost of a comparable final-pay plan ratably over the same period.

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?

Comments: The suggested approach for valuing contribution-based promises creates an undesirable and inexplicable dichotomy between the measurements of promises classified as contribution-based versus those that include salary risk. Pension promises include a number of variables, many of which are even less predictable than salary increases (over which the company has control). Yet, the proposed valuation for contribution-based promises, which would reflect "all" possible outcomes, would require the development and use of complex, costly and subjective stochastic valuation systems, rather than the deterministic approach used in valuing plans that include salary risk. While this might be warranted if it substantially improved the resulting measures, in fact, it is likely that such a stochastic approach would produce little or no substantive enhancement in the relevance and reliability of the resulting estimation of expected future benefits over amounts measured using thoughtful deterministic methodologies.

In paragraph 5.31 of the Discussion Paper, the Board notes there are no particular problems in applying the current measurement provisions of IAS 19 to benefits that have a fixed return. Nevertheless, the Board has proposed an unnecessarily complex approach to valuing such benefits, rather than focusing on the central issue — the value of an explicit guaranteed minimum return linked to an index. Such a guarantee is similar to an option and could be bifurcated from the underlying benefit promise and valued separately — either using a deterministic approach that would consider a range of possible outcomes, or stochastically. This would allow the underlying benefit accrual to be measured based on its nature —defined benefit or defined contribution—better reflecting the substance of the promise. We believe this approach would be simpler, less costly and better understood, ultimately enhancing rather than detracting from comparability.

We believe that adjusting the discount rate to reflect the credit risk associated with the unfunded portion of the benefit obligation is inconsistent with the going concern concept and rewards financially troubled companies. Interestingly, it also creates the perverse incentive for those troubled companies to increase postemployment benefit promises in lieu of pay increases, to the detriment of employees. In addition, we question whether reporting obligations at less than the amount owed, based on a presumed probability of non-payment, is more useful to investors and creditors than the amount promised.

Presumably, assets underlying contribution-based promises would be measured in a manner consistent with assets funding defined benefit promises, but the guidance should be clarified.

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?

Comment: While we agree there is no rational basis for recognizing a gain or loss at the end of the accumulation phase (to create symmetry in the measure of the identical contribution-based and defined benefit promises at that point), we also do not believe there is any reasonable argument supporting a view that obligations for an identical stream of benefits to retirees should be measured differently, depending on whether they arose from a defined benefit or contribution-based promise. In addition, such an approach would perpetuate a complex and costly valuation with no offsetting improvement in the amounts reported and would, in fact, erode the comparability and understandability of the reported liabilities. In our view, this dichotomy is indicative of a fundamental flaw in the underlying premise of classifying promises as contribution-based versus defined benefit. Consistent with our earlier comments, we believe comparability and understandability would be improved by focusing on the principal concern – guaranteed minimum returns linked to an index – and considering measurement of the underlying benefit promises as part of the more comprehensive reconsideration of IAS 19.

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?

Comments: We agree it would be difficult to disaggregate changes in the liability for contribution-based promises into components similar to those required for defined benefit promises. However, if the perceived shortcoming in IAS 19 related to promises with a guaranteed minimum return linked to an index were addressed by separately valuing that guarantee, there would be no difficulty disaggregating the components and comparability would be enhanced.

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? Why?

Comments: We believe comparability is enhanced by reporting like items in a similar manner. Therefore, we advocate presenting changes in the liability for contribution-based promises in the same manner as changes in the liability for defined benefit promises.

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 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?

Comments: Many "higher of" plans are intended to deliver benefits primarily through the defined contribution plan, with the defined benefit target formula serving simply as a minimum guarantee to protect against poor asset performance. However, under the approach described in the Discussion Paper, a large portion of the benefit would be treated as a defined benefit promise if the target formula were defined benefit. This would dramatically change the accounting for the arrangement and introduce complications in allocating "plan assets" between the defined benefit and contribution-based promises.

With such plans, the only way to reliably stochastically measure the value of the contribution-based promise is to stochastically value the underlying host defined benefit promise as well. For example, consider a plan that provides the greater of a final-pay formula and a cash balance formula. If the cash balance formula promise is to be measured in a stochastic manner (to reflect "all possible outcomes"), then its value depends on future variables (such as pay credits and interest credits) that depend on modeled inflation behavior. But that same behavior impacts the benefits provided by the final-pay formula as well. If the Board retains different measurement methodologies for contribution-based promises and defined benefit promises, we recommend that the determination of the host promise be made by the plan sponsor and its advisers based on the underlying facts and circumstances of each arrangement.

Other matters

Question 14: What disclosures should the Board consider as part of [the intended review of disclosures in a later stage of this project]?

We believe disclosure of the mortality assumption, credit adjusted discount rate, and cash flow risk should be considered. However, rather than being overly prescriptive, the disclosures should allow for professional judgment in determining certain information that would enhance decision-usefulness and understandability to the user. For companies with multinational operations and numerous plans, that may mean providing more expansive disclosure information about the most significant plans, with disclosures about smaller plans limited to the funded status, cost and cash flow information.

TOWERS PERRIN

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

Comment: Benefit plans often include multiple benefit formulas, some of which may be classified as contribution-based while others may be classified as defined benefit. It is unclear how the underlying plan assets would be split between the distinct promises. This is of particular importance as it would affect the funded status of the promise and therefore the credit-adjusted discount rate used to measure the contribution-based promise. Issues would also arise with identifying the gains and losses associated with each promise, particularly since asset gains and losses may be reported differently for contribution-based and defined benefit promises. Separating plans to report liabilities based on distinct promises will increase the complexity and cost of valuations without enhancing comparability or understanding. Therefore, we recommend retaining the plan as the basis for the accounting, with separate valuation of any guarantees.

* * * * *

We appreciate the opportunity to comment and would be pleased to discuss our comments and concerns with you further, if you so desire.

Sincerely yours,

Michael Archer, FSA
Chief Actuary
michael.archer@towersperrin.com

Diana J. Scott

Diana Scott, CPA
Principal, Technical Services
diana.scott@towersperrin.com

Massimo Borghello, FIA
Senior Actuary, Europe
massimo.borghello@towersperrin.com

Michael Pollack

Michael Pollack, FSA
Assistant Chief Actuary
mike.pollack@towersperrin.com