



COMMITTEE OF EUROPEAN SECURITIES REGULATORS

EFRAG

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RE: EFRAG's draft response on the IASB's Exposure Draft *Defined Benefit Plans (proposed amendments to IAS 19)*

The Committee of European Securities Regulators (CESR), through its standing committee on corporate reporting (CESR-Fin), has considered EFRAG's draft comment letter on the IASB's Exposure Draft (ED) *Defined Benefit Plans (proposed amendments to IAS 19)*.

We thank you for this opportunity to comment on your draft letter and we are pleased to provide you with the following comments.

CESR welcomes the proposals as a short-term solution; however we believe, like EFRAG that a comprehensive review of employee benefit accounting is needed to bring significant improvement to the financial reporting of employee benefits.

We are supportive of the immediate recognition of all changes in the value of plan assets and in the employee benefit obligation. CESR acknowledges that this amendment, together with the recognition of remeasurements in Other Comprehensive Income, provides more transparent information in the balance sheet and addresses appropriately the volatility issue.

As regards the application of a discount rate to the net defined benefit liability (asset) rather the expected return on plan assets as currently provided by IAS 19 – *Employee Benefits*, CESR has a preference for the discount rate. However, we acknowledge that there are drawbacks to this solution since, for instance, it will no longer reflect the investment policy followed by the entity.

Our detailed comments on EFRAG's draft response are set out in the Appendix 1.

I would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Fernando Restoy

Chairman of CESR-Fin



APPENDIX 1 – CESR’S DETAILED ANSWERS TO THE QUESTIONS IN THE ED

Question 1

The exposure draft proposes that entities should recognise all changes in the present value of the defined benefit obligation and in the fair value of plan assets when they occur. (Paragraphs 54, 61 and BC9–BC12) Do you agree? Why or why not?

We support the Board’s conclusions. CESR believes that entities should recognise all changes in the present value of the defined benefit obligation and in the fair value of the plan assets in the period in which they occur. We share EFRAG’s view that options hinder comparability and that the corridor approach causes a lack of transparency.

Question 2

Should entities recognise unvested past service cost when the related plan amendment occurs? (Paragraphs 54, 61 and BC13) Why or why not?

CESR believes like EFRAG that entities should recognise all prior service costs in the same period as a plan amendment is made regardless of whether the prior service cost is vested or unvested.

CESR observes together with EFRAG that this approach is inconsistent with IFRS 2 – *Share-Based Payments*. In CESR’s view internal consistency between IFRSs and for this project in particular with IFRS 2 is important.

Question 3

Should entities disaggregate defined benefit cost into three components: service cost, finance cost and re-measurements? (Paragraphs 119A and BC14–BC18) Why or why not?

It is our view that the items of defined benefit costs should be presented gross/disaggregated, based on the nature of the items. This will give the users of the financial statements a better understanding of the nature of the items in the statement of profit or loss. However, as set out in our response to question 5 below we are of the opinion that the finance component should not be presented net.

Question 4

Should the service cost component exclude changes in the defined benefit obligation resulting from changes in demographic assumptions? (Paragraphs 7 and BC19–BC23) Why or why not?

We agree that the service cost component excludes changes in the defined benefit obligation resulting from changes in demographic assumptions. CESR believes that those changes are re-measurements and that they should be treated as such.

Question 5

The exposure draft proposes that the finance cost component should comprise net interest on the net defined benefit liability (asset) determined by applying the discount rate specified in paragraph 78 to the net defined benefit liability (asset). As a consequence, it eliminates from IAS 19 the requirement to present an expected return on plan assets in profit or loss.

Should net interest on the net defined benefit liability (asset) be determined by applying the discount rate specified in paragraph 78 to the net defined benefit liability (asset)?



Why or why not? If not, how would you define the finance cost component and why? (Paragraphs 7, 119B, 119C and BC23–BC32)

CESR does not object to the Board's proposal to measure the finance cost component at the discount rate applied to the net defined benefit liability (asset), as we recognise that the use of the discount rate is a practical expedient intended to alleviate criticisms regarding overly optimistic and sometimes abusive expected rate of return assumptions. However, we acknowledge that the use of the discount rate may understate assets' returns, as companies will likely invest in assets with returns that they expect to be greater than the yields provided by high quality corporate bonds, and that also this approach will not reflect the investment policy followed by the entity.

As mentioned in the cover letter, CESR believes that there are various issues that the current ED does not address and that we would like the IASB to consider in a comprehensive project on defined benefit plans accounting. For instance, in countries where there is no deep market for high quality corporate bonds, developing additional guidance on how to assess the discount rate is needed, otherwise these entities will be compelled to use yields provided by government bonds which can significantly change the assessment of both their defined benefit obligation and the expected value of their assets.

Another area where further work may be needed deals with the consequences of changes to local regulations from the data IAS 19 has first been published. In some jurisdictions, plan assets may truly be controlled by the entity and thus qualify as an entity's asset. In such cases, it might be difficult to achieve a fair presentation of the economic effects of the pension schemes by applying the existing principles (even after the proposed amendments are made). Once again, a comprehensive project on defined benefit plans accounting could clarify this further.

Question 6

Should entities present:

- (a) service cost in profit or loss?**
- (b) net interest on the net defined benefit liability (asset) as part of finance costs in profit or loss?**
- (c) re-measurements in other comprehensive income?**

(Paragraphs 119A and BC35–BC45) Why or why not?

We agree with the proposed amendments as they will result in the presentation of the different cost items in line with their nature. Re-measurements on non-financial items are generally presented in other IFRS standards within profit or loss (e.g. IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*, IFRS 2 – *Share-Based Payments*, IFRS 4 – *Insurance Contracts*...), and a consistent application would therefore be to include this within profit or loss and not in comprehensive income. However, as a practical solution within this short term improvement project we can accept the suggested solution.

Question 7

- (a) Do you agree that gains and losses on routine and non-routine settlement are actuarial gains and losses and should therefore be included in the re-measurement component? (Paragraphs 119D and BC47) Why or why not?**

We agree that gains and losses on routine and non-routine settlement are actuarial gains and losses and should therefore be included in the re-measurement component. In principle the settlement of a plan should have marginal effect if the obligation was calculated correctly (with the exception of discounting effects). A gain or loss is consequently in nature a re-measurement. In principle we agree that non-routine settlements that in all material respects give the employees the same benefits as they have vested in the plan, should be accounted for as re-measurements, and not in profit or loss at



this stage. However, if there is a bargain in a settlement situation between employer and employees which result in employees obtaining compensation in the settlement (i.e. in better benefits than would have been vested according to the benefit formula) we believe that such effects should be presented in profit or loss.

Hence, like EFRAG, CESR believes that when introducing a different presentation for settlements and other changes (plan amendments and curtailments) there is a need for a clearer definition of what constitutes a settlement (and especially a non-routine settlement), what a plan amendment is and what curtailments are.

(b) Do you agree that curtailments should be treated in the same way as plan amendments, with gains and losses presented in profit or loss? (Paragraphs 98A, 119A(a) and BC48)

CESR agrees. Curtailments are related to future vesting of benefits such as salary increases. Hence we believe that the effect of a situation of curtailment is similar to that of a plan amendment and that the effects of such situations should consequently be presented in profit or loss.

(c) Should entities disclose (i) a narrative description of any plan amendments, curtailments and non-routine settlements, and (ii) their effect on the statement of comprehensive income? (Paragraphs 125C(c), 125E, BC49 and BC78) Why or why not?

Yes, entities should. Plan amendments, curtailments and non-routine settlements are changes that do not happen regularly, but which may have great impact on the accounting numbers. It is therefore important that information is given in the disclosures related to a description of what has happened and the impact on the financial statements. As mentioned earlier in our response to part (b) of this question we believe that the IASB should further clarify what constitutes a non-routine settlement by providing a precise definition.

Question 8

The exposure draft states that the objectives of disclosing information about an entity's defined benefit plans are:

- (a) to explain the characteristics of the entity's defined benefit plans;**
- (b) to identify and explain the amounts in the entity's financial statements arising from its defined benefit plans; and**
- (d) to describe how defined benefit plans affect the amount, timing and variability of the entity's future cash flows. (Paragraphs 125A and BC52–BC59) Are these objectives appropriate? Why or why not? If not, how would you amend the objectives and why?**

Like EFRAG, CESR is supportive of the objectives of disclosing information as set out by the IASB. We would however propose to expand a) with "to explain the risks and exposures the company is taking as part of its pension plans".

CESR believes that the Board should provide further clarification as to what "materially different risks" means. IAS 19.125 B states that an entity shall assess whether all or some disclosures should be disaggregated to distinguish plans or groups of plans. If the notion of "materially different risks" is not clear, it is doubtful that its application will be consistent. CESR fears that the examples provided in the ED will be difficult to enforce.



Question 9

To achieve the disclosure objectives, the exposure draft proposes new disclosure requirements, including:

- (a) information about risk, including sensitivity analyses (paragraphs 125C(b), 125I, BC60(a), BC62(a) and BC63–BC66);
- (b) information about the process used to determine demographic actuarial assumptions (paragraphs 125G(b) and BC60(d) and (e));
- (c) the present value of the defined benefit obligation, modified to exclude the effect of projected salary growth (paragraphs 125H and BC60(f));
- (d) information about asset-liability matching strategies (paragraphs 125J and BC62(b)); and
- (e) information about factors that could cause contributions to differ from service cost (paragraphs 125K and BC62(c)).

Are the proposed new disclosure requirements appropriate? Why or why not?

If not, what disclosures do you propose to achieve the disclosure objectives?

CESR supports the new proposed disclosure requirements but has some further detailed comments:

- We believe that referring to “information about the process” in the proposed disclosure requirement (b) is rather vague, and might be interpreted in different ways. We believe that it would be helpful to use the same wording as is used in paragraph 134 (d) I-II of IAS 36 – *Impairment of Assets*.
- We would like to include a more general description of how the pension assets are managed in (d). For many companies the fair value of the pension plan assets is among the largest items in the balance sheet (if it were to be presented gross), and the value of the company is dependent on how the assets are managed and invested. Such a description should include:
 - 1) investment strategy including asset classes;
 - 2) details regarding who is investing and managing the assets (e.g. the company itself, an asset management company with a discrete mandate, an asset management company as part of a regular investment fund, a life insurance company);
 - 3) details of any regulatory framework in which the pension assets is managed (e.g. the restriction regime on investment classes...);
 - 4) details of how currency effects are dealt with (only domestic securities, currency hedging strategies...); and
 - 5) details of any asset-liability management strategies.

Question 10

The exposure draft proposes additional disclosures about participation in multi-employer plans. Should the Board add to, amend or delete these requirements? (Paragraphs 33A and BC67–BC69) Why or why not?

CESR agrees with the additional proposed disclosures about participation in multi-employer plans.

Question 11

The exposure draft updates, without further reconsideration, the disclosure requirements for entities that participate in state plans or defined benefit plans that share risks between various entities under common control to make them consistent with the disclosures in paragraphs 125A–125K. Should the Board add to, amend or delete these requirements? (Paragraphs 34B, 36, 38 and BC70) Why or why not?

CESR is supportive of the updated disclosure requirements for entities that participate in state plans or defined benefit plans sharing risks between various entities under common control.



Nevertheless, for entities that participate in state plans, the proposed disclosure requirements would result in giving information publicly available in each country. Practical difficulties may also arise when it comes to assessing one entity's share in the state plan obligations.

Question 12

Do you have any other comments about the proposed disclosure requirements? (Paragraphs 125A–125K and BC50–BC70)

CESR is generally supportive of the additional disclosure requirements and agrees with the proposed additional disclosure requirements. We are however concerned that the part of disclosures related to IAS 19 might become substantive and that it will be important for entities to provide the information in such a way that it is most helpful for users of financial statements.

Moreover, regarding information requested by 125 E c), CESR believes that actuarial gains and losses arising from experience adjustments provide useful information on the reliability of the assumptions whereas a disclosure of actuarial gains and losses based on the nature of the assumptions seems less relevant.

Question 13

The exposure draft also proposes to amend IAS 19 as summarised below:

- (a) **The requirements in IFRIC 14 IAS 19 — *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*, as amended in November 2009, are incorporated without substantive change. (Paragraphs 115A–115K and BC73)**
- (b) **'Minimum funding requirement' is defined as any enforceable requirement for the entity to make contributions to fund a post-employment or other long-term defined benefit plan. (Paragraphs 7 and BC80)**

Like EFRAG, CESR agrees with incorporating IFRIC 14 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* in IAS 19. CESR notices that some changes in the wording have been made and that the background and the basis for conclusions included in IFRIC 14 have not been incorporated into the ED. We however believe that it might be useful to include this background and the basis for conclusions.

The definition of *minimum funding requirements* has been clarified in the proposed amendments by making reference to enforceability. It would however be helpful to clarify if this represents an exception to paragraph 3(c) of the standard meaning that some constructive obligations arising from informal practices may not meet the definition of minimum funding requirements even if the entity has no realistic alternative but to make contributions to fund the plan; for instance because failure to do so would cause unacceptable damage but where such obligations are not enforceable in court.

- (c) **Tax payable by the plan shall be included in the return on plan assets or in the measurement of the defined benefit obligation, depending on the nature of the tax. (Paragraphs 7, 73(b), BC82 and BC83)**

CESR shares EFRAG's view that this amendment clarifies that taxes payable have to be considered. CESR believes that the requirement should be expanded to include any tax (other than income tax) or social security tax payable for the employer directly relating to pension plans. In many countries social security tax is payable on all premiums paid to the plan, or on all pensions payment from the plan. IAS 19 should clarify that such direct taxes should be measured as part of the defined benefit obligation (which is in our understanding current practice in most countries).



Moreover, CESR suggests changing the wording “by the plan itself” in paragraphs 7 and 73 b to “in respect of the plan”. In most cases, a plan does not refer to any legal entity and taxes are paid directly by the entity.

- (d) The return on plan assets shall be reduced by administration costs only if those costs relate to managing plan assets. (Paragraphs 7, 73(b), BC82 and BC84–BC86)**

We agree.

- (e) Expected future salary increases shall be considered in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefits in later years. (Paragraphs 71A and BC87–BC90)**

Like EFRAG, CESR agrees that expected future salary increases should be considered in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefits in later years and believes this is in accordance with existing IAS 19 requirements.

- (f) The mortality assumptions used to determine the defined benefit obligation are current estimates of the expected mortality rates of plan members, both during and after employment. (Paragraphs 73(a)(i) and BC91)**

We agree. But we would like IAS 19 to specify that in certain “hybrid” plans the mortality and disability risk may be shared between employers. Such plans have a risk result each year, related to mortality and disability. Employers with low mortality or high disability rates will have funds transferred from the risk result. In such plans the relevant estimate is the expected mortality and disability rates of the plan members of all employers participating in risk sharing plan within the insurance company.

- (g) Risk-sharing and conditional indexation features shall be considered in determining the best estimate of the defined benefit obligation. (Paragraphs 64A, 85(c) and BC92–BC96)**

Like EFRAG, CESR agrees that risk sharing and conditional indexation should be considered in determining the defined benefit obligation.

Paragraph 64 a requires that “the measurement of the defined benefit obligation include(s) the effect of any requirements for employees to reduce or eliminate an existing deficit”. In most cases of deficit, negotiations are global and it is not practically possible to determine the part of the future contributions related to the reduction of the deficit.

Question 14

IAS 19 requires entities to account for a defined benefit multi-employer plan as a defined contribution plan if it exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual entities participating in the plan. In the Board’s view, this would apply to many plans that meet the definition of a defined benefit multiemployer plan. (Paragraphs 32(a) and BC75(b))



Please describe any situations in which a defined benefit multi-employer plan has a consistent and reliable basis for allocating the obligation, plan assets and cost to the individual entities participating in the plan. Should participants in such multi-employer plans apply defined benefit accounting? Why or why not?

It is CESR's understanding that multi-employer plans exist in many jurisdictions and that their accounting treatment is diverse. CESR agrees with EFRAG that one of the possible allocation methods is to use a criterion that is related to the basis that is also used for determining the pension contribution.

Question 15

Should entities apply the proposed amendments retrospectively? (Paragraphs 162 and BC97–BC101) Why or why not?

CESR agrees with EFRAG and the IASB that the amendments should be applied retrospectively in order to have comparable figures.

Question 16

In the Board's assessment:

- (a) the main benefits of the proposals are:**
 - i. reporting changes in the carrying amount of defined benefit obligations and changes in the fair value of plan assets in a more understandable way.**
 - ii. eliminating some presentation options currently allowed by IAS 19, thus improving comparability.**
 - iii. clarifying requirements that have resulted in diverse practices.**
 - iv. improving information about the risks arising from an entity's involvement in defined benefit plans.**
- (b) the cost of the proposal should be minimal, because entities are already required to obtain much information required to apply the proposed amendments when they apply the existing version of IAS 19.**

Do you agree with the Board's assessment? (Paragraphs BC103–BC107) Why or why not?

We agree with the Board that proposed changes in IAS 19 will cause the financial statements to be more understandable and useful. We also agree that in general the cost is minimal, but the actuarial calculations will for many companies be more costly because of the requirement of sensitivity analyses and the reclassification of the category "other long term benefits".

Question 17

Do you have any other comments on the proposals?

"Short term benefits"

The ED modifies the definition of short term benefits to benefits "expected to become due to be settled within twelve months of the end of the reporting period". The current definition has proven to be efficient and practical whereas this new proposed definition would seem more difficult to enforce. This new definition will require an estimate to be made of when the employee will exercise his right to the benefit and a portion of the plan will consequently need to be accounted for as short term with the remainder accounted for as a long term benefit.

CESR is also concerned about the classification of other long term benefits in the category long term employee benefits. Indeed, some bonuses paid in cash and contingent on performance targets are classified as other long term benefits. If they are classified as long term employee benefits, the difference between the estimated bonuses and the actual bonuses will be recognised in other



comprehensive income. We are of the view that such differences do not have the same features as actuarial gains or losses and that consequently such differences should impact the profit and loss.