Wayne Upton
Chairman of the IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Agenda Item Request: Measurement of minimum funding requirement in pension asset ceiling test

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.

As a result of the review of financial statements carried out by national competent authorities and ESMA's co-ordination activities, we have identified an issue related to the application of IFRIC Interpretation 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.*

A detailed description of the case is set out in the appendix to this letter.

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

Yours sincerely,

Steven Maijoor

APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

1. As part of their monitoring and supervisory activities, ESMA and national enforcers have identified divergent application of IFRS requirements regarding the performance of the pension asset ceiling test referred to in paragraph 64 of IAS 19 *Employee Benefits.* Divergence exists in estimating the minimum funding requirement for future service, which is one of the test's inputs.

Description of the issue

2. When entities with defined benefit pension plans have identified a surplus of pension assets over pension liabilities, paragraph 64 of IAS 19 requires them to perform an asset ceiling test in order to calculate how much of the surplus to recognise as an asset. One of two possible methods of performing the asset ceiling test considers the potential economic benefit of the surplus being available to the company as a reduction in future pension contributions. Using this method, IFRIC 14 limits the amount of pension asset that can be recognised to the cumulative future pension service cost, less any minimum pension funding requirement relating to future service.

3. Paragraph 17 of IFRIC 14 requires an issuer to determine the cumulative future service costs using assumptions consistent with those used to determine the defined benefit obligation and with the situation existing at the balance sheet date.

4. Paragraph 21 of IFRIC 14 requires the future minimum funding requirement contributions to be estimated using assumptions consistent with the minimum funding basis and, for any factors not specified by that basis, assumptions consistent with the defined benefit calculation in IAS 19. The estimate must not include the effect of expected changes in the terms of the minimum funding basis that are not substantively enacted or contractually agreed at the end of the reporting period.

5. When estimating future service costs, paragraph 16 of IFRIC 14 is clear that an entity should estimate them over the shorter of the life of the pension plan and the life of the entity. However, ESMA has identified divergent views with respect to the period for which the future minimum funding requirement contributions should be included in the calculation when these are contractual amounts agreed with pension trustees.

6. Under such arrangements, minimum funding arrangements are regularly renegotiated with the pension fund trustees, e.g. on an annual or triennial basis. The negotiated amount must then be paid for a fixed period, e.g. five years. There may be a notice period required before an entity can choose to cease future pension funding, however it will not be contractually required to continue with future pension contributions over the life of the plan.

View 1 – Assume that the future minimum funding requirement will apply for only the minimum period agreed with the pension trustees

7. Proponents of view 1 argue that paragraph 21 of IFRIC 14 only requires minimum funding requirements to be included in an asset ceiling test for the period to which an entity has contractually agreed to as at the balance sheet date.

8. For example, if the company is only committed to make minimum contributions for five years, only five years of minimum pension contributions would be included in the asset ceiling test.

View 2 – Assume that the minimum funding requirement will continue over the estimated life of the pension plan

9. Proponents of view 2 argue that the requirement to use terms and conditions contractually agreed at the balance sheet date refers only to the agreed contribution rate. Paragraph 21 does not explicitly refer to the period for which minimum funding requirements should be included. It also refers to using IAS 19 assumptions for any factors not specified by the minimum funding basis. Proponents of view 2 argue that using the same period for future service costs and minimum funding requirements is a better reflection of how the funding arrangements work in practice.

10. Proponents of view 2 also refer to Example 3 of the Illustrative examples to IFRIC 14. This example shows the future service cost and minimum service contributions being extrapolated over the same period. However, the assumptions underlying this example are not specified.

Request

11. ESMA seeks clarification of whether an entity with a contractually agreed future minimum funding requirement should assume that this requirement will exist over the life of the pension plan when performing an asset ceiling test.

12. ESMA is aware of examples of this divergent practice that have recently been identified by European jurisdictions. Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee considers clarifying the accounting requirements in this respect.