26 SEPTEMBER 2008

European Federation for Retirement Provision

IASB DISCUSSION PAPER

PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS

EFRP RESPONSE

1. IDENTIFICATION OF RESPONSE

The **European Federation for Retirement Provision** represents the various national associations of pension funds and similar institutions for workplace pension provision, the IORPs. The EFRP has members in most EU Member States[1] and also in some non-EU Member States that have a significant – in size and relevance - occupational pension system.

73 million EU citizens are covered for their occupational pension plan by EFRP Member Associations whose members manage approximately € **3,8 trillion of assets (2006)** for future occupational pension payments.

2. VIEWS EXPRESSED IN PAAINE CONSULTATION – JULY 2008

In July 2008 the EFRP responded to the **PAAinE discussion paper** "The Financial Reporting of Pensions'. The key messages included:

- Pension liabilities should not be discounted at the risk free rate as proposed in the paper. The current AA corporate bond rate is appropriate as it reflects that pension liabilities carry some risk.
- Future discretionary salary increases should no longer be included in the measurement of pension liabilities for current employees. The effect of these should however be included in the disclosures in company accounts.
- Expected returns should continue to be included in financial statements (rather than actual returns) as pension schemes invest over many decades to meet their liabilities, and returns in an annual period are volatile and distort shareholders expectations. Better disclosure of how expected returns are derived is a more appropriate solution.
- Employers in industry-wide plans – such as in the Netherlands - and other multi-employer arrangements where risks are shared, should continue to be exempt from the pensions accounting standard.
- Pension funds need not include in their own accounts the liabilities on the same basis as the sponsoring employers, as each of those accounts serve different purposes.

[1] EU Member States: Austria, Belgium, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Portugal, Slovakia, Spain, Sweden, UK.
Non-EU Member States : Croatia, Guernsey, Iceland, Norway, Switzerland

Our response to the PAAiNE discussion paper is attached to this response and is an integral part of this response.

3. RESPONSE TO IASB CONSULTATION

3.1 General Comments

The Discussion Paper outlines the IASB's preliminary views on the short-term improvements needed to provide users with better information about post-employment promises while it works with FASB on a longer-term project to provide users of accounts with better information about post-employment promises. The IASB emphasises that the Discussion Paper is a first step in the Board's project on accounting for post-employment benefit promises and that it is limited in scope to four issues.

The Discussion Paper proposes:

- the immediate recognition of all gains and losses arising from DB plans;
- changes in the presentation of pension cost in the income statement;
- the definition of a new category of 'contribution-based' pension promises and how they should be accounted for;
- an accounting methodology for benefit promises with 'higher of' options;

We believe that the **proposal to eliminate the corridor option is premature** and should await the outcome of the IASB's full review of accounting for post-employment benefits. Some of our Members are concerned about the elimination of the corridor approach as it also serves to moderate the effect of measurement flaws in current IAS 19 regulation.
All our Members recognize that accounting standards are moving towards the elimination of multiple recognition options and therefore accept the logic of removing the range of options currently available.
We believe that elimination of the corridor option must follow, rather than precede, a new standard on presentation.

The EFRP believes that **valuation changes arising from immediate recognition in the balance sheet should not be taken through the profit and loss account** because the predictive quality of the operating results is severely diminished and because other accounting areas (e.g. financial instruments) are not treated analogously yet. Of the approaches set out in the Discussion Paper, our strong preference is for Approach 3.

We would also like to make clear up-front our **strong opposition to the IASB's proposals on 'contribution-based' promises**. They represent a fundamental change in pensions accounting and should be seen as out of scope in what is intended as an amending proposal. Furthermore, they seem to pre-empt the outcome of IASB's full review of pensions accounting. If the proposed approach is adopted for accounting for these promises we find it difficult to see how standards setters will be able to consider dispassionately how best to account for pension promises more generally.

We also believe that the proposals are internally inconsistent and that the issue that they are directed at addressing – how to account for defined contribution benefits with some element of guaranteed return – can be handled on the basis of a much more limited amendment of existing standards.

We expect that the **proposals will create more problems than they resolve** and are likely to make the process of convergence more complicated. One example is Germany, where it is estimated that of all the pension promises currently classified as defined benefit, more that half will fall under the contribution based category (a shift from 70% to 30% DB as a proportion of all plans). Another is the UK, where a host of career average plans will have to be reclassified as contribution based.

3.2 Responses to Specific Questions Raised in the Discussion Paper

Scope of the Project

Q1 *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?*

We believe that the **scope of the Discussion Paper is already too wide**. Retention or elimination of the 'corridor' and changes to presentation in the income statement should await the outcome of the IASB's project on presentation, which will provide the necessary context for any decision on the 'corridor' and how the resulting returns are taken through the income statement.

We accept that there is a **more immediate need to address accounting for DC benefits with defined or guaranteed returns**, but we believe that the Board's proposals for a new category of Contribution Based promises are unnecessarily complex and fundamentally flawed. The proposed amendments to the definitions are difficult to understand and it appears that they will result in some types of schemes that we would see as being defined benefit being accounted for as contribution based schemes, with the result that it is difficult to work out how some schemes will be affected. Furthermore, the **guidance on measurement**

of contribution-based promises is unclear and unsatisfactory, because it replaces a tried and tested practical differentiation on the grounds of residual employer risk (the delineation criterion between DB and DC promises) to one that is essentially artificial and therefore difficult to justify (e.g. why should a life annuity promise, fixed currency terms be given the label of a contribution based promise?).
We suspect that the guarantees included in a number of defined contribution schemes that are of concern to the Board can be accounted for on the basis of slight amendments to IAS 19.

Recognition and presentation of defined benefit promises

Q2 *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?*

While we agree that delayed recognition of actuarial gains and losses is not in accord with the conceptual framework, we believe that the IASC's opinion at the time that IAS 19 was issued remains valid: that **immediate recognition can only be achieved when fundamental issues relating to presentation in financial statements are resolved**[2].

Q3
(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?

Our strong **preference is for Approach 3**.

Financial statements are unlikely to be useful for decisions unless material items with different predictive values are separated from each other. While we agree with the IASB that the distinction between income and capital returns must to some extent be arbitrary, we believe that there is predictive value in attempting to establish an underlying trend in income returns separate from market fluctuations.

[2] the IASC's opinion is referred to in paragraph 2.6 of the Discussion Paper, page 28.

We would be particularly worried about the adoption of Approach 1, which would take all changes in the value of plan assets through the profit and loss account. We are concerned that the operating and even financing results would be overwhelmed by the random noise in the actual returns and at the possible impact that this might have on decision-making. Taking potentially large and highly volatile valuation changes through the profit and loss account could dominate operating earnings and be extremely misleading .

We are surprised at the Discussion Paper's comments about the 'complexity' involved in implementing Approach 3, which seems to be very similar to current practice and should therefore be seen as well tried and understood. While we understand the IASB's concerns about the use of expected returns, **expected returns** can give a good guide to management policy and thinking. They **remain our preferred measure of interest income** and we understand that the majority of users find this measure relevant and useful.
We recognise that there have been misuses in the past in some jurisdictions around the world where unrealistically high expected returns have been assumed. In practice, however, such practice no longer exists, since the issue has been addressed, resolved and has been diligently monitored for some years by both auditors and regulators such as the SEC.

Q4
(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 that improved disclosures not only provide useful information for users of accounts but also limit the opportunities for misuse by preparers. On expected returns, we would point to existing requirements in the UK and US accounting standards, which require disclosure of assumptions about expected returns for each material asset class and to IAS 19 and FRS 17 that require a five-year historical record comparing expected and actual returns.
We would welcome to consider a more flexible approach to the timeframe because 5 years may not always be the best timeframe to assess long-term trends.

Definition of contribution-based promises

Recognition issues related to contribution-based promises

Q5 *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?*

In attempting to clarify the boundary between DB and DC pensions, the Board has proposed changes that could have a dramatic impact on the reported pension liabilities in many countries. We expect that the proposals will create more problems than they resolve and that they are likely to make the process of convergence more difficult.

The proposals involve **fundamental changes in accounting practice** and therefore, as a matter of principle, are **not appropriate for what is intended as an interim amending standard**. Furthermore, the new definition replaces a tried and tested practical definition based on a differentiation on the grounds of residual employer risk (the delineation criterion between DB and DC promises) to one that is essentially artificial and therefore difficult to justify.

Q6 *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?*

If the Board's analysis of the impact of its proposals (through the fourteen examples of pension promises that it provides) is correct, the **proposals would affect the majority of pension promises in some countries**. Even in countries that are less affected, the proposals would create problems for firms seeking to reduce their pension risks – for example, by moving from final salary to career average benefits, which under the Board's proposals would be subject to a more onerous measurement and cost recognition requirement, possibly leading to an increased – rather than a reduced – reported liability despite the reduction in risk.

Q7 *Do the proposals achieve that goal? If not, why not?*

Of the 14 examples of pension promise analysed in the Discussion Paper, six (numbers 5, 6, 7, 10, 13 and 14) involve a switch from IAS 19 DB status to CB status. We believe that the changes, whose impact will be significant for the schemes affected, are difficult to understand and will prove to explain; for example, it is difficult to see why final salary and career average schemes should be accounted for on a different basis, however hard one might try to distinguish them as representing a different balance of asset and salary risk.

Q8 *Do you have any comments on those preliminary views? If so, what are they?*

We believe that the proposed definitions and accounting methodology for CB promises represent a fundamental change in pensions accounting and could have a dramatic impact in many countries. The changes in definitions are arbitrary, difficult to understand and will prove hard to justify. For our thoughts on the longer term direction for pension accounting, please refer to our attached response to the PAAinE discussion paper 'The Financial Reporting of Pensions".

Measurement of contribution-based promises

Q9
(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?

See our answer to Question 5. We feel that the Board's proposals involve fundamental changes in accounting and are not appropriate for what is intended as an interim amending standard.

How best to account for risk is a difficult and complex subject and we believe that it is not an appropriate subject to introduce in an amending standard. It should await the more fundamental review that the Board is planning to undertake with FASB on pensions accounting. Our views on accounting for risk are set out in more detail in our attached response to the ASB/EFRAG's Discussion Paper 'The Financial Reporting of Pensions'. We believe that in the meanwhile the current requirement to discount DB scheme liabilities at a good quality corporate bond rate adequately recognises that such risk is imperfectly but at least consistently measured in practice.

Q10
(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?

In general, we 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 but also that there cannot be any justification for identical benefits (e.g. a life annuity in payment) to be treated differently for accounting purposes.

However, the risk to the employer should be the characteristic that determines the appropriate accounting for the liability in the payout and deferment phases and in the accumulation phase. This implies that the accounting can be different for groups of participants in the same plan which would be an appropriate reflection of changes in underlying economic circumstances.

This inherent contradiction also identified by the Board is evidence of the incoherence of the approach proposed and further reason for the proposals on CB promises to be withdrawn.

Q11
(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 do not believe that the introduction of contribution based promises provides useful information to users of financial statements as we have explained earlier in this letter.

Q12 *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?*

We do not believe that the introduction of contribution based promises provides useful information to users of financial statements as we have explained earlier in this letter.

Q13
(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?

We suspect that it should not be too difficult to identify and measure 'higher of' options within the general principles already included in IAS 19 (e.g. in IAS 19.85 and IAS 19.104f)

Other matters

Q14 *What disclosures should the Board consider as part of that review?*

In reference to expected returns, we recommended in our answer to Question 4 the requirements of the UK and US standards as well as existing principles in IAS 19 for disclosure of assumptions about expected returns for each material asset class and five-year historical record comparing expected and actual returns.

Q15 *Do you have any other comments on this paper? If so, what are they?*

As we have stated at various points in our response, we feel that the Board's proposed definitions of CB promises and the accounting proposed for them represent a fundamental change in accounting practice and should await the full review of pensions accounting that is being undertaken by the Board and FASB. The proposals do not appear to be internally consistent and we expect that the remedy being proposed is likely to be worse than the problem that it is attempting to resolve. They should therefore be withdrawn. We likewise feel that the proposals on recognition should await or at the very least not pre-empt the outcome of the Board's project on financial statement presentation.

Annex 1 – EFRP response to PAAiNE consultation - July 2008

4. KEY ISSUES FOR EFRP

The exclusion of discretionary salary increases when calculating scheme liabilities.

We support the general idea of excluding **future discretionary salary increases** in the calculation of the scheme liabilities. We feel that discretionary salary increases are not liabilities at the balance sheet date but are conditional liabilities, in that they depend on the employee to be still in service to receive such increases and on the ability and desire of the employer and/or the pension fund to pay them. An advantage of this adjustment to IAS 19 is that pension costs will better reflect costs incurred in the year as a result of salary increases granted during the year.

Nevertheless, we believe that salary increases:

- that the employer cannot avoid;
  - for example unconditional indexed increases (whether imposed by law or agreed by contract);
- determined by binding labour agreements;

should be included in the calculation of the liability. In such cases a best estimate of the increase should be used.

The EFRP does not accept the proposal that pension liabilities should be discounted at the risk-free rate rather than at a good quality (AA) corporate bond rate (unless a lower 'settlement amount' is available).

We do not accept that the rate for discounting liabilities should be the risk-free rate or the redemption yield on government bonds. We believe that the nature of the liabilities make this inappropriate, as they are not certain and also carry some risk. Examples of such risks are:

- mortality risk
- dependency risk – i.e. whether an individual will be married or have other eligible dependants on death is not known in advance, and only an estimate can be made in advance.
- duration-matching risk – i.e. the liabilities may often stretch out far beyond the length of any government bonds or the duration of the liabilities may change over time

In principle a good quality corporate bond rate should be seen as making allowance for such uncertainties and risks but the subprime mortgage crisis showed the shortcomings of this approach as well.

An alternative could be to base the **discount rate on a sustainable spread between the AA corporate bond rate and the swap rate** (that is, on the swap rate plus a premium); what this premium should be could be determined by the standards-setters or left by them to the judgement of the auditors. Our preference for the use of a swap rate, rather than a government bond rate, is based on the fact that the swap market in mature markets is considerably larger and more liquid than the equivalent government bond market and can be used to match the duration of the liabilities better.
It should also be noted that government bond yields are likely to be depressed if pension liabilities were discounted at the risk-free rate, by pension funds attempting to hedge the accounting liabilities of their sponsoring employers by shifting their asset allocation towards government bonds.

However, EFRP members remain convinced that the use of something closer to a risk-free rate is only acceptable if future discretionary salary increases are excluded from the calculation of the liabilities.
If future discretionary salary increases are to be included in the calculation, it would be necessary to include a higher discount rate in order to reflect the employer's discretion over the nature and the amount of such increases.

We believe that the Discussion Paper underestimates the extent to which employers have discretion to make salary increases non-pensionable. This is particularly true today, when it would not be unusual in some EU Member States for an employer to close the scheme entirely rather than face the cost of such increases.

The EFRP is opposed to the proposal that actual rather than expected returns should be reported in the income statement. A key issue is how valuation changes in the assets and liabilities are taken through the income statement.

We are opposed to the proposal in the Discussion to use actual returns rather than expected returns in the income statement and are particularly worried about the potential impact of the Discussion Paper's conclusion that actual, rather than expected, returns should be taken through the income statement as a financing item.

We believe it is appropriate to continue to use expected returns because the investments are made on a basis reflecting the typically long-term nature of the liabilities, which can stretch out over many decades. We also believe that expected returns provide useful information to investors about management intentions and expectations. An annual reporting period is a small time in the life of a pension fund and a focus on volatile short-term returns over a single reporting period, would have the effect of encouraging pension schemes to adopt inappropriately conservative investment policies to the detriment of Member States' economies and European competitiveness in general.

We had understood that the accounting profession and standards setters had agreed that a change of this nature would not be introduced until after the implementation of a new standard on comprehensive income/performance reporting.

We believe it is sensible for the actual returns achieved, for a number of previous years, to be disclosed so that investors and analysts can take a view on the reasonableness of the expected return used, and for the gains and losses between the expected return and the actual returns to be taken elsewhere in comprehensive income. IAS 19 already requires such disclosure for a period of 5 years. If actual returns are exclusively shown in the income statement, investors may be led to believe that in years of high actual returns, these are available for distribution to them, when they clearly would not be.

If actual returns are used, we believe this would also have a negative impact on the development of defined benefit pension arrangements because, whilst we feel that most investment analysts are used to adjusting reported income to obtain the underlying trend, we fear that finance directors and corporate boards would react to the apparent volatility in income (and, more specifically, in the profit and loss account) and that this would give rise to the closing of pension funds or other action that would have the effect of reducing pension benefits.

We recognise that there have been abuses in some jurisdictions, where unrealistically high expected returns have been taken through the profit and loss account to boost reported profits, but we feel that such abuses should be tackled directly. It is suggested to provide more guidance for setting expected return e.g. based on historical investment return averaged for a long period or on objective benchmark returns per strategic asset class.

In summary we believe that, instead of reporting actual returns in the income statement with a separate note showing expected returns, as proposed in the Discussion Paper, the income statement should continue to report expected returns, but that this should be accompanied by full disclosure of actual returns and their history.

Employers involved in multi-employer arrangements should continue to be exempt from the standard.

We accept that in theory employers involved in some multi-employer plans should account for their share of the plan's liabilities. We, however, do not accept that this is universally the case. Where there is an element of risk sharing and the employer can cease to participate in the fund without any further liability attaching to him, we do not see how this would oblige such an employer to account for a share of the fund's liability. We, also, do not see how it can be reliably done in practice.

The Discussion Paper correctly identifies the problems in obtaining necessary information for all three measurement methodologies that it proposes, and we doubt whether there can be any realistic basis that can be consistently applied for determining an 'allocation key' for the options based on proportionate shares, (whether of the net assets / net liability of the scheme or of any recovery or asset return plan).

The Discussion Paper suggests that the key could be based on contribution levels, but this would be clearly inequitable as between employers that have recently joined the scheme (and therefore not built up accrued benefits for past service) and employers with a longer record of involvement in the scheme.

As a result of the above we believe all multi-employer plans should continue to be exempt from the standard except where the assets, (or a proportion of the total assets of the plan), are separately identified as belonging to an employer section, as is the case in some multi-employer plans in some jurisdictions.

Pension funds need not to account annually in their own accounts for the liabilities on the same basis as the scheme sponsor.

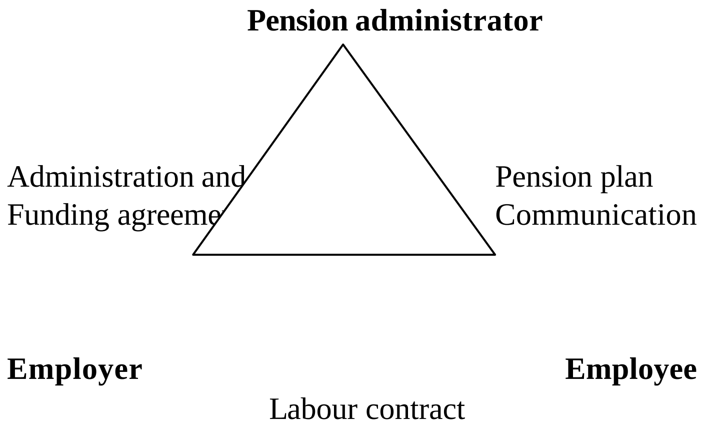
In most Member States the liabilities of pension funds are accounted for annually in their own accounts but are calculated in accordance with the relevant national regulatory requirements. A notable exception is the UK, where the funding statement is not formally included as part of the accounts.

The EFRP considers that it is worth remembering that the audiences for the two sets of accounts are different. For corporate accounts, the audience is the investor or their agent who is trying to place a current value on the entity relative to its market value to see if it is an attractive investment, whereas for a pension fund sponsored by an employer the audience is the member who wants to understand whether the pension fund has sufficient assets to meet the long-term commitment to him, or her, to pay his, or her, benefits.
We, therefore, believe it is for the national pension regulator to determine how the scheme liability should be calculated and reported to members.

The assessment of assets and liabilities for employer when the pension vehicle or the employees bear a material part of the risks involved.

In certain jurisdictions when assessing pension costs and liabilities of the employer it is important to take into account the nature of the pension arrangements agreed with the employees and, if applicable, the contracts between the pension fund or insurer involved, with the employers and the employees

In case of an independent pension administrator that is not controlled by the employer there can be large differences between the liabilities of the employer and the pension administrator. Certain risks can be transferred to the pension administrator and to employees. Furthermore, employees may contribute variable pension premiums themselves in certain plans. In such cases the possible risk sharing between employer and employees needs to be taken into account in the measurement of the employers' liability.
Depending on the contractual agreements this can even lead to a situation where the employer does not run any risk after paying a fixed contribution and therefore shows a DC-plan in its accounts, whereas the pension administrator has DB liabilities.
With regard to pension indexation, where the pension administrator is able to determine the level of future indexation independently of the employer and the employer is not under a legal or constructive obligation to grant such indexation again the liability of the employer is different from the liability of the pension plan.



As a result it is crucial to observe the agreements between employer, employees and pension administrator and the way these work out in practice, to decide on the liabilities and pension costs of the employer.

5. SPECIFIC QUESTIONS POSED IN THE DISCUSSION PAPER

Chapter 2: Liabilities to pay benefits

Q1 Should a liability to pay benefits that is recognised be based on expectations of employees' pensionable salaries when they leave service, or on current salaries (including non-discretionary increases)?

As explained above (paragraph 2 i), the liability to pay benefits should be based on current salaries, but should also include non-discretionary salary increases.

Q2 Should financial reporting be based on the premise that a liability is owed to an individual employee or to the workforce as a whole? What consequences do you consider your view has for the recognition and measurement of pension obligations?

In our view, the employer's obligation is to each individual employee, unless a pension plan in a particular jurisdiction has an obligation to pay a group of pensioners a total amount which is then shared out between themselves under some criteria. We are not aware of any such arrangements outside of first pillar government social security arrangements.

Q3 Do you agree that recognition should be based on the principle of reflecting only present obligations as liabilities?

We agree – specifically, discretionary future salary increases should be excluded.

Chapter 3: Assets and liabilities: reporting entity considerations

Q4 Do you agree that the consolidation of pension plans should be subject to the same principles as are usually applied in determining whether consolidation is appropriate?

In general we agree that the criterion for consolidation should be control (that is, that the sponsor has control over the pension plan), but subject to a further criterion that must also be met before a pension plan is consolidated.
We believe that even where the sponsor has control over the pension plan while the sponsor remains a going concern, the plan should not be consolidated if the sponsor's creditors are denied access to the plan's assets in the event of the sponsor becoming insolvent.
The pension plan should only be consolidated where both criteria are met: that the sponsor has control and the sponsor's creditors have access to the plan's assets in the event of the sponsor becoming insolvent. In general pension plans will not be consolidated using these principles.

Chapter 4: Recognition of pension assets and liabilities

Q5 Do you agree that changes in assets and liabilities relating to pension plans should be recognised immediately, rather than deferred and recognised over a number of accounting periods or left unrecognised provided they are within certain limits (a 'corridor') approach?

We accept the principle of immediate recognition – although not if the entire effect is to be shown in the income statements. As already noted, we are extremely concerned about how these changes are reported and the unintended consequences in the form of the impact on pension provision if the changes have to be taken through the income statement. We would support that the **unanticipated changes should be shown in a SORIE or OCI type statement.**

Chapter 5: Measurement of liabilities to pay benefits

Q6 Do you agree with the paper's views in the measurement of liabilities to pay benefits? In particular, do you agree that:

- *Regulatory measures should not replace measures derived from general accounting principles?*

We agree.

- *The discount rate should reflect the time value of money only, and therefore should be a risk-free rate?*

We do not agree. As explained above (paragraph 2 ii). We believe that the discount rate should be higher than the risk-free rate to make allowance for the nature of the liabilities and the risks and uncertainties attached to them.

- *Information about the riskiness of a liability (i.e. the risk that the amount of pension benefits will differ from today's expectations) is best conveyed by disclosure rather than by adjusting the amount of the reported liability?*

We agree.

- *The liability should not be reduced to reflect its credit risk?*

We agree.

- *Expenses of administering the plan's accrued benefits should be reflected in the liability?*

We do not agree. Expenses should be recognised when they arise, although we would accept that investment expenses should be deducted from the expected returns, and disclosed for the actual returns, this is because part of the decision in making an investment is the cost of so doing, i.e. the net return is used to make an investment decision.

Q7 Where employees have options to receive benefits in different ways, should the liability be reported at the highest amount or at an amount that reflects the probability of different outcomes?

The EFRP believes that it is more appropriate to reflect such situations using the probability of different outcomes – tax and other considerations mean that beneficiaries will not necessarily choose the option that is most costly to the plan.

Chapter 6: Measurement of assets to pay benefits

Q8 Do you agree that assets held to pay benefits should be reported at current values?

We agree.

Chapter 7: Measurement of employer interests in the assets and liabilities of trusts and similar entities

Q9 Do you agree that a 'net' asset or liability should be based on the difference between the amounts at which the assets and liabilities would be measured if they were measured directly?

We agree.

Chapter 8: Presentation in the financial statements

Q10 Do you agree that different components of changes in liabilities and/or assets should be presented separately?

We agree.

Q11 Do you agree that the financial performance of an entity should reflect the actual return on assets, rather than the expected return, and that the expected return should be required to be disclosed?

No, the expected return should continue to be shown in the income statement, with greater detail on actual returns disclosed in the notes to the accounts. We would support a requirement to provide a five-year history of actual net returns (or gross returns with the investment costs explained) in the notes to the accounts as IAS 19 currently requires.
Our reasoning for this is explained earlier, but is in summary, because the investments are typically made for a much longer term than the reporting period it is not relevant to the income statement, and would give investors a misleading view of the development of income in future.

Chapter 9: Disclosures in the employer's financial statements

Q12 Do you agree with the objectives of disclosure that are identified in this Chapter? Are there specific disclosure requirements that should be added to or deleted from those proposed?

As mentioned earlier we would propose that the Projected Benefit Obligation is disclosed in the notes to the accounts together with the effect on this measure if the discount rate were changed to the expected return on the assets. This would give investors a view as to the long-term funding requirement for the pension arrangements as well as the current market value. Where there are no assets, i.e. the liabilities are just a provision on the balance sheet we would propose that an appropriate long-term return is used, e.g. a model portfolio, or the employer's Weighted Average Cost of Capital.

Chapter 10: Accounting for multi-employer plans

Q13 Do you agree that multi-employer plans should be reflected in an employer's financial statements using the same principles as those that apply to a single employer plan? How, in your view, should an accounting standard require that this be implemented in practice?

We do not believe that in practice it is feasible to establish an acceptable allocation key for arrangements where there is an element of risk sharing. We do not see how an employer's share of a multi-employer plan could be accounted for in practice, except where the assets and liabilities of that employer are separately identified in a section of the plan.

Chapter 11: Financial reporting by pension plans

Q14 Do you agree that a pension plan's general purpose financial report should include its liabilities to pay benefits in the future? Do you agree that the plan's liabilities for future benefits should be quantified using the same principles as an employer's liability?

We believe that it is a matter for the national pensions regulator to determine how and whether the liabilities should be included within a pension plan's accounts. However, we do not agree that these should be measured in the same manner as for measuring an employer's liability in its accounts. The two sets of accounts address different audiences for different purposes, and we believe the basis for measuring liabilities in a plan's accounts should be left to the regulatory authority in each jurisdiction.

Q15 Do you agree that a pension plan's statement of financial position should reflect an asset in respect of amounts potentially receivable under an employer's covenant, and that this should reflect the employer's credit risk?

Where the fiduciaries of a pension plan have reached a contractual agreement for the employer to make additional contributions over a period, usually to make good a deficit on a funding basis, we would agree that the amounts should be recognised as an asset of the plan and should be shown in the plan accounts. We do not, however, accept that a deficit on an IAS basis should be shown as an asset of the Scheme.

General questions

Q16 Are there types of pension arrangements that require further consideration? Please identify the specific features of these arrangements and suggest how the principles of this paper would require development to secure appropriate financial reporting for them.

We think that the treatment of career average pension plans and other defined benefit pension plans should follow the treatment of defined benefit final salary plans, but that some specific hybrid plans based on a cash benefit or notional cash contribution do require further consideration.

Q17 Are there further specific issues relating to the cost and benefit of the proposals that should be taken account of in their further development?

No.