STAFF PAPER

**IFRS Interpretations Committee Meeting**
July 2013

**IFRS IC** Nov 2012**,** Jan, March and May 2013
**IASB** Feb 2013

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| **Project** | **IAS 19 *Employee Benefits*—Discount rate: Regional market issue** | | |
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## Introduction

1. In June 2013, the IFRS Interpretations Committee ('the Interpretations Committee') received a request to address explicitly as part of the "discount rate project" the issue of a regional market sharing the same currency.

2. The submitter notes that at the May 2013 meeting, the Interpretations Committee requested the staff to refocus its work on whether corporate bonds with a rating lower than 'AA' can be considered to be high quality corporate bonds (HQCB). The submitter's concern is that the Interpretations Committee does not plan to issue a formal clarification regarding the application of the requirements of IAS 19 *Employee Benefits* to determine the discount rate to a regional market sharing the same currency (eg the Eurozone).

3. The submission is reproduced in full in Appendix B of the paper

## Objective

4. The objective of this paper is to:

   (a) provide a brief description of the issue raised by the submitter;

   (b) provide an analysis of this specific issue;

(c) make a recommendation that the IASB should amend paragraph 83 of IAS 19 through Annual Improvements; and

(d) ask the Interpretations Committee whether it agrees with the staff recommendation.

## Description of the issue

5. The submitter states that:

(a) the valuation of post-employment benefit obligations in accordance with IAS 19 continues to be a very topical issue in the preparation of IFRS financial statements, notably in the current environment of low interest rates in Europe;

(b) market participants have expressed concerns about the consistency of application of the requirements of IAS 19 in relation to the determination of the discount rate with reference to HQCB and with reference to a regional market sharing the same currency or currencies pegged to this regional currency;

(c) according to paragraph 83 of IAS 19 **in countries** where there is no deep market for HQCB the market yields on government bonds shall be used;

(d) in June 2005 the Interpretations Committee decided that “the reference to ‘in a country’ could reasonably be read as including high quality corporate bonds that are available in a regional market to which the entity has access, provided that the currency of the regional market and the country were the same (eg the euro).”:

(e) in January 2013 the Interpretations Committee confirmed this position and clarified that “for a liability expressed in euro, the deepness of the market of high quality corporate bonds should be assessed at the Eurozone level”;

(f) the Interpretations Committee's agenda decisions are important source of guidance, but they do not have the same authoritative status as amendments to Standards; and

(g) if no explicit clarification is made, potentially diversity in practice will persist.

6. In the light of the above, the submitter asks the Interpretations Committee to address the issue of a regional market sharing the same currency as part of the discount rate project.

## Staff analysis

7. The Interpretations Committee discussed this specific issue in January 2013. We report below the relevant paragraph of the January 2013 *IFRIC Update*:

> The Interpretations Committee expressed support for the June 2005 Interpretations Committee agenda decision that, in determining the discount rate, an entity shall include HQCB issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid. A consequence of this view is that for a liability expressed in euro, the deepness of the market of HQCB should be assessed at the Eurozone level.

8. On the basis of our discussions with interested parties we understand that the predominant approach used in practice for euro-denominated pension obligations is to determine the basket of HQCB at Eurozone level. However, we are aware that some believe that the basket of HQCB should be determined at country level, because paragraph 83 of IAS 19 states that [emphasis added]: "…**In countries** where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds shall be used".

9. We note that paragraph 83 of IAS 19 states that: "The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations".

10. Consequently, we think that in determining the discount rate, an entity shall include HQCB issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid. A consequence of this view is that for a liability expressed in euros, the depth of the market for HQCB should be assessed at the Eurozone level and not at a country level.

## Agenda criteria assessment

11. Our assessment of the Interpretations Committee's agenda criteria is as follows:

| We should address issues(5.16): | |
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| that have widespread effect and have, or are expected to have, a material effect on those affected;<br>where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and<br>that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*. | Yes. The issue is widespread and may have a significant effect on the entities affected. We are aware that different views exist in practice. The issue can be resolved within the confines of IAS 19. |
| In addition: | |
| Can the Interpretations Committee address this issue in an efficient manner (5.17)? | The issue can be resolved efficiently because the Interpretations Committee has already expressed its view on this matter. |
| Will it be effective for a reasonable time period (5.21)? Only take on the topic of a forthcoming Standard if short-term improvements are justified. | Yes, if the Interpretations Committee will agree with our recommendation to terminate the project on the discount rate (See Agenda Paper 11). |

## Assessment against the annual improvements criteria

12. Our assessment of the issue against the annual improvements criteria is as follows:

| In addition to the implementation and maintenance criteria, an AIP should (6.11, 6.12): | |
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| Replace unclear wording or<br>Provide missing guidance or<br>Correct minor unintended consequences, oversights or conflict | Yes. In our view the wording of paragraph 83 of IAS 19 may be clarified by deleting the reference to "countries". |
| Not change an existing principle or propose a new principle | Yes. We are not changing an existing principle or proposing a new principle. The principle will remain that the currency of the corporate bonds or government bonds shall be consistent with the currency of the post-employment benefit obligations. |
| Not be so fundamental that the IASB will have to meet several times to conclude (6.14) | Yes. On this specific issue the Interpretations Committee has already expressed its view. Consequently it should reach a consensus on a timely basis. |

## Staff recommendation

13. On the basis of our technical analysis, we think that in determining the discount rate, an entity shall include HQCB issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid.

14. On the basis of our assessment of the Interpretations Committee's annual improvements criteria, we think that the Interpretations Committee should recommend that the IASB should amend paragraph 83 of IAS 19 through Annual Improvements in order to clarify that in determining the discount rate an entity shall include HQCB issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid.

15. Our proposed amendment to IAS 19 is included in Appendix A of this paper.

| **Questions for the Interpretations Committee** |
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| 1. Does the Interpretations Committee agree that in determining the discount rate an entity shall include HQCB issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid?<br><br>2. Does the Interpretations Committee agree that it should recommend to the IASB to clarify paragraph 83 of IAS 19 by deleting the reference to "countries"?<br><br>3. Does the Interpretations Committee have any comments on the proposed wording for the amendment to IAS 19 in Appendix A? |

# Appendix A—Proposed amendment to IAS 19 showing differences from the currently effective Standard

A1 The proposed amendment to paragraph 83 of IAS 19 is presented below.

## Proposed amendments to IAS 19 *Employee Benefits*

Paragraph 83 is amended as follows: (new text is underlined and deleted text is struck through).

**83 The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. In ~~countries~~ <u>currencies</u> where there is no deep market in such high quality corporate bonds, the market yields (at the end of the reporting period) on government bonds shall be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations.**

<u>175 *Annual Improvements 2012–2014* cycle, issued in [date], amended paragraph 83. An entity shall apply that amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.</u>

## Basis for Conclusions on proposed amendments to IAS 19 *Employee Benefits*

*This Basis for Conclusions accompanies, but is not part of, the proposed amendments.*

BC1 The IFRS Interpretations Committee ('the Interpretations Committee') was asked to clarify the requirements of IAS 19 *Employee Benefits* to determine the discount rate to a regional market sharing the same currency (eg the Eurozone). The issue arose because some believe that the basket of high quality corporate bonds should be determined at a country level, and not at a currency zone level, because paragraph 83 of IAS 19 states that in countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds shall be used.

BC2 The Interpretations Committee noted that paragraph 83 of IAS 19 states that the currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations.

BC3 The Interpretations Committee therefore recommended that the IASB should mend paragraph 83 of IAS 19 through Annual Improvements in order to clarify that in determining the discount rate an entity shall include high quality corporate bonds issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid. Consequently, the deepness of the market for high quality corporate bonds should be assessed at currency zone level and not at country level.

European Securities and Markets Authority

The Chair

Date: 26 June 2013
ESMA/2013/815

**Mr Wayne Upton**
**IFRS IC**
**Cannon Street 30**
**London EC4M 6XH**
**United Kingdom**

**Ref: Amendment to IAS 19 *Employee benefits*: Regional market issue**

Dear Mr Upton,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

ESMA believes that the valuation of post-employment benefit obligations in accordance with IAS 19 - *Employee Benefits* continues to be a very topical issue in the preparation of IFRS financial statements, notably in the current environment of low interest rates in Europe. This has been documented by a debate about determination of the discount rate for post-employment benefit obligations during the meetings of IASB and IFRS IC in recent months. Market participants have expressed concerns about the consistency of application of the IAS 19 requirements in relation to the determination of the discount rate with reference to high-quality corporate bonds and with reference to a regional market sharing the same currency or currencies pegged to this regional currency.

Although IAS 19 does not explicitly identify which corporate bonds qualify in the category of ‘high-quality corporate bonds’, the predominant past practice has been to consider corporate bonds to be high quality if they receive one of the two highest credit ratings rating agency. This past practice has been confirmed in November 2012 and January 2013 IFRS IC Updates[1,2].

In cases where there is no deep market in such bonds in 'a country', the market yields for government bonds shall be used (c.f., IAS 19, paragraph 83). In June 2005 an IFRIC Agenda decision[3] indicated that the reference to 'a country' mentioned above **could reasonably be read** as "*including high-quality corporate bonds that are available in a regional market to which the entity has access, provided that the currency of the regional market and the country were the same (e.g. the euro)*". In January 2013, the IFRS IC Update confirmed[4] this position and clarified that "*for a liability expressed in euro, the deepness of the market of high-quality corporate bonds **should be assessed** at the Eurozone level*".

During its May 2013 meeting[5], IFRS Interpretations Committee (IFRS IC) decided to add to its agenda the scope issue regarding which corporate bonds qualify in the category of 'high-quality corporate bonds' without further clarifying or changing the objective of the Standard. ESMA agrees that explicit guidance is required in this area.

However, ESMA notes that the IFRS IC does not plan to issue a formal clarification which would confirm the agenda decision taken in June 2005 regarding the application of the IAS 19 requirements to a regional market sharing the same currency. ESMA is very concerned about this tentative decision taken by the IFRS IC during its May meeting. ESMA is worried that unless the issue of a regional market sharing the same currency is formally clarified as part of the planned amendment to IAS 19, the objective of consistent application cannot be fully achieved.

ESMA notes that although IFRS IC agenda decisions and IFRS IC Updates are important sources of guidance for prepares, auditors and accounting enforcers, they do not have the same authoritative status as amendments to standards as they do not constitute part of the IFRSs in accordance with IAS 8 - *Accounting Policies, Changes in Accounting Estimates and Errors* and are not subject to the full due process. ESMA also notes that the wording of the June 2005 Agenda Decision and the January 2013 IFRS IC Update is not identical and the rationale of this change of wording is not explicitly explained.

[1] IFRS IC Update – November 2012, IFRS Foundation, November 2013
[2] IFRS IC Update – January 2013, IFRS Foundation, January 2013
[3] IFRIC Update – June 2005, International Accounting Standards Committee Foundation, June 2005
[4] IFRS IC Update – January 2013, IFRS Foundation, January 2013
[5] IFRS IC Update – May 2013, IFRS Foundation, May 2013

ESMA is of the view that if no explicit clarification is made, potentially diversity in practice will persist, with negative impact on consistent application and enforceability (resulting in less comparable financial statements). As a consequence, ESMA asks the IFRS IC to reconsider its tentative decision taken during its May meeting and address explicitly the issue of a regional market sharing the same currency as part of the planned amendments to IAS 19.

We would also like to ask you to clarify whether the IAS 19 requirements for regional markets sharing the same currency also apply in the case that a currency is pegged to another currency.

We would be happy to further discuss this issue with you.

Yours sincerely,

Steven Maijoor
Chair
European Securities and Markets Authority