Pension Fund Association

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Contact **Masahiro Inaba**

24 September 2008

Dear Sirs,

Discussion Paper: Preliminary Views on Amendments to IAS19 Employee Benefits

We express our sincere respect to the International Accounting Standard Board for the publication of the IASB Discussion Paper "Preliminary Views on Amendments to IAS19 Employee Benefits", inviting comments in order to prepare an exposure draft to amend current IAS19 scheduled in 2011.

Pension Fund Association is an organized entity, established by Employees' Pension Insurance Law to take over pension rights of active employees from where they have been working for, passing them to their next corporate pension plans if certain conditions are met, and undertake responsibility to pay pension benefits of early leavers (20million) and pensioners (3million), based on monies accumulated and received from their former employers' pension plans. Those funded assets within our organization are now reaching Yen 12 trillion. Besides these operations, Pension Fund Association is providing information concerning corporate pensions, publishing proposals or requests to relevant authorities and/or regulators, thus promoting the quality and development of corporate pension plans.

As to post-retirement benefit accounting standards, it is absolutely necessary to review the issues on the matter, paying much attention on the circumstances in each jurisdiction with full consideration from various viewpoints, because they could have adverse effect on the post-employment benefits in general, including public pensions.

Pension Fund Association is the national organization of corporate pension plans in Japan, and on behalf of them, we will present our comments on the discussion paper in the following, with careful consideration of the current situation in our country.

1. Post-employment benefit accounting and international comparability (Question 1)

Post-employment benefit plans reflect differences in the concept to secure remuneration or benefits among countries, for example, strength and pace to the extent of which benefits are vested, benefit calculation formulas, concept of benefit vesting, status of life-long benefits, degree of marketability for pension liabilities.

Therefore, for the preparation of globally unified accounting standards, it is utterly necessary to reflect those differences in order to keep fairness among countries, thereby attaining international comparability. It is strongly recommended to research pension systems in each country so that this purpose can be achieved.

2. Immediate recognition of changes in defined benefit promises (Question 2)

Introducing the reclassified definition of "defined benefit promises", the Board's preliminary views say "Entities should recognize all changes in the value of plan assets and in the defined benefit obligation in the financial statements in the period in which they occur." and "Entities should recognize unvested past service cost in the period of a plan amendment."

As the recognition issues are closely related with other issues such as measurement of the obligation, including the criteria for selecting input assumptions, and these issues remain untouched in the present review, we do not agree with the approach to adopt immediate recognition of changes in the defined benefit promises as in the preliminary views.

3. Presentation of defined benefit costs (Question 3(a))

We consider net income is an important indicator when evaluating performance of an entity, and accounting procedures in which net income could fluctuate so large as not be able to reflect status quo of the entity is not good for users. Especially if the effects of momentary fluctuation of interest rates and an asset valuation at a moment, which are not directly related to the business of the entity, are wholly incorporated into costs for a period, the net income for the period could be distorted substantially, and usefulness of financial statements would be severely undermined if the investment decision is made based on them. Therefore, we do not agree with the Approach 1 (Paragraph 3.11) described as " Entities present all changes in the defined benefit obligation and in the value of plan assets in profit or loss."

As to Approaches 2 and 3, we would also rather be in the negative, although we have been in the reviewing process to these approaches and have not got the final conclusion until now.

4. Distinction between "defined benefit promises" and "contribution based promises" (Questions 5&6)

The Board's preliminary views to distinguish "defined benefit promises" and "contribution based promises" and to change accounting procedures according to the distinction might be practically unworkable on the reasons described below, and the alteration of accounting procedures could cause confusions:

(i) There are many plans to be reclassified from "defined benefit plans" to "contribution based promises" as in the Board's preliminary views in Japan. For example we have plans where benefits are calculated in proportion to the accumulated points earned up to the date ("point system plans"). Flat amount benefit plans are also included in the new category.
For these plans, there seem no definite reasons to change accounting procedures substantially based on only that they are classified as "contribution based promises"; and

(ii) There are certain plans which have both features of “defined benefit promises” and “contribution based promises”. Therefore, it seems not suitable to introduce accounting standards in which measurement of benefit liability and accounting procedures of two types of pension promises could diverge quite wide depending on where the benefit type be classified by certain, often inessential features, although economy of the both benefits are almost the same. For example, there are some “point system plans” in which benefits are calculated by multiplying unit value of a single point by points earned annually and piled up to the date of retirement, but the unit value can be varied according to the performance of the employer for each period. Which classification should be applied to these types of pension plans, “defined benefit promises” or “contribution based promises”?

5. Fair value of the benefit liability in “contribution based promises” (Question 9 (a)(b))

Post-employment benefit systems in Japan have been developed with main weights on lump-sum retirement benefits, where the amount of the benefit differs according to the reason of the retirement (e.g. reaching retirement age, involuntary retirement and voluntary retirement) and the degree to which the benefit right is affirmed is often open until the retirement. Hence, there are many “ contribution based promises” type plans to reserve certain features to remunerate services in which retirement benefits are finally determined according to the retirees’ situation at the very moment of their retirement.

According to the Board’s preliminary views, the measurement of benefit liability should be based on fair value. However, post-employment benefit systems in Japan have the features described as above, it seems practically difficult to measure post-employment benefit liability based on fair value, except certain type of promises* , moreover to incorporate the credit risk of the entity in the measurement due to the reasons in the following:

(i) Domestic corporate bond markets in Japan are not large enough, with low issuance of lower graded corporate bonds, to be able to provide credit risk information worth to be trusted ; and

(ii) Even if the credit risk is evaluated, it is not enough to measure the fair value of the benefit liability properly, because the entity may avoid its possible insolvency by reducing benefit amounts to some extent through certain procedures including getting agreements from participants.

* Substitute portion benefits in Employees’ Pension Funds are benefits contracted out from a part of Employees’ Pension Insurance (public pension for the private sector in Japan). The benefit obligation for the substitute portion can be returned to the government at any time when the employer wants to unload the benefit liability of the portion, and the settlement price of the benefit liability to be taken over is determined according to the method described in the regulations. However, the benefit liability of the substitute portion is evaluated as PBO using the projected unit credit method, according to the current Japanese GAAP. Accordingly, the benefit liability for the portion as evaluated by the Japanese accounting standards is different from the settlement price.

6. Measurement of the benefit in the payment phase (Question 10 (a))

If the same ongoing obligation arise from different types of promises in the payment phase, they should be accounted for in the same manner regardless of that they are classified as "defined benefit promises" or as "contribution based promises" in the accumulation phase. It looks absurd to apply different accounting to the same pension obligation only to keep internal consistency within hypothetical " contribution base promise" concept.

7. Treatment of current defined contribution plans (Question 7)

As for current defined contribution plans, the Board's preliminary views classify them to "contribution based promises", however, these plans have certain decisive characteristics that employers have no obligations to pay additional contributions to these plans being in financial difficulties, and transaction procedures in these plans are definitely distinguished from other "contribution base promises" with defined benefit features. Therefore, classification in the accounting meaning for these plans should be independent of other plans or promises.

End of comments.

If you have any questions on this letter, please contact Masahiro Inaba (inaba@pfa.or.jp) or Noribumi Yokota (noribumi-yokota@pfa.or.jp).

Yours sincerely

PFA

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