Sir David Tweedie
Chairman,
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

September 26, 2008

Re: Discussion Paper "Preliminary Views on Amendments to IAS 19 Employee Benefits"

Dear Sir David:

The Canadian Institute of Actuaries (CIA) is the national organization of the actuarial profession. Member driven, the CIA is dedicated to serving the public through the provision, by the profession, of actuarial services and advice of the highest quality. The CIA welcomes the opportunity to comment on the March 2008 Discussion Paper, "Preliminary Views on Amendments to IAS 19 Employee Benefits" from the International Accounting Standards Board.

These comments have been prepared by the CIA's Task Force on International Pensions and Employee Benefits Standards. It has also been subject to the due process required for it to constitute a formal view of the CIA and will be posted to the CIA's official website.

General Comments

- The CIA is primarily commenting on issues that have actuarial implications, and not on pure accounting matters. Silence on the accounting issues should not be taken as an expression of support for them.
- The CIA is concerned that the proposed accounting treatment will cause substantially different accounting for common similar plans. In Canada, career average pay and flat dollar benefit plans are prevalent and we believe it would be inappropriate to account for them differently from final average pay plans, as the benefit formulas may differ on paper but the benefits ultimately provided may be quite similar.
- The CIA's understanding is that a fundamental long-term goal is uniform financial reporting standards worldwide. Several of the proposals change practices that are currently essentially uniform between the FASB/CICA and IASB and introduce substantial new differences. This is counterproductive. Even if the IASB believes that the current accounting is problematic, it should not be causing consistent practice to diverge when its goal is convergence.
- The CIA recognizes that the IASB's view is that its standard-setting objective is to accurately reflect and report on financial events, and if such transparency changes behaviour, it is because

the behaviour could not stand the scrutiny that proper reporting provides. Nonetheless, the use of settlement-type, point-in-time accounting for post-retirement benefits has unquestionably been a major factor in the decline of defined benefit plans, to the detriment of workers and retirees around the world.

- IN4(c) phrases the project as addressing the issue of “accounting for benefits that are based on contributions and a promised return.” It appears that the major flaw that the IASB is attempting to address with the discussion paper is to change the accounting treatment for what is known as a cash balance plan. However, it appears that the proposed reclassification of all plans into either a “contribution-based” promise or a “defined benefit” promise has captured traditional career average and flat dollar defined benefit pension plans as a “contribution-based” promise. Such treatment would be very inappropriate for post-retirement plans in Canada and we do not support such a change.

  If the main concern being addressed with this fundamental change to the classification system is to ensure that “cash balance” plans be accounted for as contribution-based promises, then we suggest that the IASB consider simply amending the current definition of defined contribution (DC) plans to specifically include these types of plans. Similarly, if the IASB wants to capture certain other plan types, such as DC plans with minimum promised returns, “greater of” promises, or others, we suggest that they be explicitly included.

  We believe that the fundamental change of an entirely new classification system as is being proposed be included in the comprehensive project, when it can also look at the other various non-pension post retirement benefits rather than in this interim measure.

- We recognize and support the ultimate goal of improving the accounting for employee future benefits and achieving global convergence. While we understand that it will take many years to achieve the IASB’s long-term goal, we question the logic behind implementing a short-term solution that creates inconsistencies in reporting within IFRS and creates further divergence from Canadian GAAP. As Canada moves to adopt IFRS in 2011, we will likely be faced with changing to IAS 19 in its current state, then changing again a few years later to the amended IAS 19. We would; therefore, encourage any changes to IAS 19 to be effective January 1, 2011, or alternatively, that early adoption be permitted.

The CIA would prefer a regime where under plans that provide similar benefits receive similar treatment. The proposed distinction between contribution-based promises and defined benefit promises will result in situations where similar promises receive dissimilar treatment. This suggests a flaw in either the proposed categorization of promises or the proposed treatment of different categories, or both. If possible, we would prefer that the same paradigm be used to value all promises. Alternatively, different paradigms could be applied to different categories, but should converge to the same results as the differences in the promises converge.

The CIA encourages the IASB to be cognizant of the consequences of its actions, and affirmatively to seek options among reasonable choices that are socially desirable. The CIA believes that the Preliminary Views, if adopted, will exacerbate the already undesirable accounting impact of IAS 19.

We have prepared a response to the questions that, in our view, have actuarial implications from a Canadian perspective. Reference is made to both the standards of the Canadian Institute of Chartered Accountants and the US Financial Accounting Standards Board as many Canadian companies report under both Canadian and US GAAP.

Question 2

Chapter 2 describes the Board's deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in paragraphs PV2-PV4.

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?

Response 2

While we do not fundamentally object to the principle of immediate recognition of changes in the value of assets and obligations in the period in which they occur (PV2), we believe it is not appropriate to include it as part of this interim step prior to the comprehensive review, as this is an area where the IASB and FASB/CICA are essentially in concurrence today.

It appears that the discussion paper may require re-measurement of the actuarial liabilities at interim financial reporting periods, which would prove problematic where quarterly financial statements must be presented, as is the case for public companies in Canada. Once again, we note that this is an area where the IASB and CICA are essentially in concurrence today, so this change would be introducing divergence into an area where there is currently consistency.

Recognition of past service cost immediately (vested or non-vested) (PV4) is, in our opinion, typically a misallocation of remuneration to the labour that will generate revenue in return. This is acknowledged to some degree in the discussion paper. Currently the IASB and FASB/CICA diverge on this issue, and the proposed change modestly increases the differences. We believe that the FASB/CICA's approach is preferable. A change by the IASB to the FASB/CICA approach would encourage convergence and would be a better reflection of the exchange of labour for compensation. Indeed, the current divergence presents serious problems in collective bargaining. Choices as to how the same compensation value is delivered for the same labour have drastically different accounting impacts if one of the alternatives relates to past service. In addition, identical companies with identical employee benefits have drastically different accounting solely based on whether the ultimate reporting entity is subject to the FASB/CICA or IASB.

Question 5

The Board's intention in defining contribution-based promises is to capture those promises for which the measurement requirements of IAS 19 are difficult to apply. However, in trying to find an appropriate and conceptual way to distinguish these promises, the Board has included in the scope of the project some promises for which the measurement requirements of IAS 19 are not

particularly difficult to apply. In particular, the scope includes promises in which the benefit includes a fixed return on contributions.

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?

Response 5

We are in substantial disagreement with Chapter 5 of the Discussion Paper and its regrouping of employee benefits. In order to ensure that “cash balance” and other targeted plans be accounted for as contribution-based promises, we suggest that the IASB consider including them in the current definition of defined contribution plans to specifically include these types of plans.

While we prefer there to be no grouping of employee benefits, in the event that grouping continues, we find that the proposed definition for the *contribution-based promise* is focused on a secondary rather than the primary aspect of the post-employment promise.

In our opinion the primary aspect of a post-employment promise is whether or not the post-employment promise is focused on defining an annuity or a lump sum. This primary aspect groups what, in Canada, are called career average defined benefit pension plans and final average defined benefit pension plans together as a *defined annuity promise* and leaves what we call money purchase pension plans as a *defined lump sum promise*. This separates plans that promise an annuity from those that promise a lump sum.

In our opinion, the proposed definition inappropriately combines annuity promises (career average defined benefit pension plans) with lump sum promises (money purchase pension plans) under one group, namely a *contribution-based promise*.

Our proposal is to replace the definition of the *contribution-based promise* with the following *lump-sum based promised*:

> A *lump-sum based promise* is a post-employment promise in which, during the accumulation phase, the promise is expressed as the accumulation of contributions plus interest, which, for example, may be zero, prescribed or based upon actual investment returns, and the promise is either the payment of a lump sum or the conversion of the lump sum into an immediate or deferred annuity at or after completion of employment.

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?

Response 6

The definition of contribution-based promises as drafted would inappropriately capture career average defined benefit pension plans and flat dollar defined benefit pension plans, which comprise over half of all defined benefit pension plans in Canada.[1] This is contrary to the Board's objective not to change accounting for typical defined benefit pension plans. Although other post-retirement benefit plans are excluded from the scope of the discussion paper, certain types of post-retirement health care plans that, for example, allocate an annual dollar amount to retirees as a health care spending account would be classified as a contribution-based promise.

This would create practical difficulties as the accounting treatment would differ for substantially similar plans. Impracticalities will also arise in the measurement of such types of plans given the lack of guidance provided in applying a fair value measurement of the obligation. For example, the rate applicable under a flat dollar plans is typically negotiated and increased annually, not unlike final salary defined benefit plans. Similarly, career average plans are often upgraded to current earnings levels. Therefore, there is no apparent reason to treat them differently from final average pay plans.

Question 7

Contribution-based promises, as defined in this paper, include promises that IAS 19 classifies as defined contribution plans. The Board does not intend this proposal to lead to significant changes in the accounting for most promises that meet the definition of defined contribution plans in IAS 19.

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

Response 7

The proposals do not appear to cause significant changes in the accounting for traditional defined contribution plans as currently classified under IAS 19 – provided there are no minimum guarantees. However, it is imperative that further guidance be provided on the measurement and application of "fair value."

Question 8

Chapter 6 discusses recognition issues related to contribution-based promises. The Board's preliminary views are summarized in paragraphs PV9-PV11.

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

Response 8

We agree that unvested contribution-based promises should be recognized as a liability in order to be consistent with defined benefit promises.

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[1] Statistics Canada, 2007

We agree that benefits from a contribution-based promise should be allocated and recognized in accordance with the benefit formula as this is how defined contribution-type plans are currently accounted for.

We agree that an entity should not recognize an additional liability for additional amounts to be paid should an employee leave service immediately after the reporting date.

Question 9

Chapter 7 describes the Board's deliberations on the measurement of contribution-based promises. The Board's preliminary view is that entities should measure the liability for a contribution-based promise at fair value assuming the terms of the benefit promise do not change. The Board reasons that fair value assuming the terms of the benefit promise do not change meets the measurement objectives described in this paper, i.e., it is based on:

- **(a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the cash flows;**
- **(b) current market discount rates that adjust the estimated future cash flows for the time value of money; and**
- **(c) the effect of risk, other than the risk that the terms of the benefit change.**

(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?

Response 9

As previously indicated, we believe that the "contribution-based promises" may not be appropriate to address in Phase 1, and that, at least in Canada, the dividing line between final salary plans and contribution-based promises will result in common plans with similar characteristics being treated differently – an inappropriate result.

The "fair value" concept, particularly without guidance, will be difficult to apply. At present, the market for employee benefits is quite limited and the prices of the actual transaction are not in the public domain. There would need to be adjustments to the discount rate to reflect the illiquidity of a benefit as well as credit risk. For a single plan, there would need to be a credit risk adjustment for the unfunded benefits, but not for the funded portion. In order to adjust this latter factor properly for duration, assets would need to be allocated to specific benefits, whereas, in reality, all assets are available for all benefits. Of course, there would be a comparability problem that does not exist at present, given that different companies would use different discount rates for apparently identical obligations.

Collective bargaining would also be impacted as the same benefit change would have different values for different companies solely because of differing credit risk factors.

In any event, just as we are opposed to treating similar obligations differently during the accumulation phase, we are opposed to treating similar obligations differently during the distribution phase. If the IASB concludes that the contribution-based benefit concept should be implemented as presented, we would still support uniform accounting treatment consistent with current standards during the distribution phase, recognizing that this will produce a gain or loss at the time of retirement due to the change in assumptions.

Question 10

The definitions of contribution-based and defined benefit promises rely on the nature of the benefit promise during the accumulation phase. The Board's preliminary view is that the liability for benefits in the payment and deferment phases should be measured in the same way as they are in the accumulation phase, even though this could result in the same liability being measured in different ways depending on the way it was accumulated. The Board's reasons are set out in Chapter 8.

(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?

Response 10

Identical benefits may become crystallized during the payout and deferment phases that arise, respectively, from contribution-based or defined benefit promises in the accumulation phase. It is troubling that such promises would be valued differently during payout and deferment when they are otherwise identical. To minimize this possibility, contribution-based promises would need to be defined as narrowly as possible (see our responses to questions 5 and 6).

One could conceive of changing the valuation methodology during the payout and deferment depending on the character of the promise in these phases (e.g., if a contribution-based promise is crystallized into a defined benefit promise upon deferment and payout, then value it as a defined benefit promise during these phases). However, this may be difficult to implement and would raise challenging questions surrounding the point and manner of transition.

The proposed valuation approach for contribution-based promises requires the use of stochastic techniques. Such techniques are not currently in wide use by actuaries and auditors with respect to employee benefit plans, so neither training nor computer systems are geared to their use. Also, there is considerable subjectivity involved in stochastic techniques (i.e., postulation of the distribution of future outcomes). Therefore, we believe that determining "fair value" will prove difficult, expensive and, ultimately, subjective. Also, the proposed difference in treatment of "own credit risk" between contribution-based and defined benefit promises would exacerbate comparability problems.

An alternative valuation approach is to continue to apply "defined benefit" techniques using deterministic assumptions, but with judgment exercised in the setting of those assumptions. That is, one could shade the deterministic assumptions up or down to take some account of the range of possible outcomes and the associated risks. While this would not overcome subjectivity, it may be more practical than inventing a whole new approach.

As the recommendations in the discussion paper are intended to be interim measures, the development of an entirely new approach to accounting for pension plans should be postponed and considered as part of the comprehensive review.

Question 13

The Board's preliminary views on benefit promises in which the benefit is the higher of a defined benefit promise and a contribution-based promise are summarized in paragraphs PV16-PV18.

(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?

Response 13

There are a number of practical difficulties in identifying and measuring the 'higher of' option. Unless companies that sponsor contributory defined benefit pension plans in Canada can successfully argue that the value of the 'higher of' option is immaterial, the proposals would significantly increase the cost of complying with the accounting standards. In considering this, it is important to note that benefit promises with a 'higher of' option could potentially include a very large number of Canadian pension plans. For example, a number of Canadian plan sponsors (largely universities) sponsor hybrid pension plans that provide a pension at retirement which is the greater of a pension based on a final average earnings formula (i.e., a defined benefit promise) and a pension based on the accumulated contributions with interest (i.e., a contribution-based promise).

The majority of Canadian defined benefit pension plans require employees to contribute to the pension plan. For all of these plans, provincial pension benefits legislation requires that employee contributions, with interest, are not used to provide more than one half of the total benefit. Excess contributions are either refunded to the member or, in some jurisdictions, used to provide an additional benefit.

There are also a number of pension plans where the benefit at retirement is the greater of (a) a flat benefit or a career average formula, and (b) a final average earnings formula. For example, a company may have a flat benefit plan in place for unionized employees and a final average earnings plan for management. Employees who are promoted into management may receive a guarantee that their pension benefit will not be less than what they would have received if they stayed in the union plan.

Section 10.4 states that, “The projected unit credit method uses point estimates to calculate the expected value of the liability, and thus ignores the value of the option to obtain the higher benefit. Embedded guarantees and options have a value for which recognition and measurement provides useful information. Ignoring the value of any option underestimates the liability.” This statement is true for hybrid pension plans, but it is also true for many defined benefit pension plans. Implementing a new set of accounting rules for plans that provide a ‘higher of’ option without re-visiting the accounting rules for other pension arrangements does not seem appropriate.

It may not always be appropriate to assume that the ‘host’ promise is a defined benefit promise. For example, hybrid pension plans sponsored by Canadian universities are written and communicated as the sum of:

- A pension based on accumulated contributions with interest; and,
- A supplemental benefit, if needed, which brings the member’s total pension up to the level determined by a final average earnings formula.

For many of these plans, the expected pension based on accumulated contributions with interest is greater (in some cases significantly greater) than that determined by the final average earnings formula. For these plans, it would be more appropriate to assume that the ‘host’ promise is a defined contribution promise.

The inconsistencies in the assumptions used to value contribution-based promises and defined benefit promises would complicate the calculation of the fair value of the embedded option.

The Canadian Institute of Actuaries (CIA) is pleased to offer these comments and thanks you for your consideration. If you have any questions or would like to discuss our comments, please contact Daniel Lapointe, Executive Director, by phone at 1-613-236-8196 or by e-mail at executive.director@actuaries.ca.

Sincerely,

Michael A. Hale, FCIA, FSA
President
Canadian Institute of Actuaries