Committee of European Banking Supervisors

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International Accounting Standards Board
30 Cannon Street,
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Dear Madam, dear Sir,

Exposure Draft ED/2010/3 Defined Benefit Plans – Proposed Amendments to IAS 19

The Committee of European Banking Supervisors (CEBS), comprised of high level representatives from banking supervisory authorities and central banks of the European Union, welcomes the opportunity to comment on the IASB's Exposure Draft ED/2010/3 Defined Benefit Plans – Proposed Amendments to IAS 19.

Banking supervisory authorities and central banks have a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline.

Notably, CEBS has an interest in the reporting of post-employment benefits ("long-term employee benefits", under the ED's terminology) to the extent that they may have a material impact on banks' financial position and, potentially, on key components of prudential regulatory capital. Therefore, CEBS welcomes the IASB's efforts to improve the accounting for post-employment benefits.

While CEBS agrees with the overall purpose of the exposure draft, i.e. to improve the accounting for long-term employee benefits, we have some comments and concerns about the impact of the proposals put forward in the consultation paper in order to achieve that objective.

Regarding process, we understand the reasons why the IASB intends to introduce limited changes in the relatively near term. Given the importance and complexity of the issues surrounding pension schemes, CEBS can see arguments for the IASB to consider substantive changes to the standard only as part of a more fundamental review. With this in mind, CEBS encourages the IASB to carry out such a review bearing in mind that future changes should be consistent and coherent with any changes made at this point, to minimise the burden of constant change in accounting standards.

Should the IASB decide not to defer implementation of the changes set out in the ED, CEBS would urge the IASB to focus particularly on our comments on Questions 13 (g), 14 and 15. These issues are important for some EU constituents in the context of fairly representing the economic implications of conditional indexation features and multi-employer plans, and of the overall impact of the proposals.

CEBS does not comment on all the questions posed by the IASB in the ED but rather addresses only those issues that are considered the most relevant in the appendix below.

The comments put forward in this letter have been coordinated by CEBS's Expert Group on Financial Information (EGFI) chaired by Mr. Didier Elbaum (Deputy Secretary General, Autorité de Contrôle Prudentiel) - in charge of monitoring any developments in the accounting area and of preparing related CEBS positions - and in particular by its Subgroup on Accounting under the direction of Mr. Ian Michael of the UK FSA. If you have any questions regarding our comments, please feel free to contact Mr. Elbaum (+33.1.4292.5801) or Mr. Michael (+ 44.20.7066.7098).

Yours sincerely,

Giovanni Carosio
Chair, Committee of European Banking Supervisors

Appendix - General comments

As mentioned in the cover letter and also in our comment letter on the DP "Preliminary Views on Amendments to IAS 19 Employee Benefits", CEBS agrees with the overall purpose of the IASB of improving the accounting for long-term employee benefits. However, CEBS would like to encourage the IASB to give due consideration to consistency between the urgency in implementing immediate improvements and the changes envisaged in subsequent phases of this project in the context of a more comprehensive review of IAS 19. While we consider the issues addressed in this exposure draft are key aspects of the accounting for long-term employee benefits, CEBS is of the view that other aspects could improve the understandability of accounting information related to employee benefits and therefore should also be considered in future parts of this project.

Considering the complexity of defined benefit pension schemes and the importance of these schemes in some banking systems, sometimes acting as the main (or only) source of payment of retirement pensions for their employees, CEBS believes that the transitional arrangements for implementation of the changes foreseen in this project should take into account the material impact of the proposals on banks' financial position and, potentially, on key components of prudential regulatory capital.

Although CEBS recognises benefits in the proposals set out in the ED, namely improvements in the transparency, understandability and comparability of the information conveyed in the financial statements, CEBS has some concerns about the impact of those proposals on the volatility of financial institutions' other comprehensive income (OCI). We also think that this ED again highlights the need for a conceptual project on the distinction between P&L and OCI.

Moreover, CEBS considers that, given the likely impact on the financial position of some entities, the IASB should analyse an alternative transition approach as described in the answers below.

Responses to the questions

Recognition (Questions 1 and 2)

CEBS concurs with the proposal of eliminating the deferred recognition of gains and losses arising from defined benefit plans, and therefore with the immediate recognition model, especially as it contributes to reducing some of the drawbacks associated with such an option (e.g. the fact that an entity may recognise an asset when a plan is in deficit or a liability when a plan is in surplus, or the recognition of such an asset or liability is dependent on unrecognised actuarial losses or gains). We believe that the benefits for users of financial information in terms of understandability and comparability of that information will be realised by the elimination of the options allowed by IAS 19.

Moreover, we agree with immediate recognition in the period of a plan amendment, as an amendment introduces immediate changes in the cost profile of the plan for the employer that is not dependent on the volatility of estimates.

Nevertheless, CEBS is concerned with the impact that the immediate recognition model may entail in certain jurisdictions, especially in the current economic environment, and therefore would like to encourage the IASB to explore the possibility of allowing transitional provisions in the adoption of the new rules.

Disaggregation (Questions 3 to 5)

CEBS broadly agrees with the proposed defined benefit cost disaggregation based on the different predictive implications, as it contributes to a more transparent recognition of the components and improves comparability across institutions. CEBS supports the IASB's proposal to exclude from the service cost component the changes in demographic assumptions as, given the long term nature of such demographic estimates, and therefore their different predictive implications, changes in those assumptions could have unintended consequences on the service cost component. This could lead to a misleading representation of an entity's on-going operational costs and therefore of its results.

As stated in our comments on the DP, we agree that the use of the expected return on plan assets should be avoided. CEBS acknowledges that the division of the return on assets into an expected return and an actuarial gain or loss is complex and could lead to arbitrage and subjectivity in the setting of the expected rate of return. That said, we are concerned that the approach set out in the ED may not lead to faithful representation of a pension fund's investment policy and the returns from it. If this approach is to be retained in the final standard, CEBS would like to invite the IASB to emphasise the importance of applying reliable interest rates to the net defined benefit liability (asset) in order to avoid incentives for using inappropriately low (or high) interest rates in order directly to affect the accounting results.

Presentation (Question 6)

From the three approaches presented in the DP, CEBS considers that the one envisaged in the ED better addresses CEBS' concerns regarding the volatility of pension costs arising from very long term and potentially subjective assumptions, by allowing the changes in estimates arising from financial and demographic assumptions to be (immediately) recognised in OCI (the re-measurement component).

Nevertheless, CEBS is concerned about the increased volatility in OCI, if a bank's current accounting policy for actuarial gains and losses relies on the "corridor" approach, as in that case actuarial differences previously reflected in the balance sheet (in application of current paragraph IAS 19(54)), including those inside the corridor, would be also recognized in OCI as a re-measurement component. This increased volatility in OCI would imply increased volatility in the regulatory capital of credit institutions. This would need to be carefully taken into account by CEBS should the proposals be adopted.

According to paragraph 119A, net interest on the net defined benefit liability (asset) shall be presented as part of finance costs in profit or loss. However, paragraph 119C gives the option to disaggregate net interest into interest income on plan assets and interest cost on the defined benefit. In CEBS' view, providing a presentation option in paragraph 119C is not consistent with one of the objectives of the ED, namely the reduction of complexity of IAS 19 by reducing the recognition and presentation options allowed currently in the standard for defined benefit pension schemes.

Disclosures (Questions 8 and 9)

CEBS welcomes the IASB's decision to take on board our comment on the preceding DP regarding the need for reinforced disclosure requirements, in particular around the more qualitative disclosures on actuarial assumptions and information on the sensitivity analysis of changes in these assumptions. In fact, given the complexity of the issues surrounding the defined benefit pension schemes, CEBS considers it is of the utmost importance to provide users of financial statements with more understandable information to assess the amounts presented in the financial statements in relation to the pension schemes and the impact of those plans in the entity's performance.

Nevertheless, CEBS has identified relevant information requirements that could be included in the disclosure requirements and invites the IASB to further consider these suggestions:

a) The disclosures on the "*Characteristics of defined benefit plans*" (paragraph 125C) should include the "movements" in the employees participating in a defined benefit plan (i.e. the number of people who retired in that year, the number of new employees, etc.).

b) The disclosures regarding the "*Explanation of amounts in the financial statements*" should allow for the split of those components between current employees and former employees already retired.

   Moreover, CEBS considers that the net interest on the net defined benefit liability (asset) should be disaggregated into interest income on plan assets and interest cost on the defined benefit obligation in the note disclosures, rather than disaggregation as a presentation option as put forward in 119C. As mentioned before, this presentation option is in CEBS's view not consistent with one of the objectives of the ED (reduction of the complexity of IAS 19 by reducing the presentation and recognition options allowed in the standard for defined benefit schemes).

   However, in CEBS' view, the disaggregated disclosure of those components in the notes is needed in order to meet the information needs of users and therefore the disclosure requirement in 125E(b) should be revisited.

c) If an entity has contractual insurance policies related to its responsibilities arising from the defined benefit pension schemes, it should provide a description of the general terms of those contracts and the employees covered by them, such as the responsibilities incurred by the insurance company and whether it is part of the institution's group.

d) In the disclosures' section *"Amount, timing and uncertainty of future cash flows"*, CEBS considers that, if the IASB's purpose was to introduce a sensitivity analysis requirement, then the references established for that analysis are too subjective, not only in terms of the quantitative variation to estimate the impact (i.e. changes of plus 1% and minus 1%?) but also in terms of the scope of actuarial assumptions to be considered in that estimation (what should be considered as a significant actuarial assumption?). In CEBS' view, the IASB should aim to minimise the risk of possible differences in interpretations and options, which could create an uneven playing field when entities apply the new rules.

   In the comment letter to the DP, CEBS mentioned that according to IAS 19 120 A (o) in the existing IAS 19 standard an entity shall disclose the effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rate on (i) the aggregate of the current service cost and interest cost components of net periodic post-employment medical cost and (ii) the accumulated post-employment benefit obligation for medical cost. In this vein, CEBS re-invited IASB to extend these kinds of disclosures that are currently required only for medical schemes, to other aspects of defined benefit plans. In particular, CEBS now suggests that the "*significant actuarial assumptions*" (paragraph 125 I) should at least comprise the actuarial assumptions envisaged in paragraph 73 and the entity should provide fully reasoning for having not considered any of those actuarial assumption as "significant".

Risk-sharing and conditional indexation features (Question 13.g)

CEBS welcomes the proposed amendments as mentioned under question 13.g as it requires constituents to measure the defined benefit obligations in accordance with expected cash outflows by means of the best estimate. However, CEBS is concerned that these new proposals could lead to difficulties in interpretation in practice. Therefore, CEBS would welcome additional guidance for operational purposes. In that vein CEBS would welcome a limited number of principles rather than detailed prescribed requirements. In practice contracts between pension funds and sponsors can have detailed and complex features which could not all be covered by rules-based requirements.

Multi-employer plans (Questions 14)

CEBS concurs with the Board's view that a defined benefit multi-employer plan should be accounted for as a defined contribution plan if there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual entities participating in the plan. This would apply to many plans that meet the definition of a defined benefit multi-employer plan.

However, CEBS believes that in a situation where plan assets are ring-fenced for each participating entity and the cost to a participating entity in the plan is calculated on the basis of information associated with the current and former employees of the individual entity (and not with employees of other entities), the defined benefit multi-employer plan can have a consistent and reliable basis for allocation to the individual entities participating in the plan.

Transition and Benefits and Costs (Questions 15 and 16)

Although the general requirement as envisaged in IAS 8 could be acceptable, as noted above CEBS invites IASB to consider an alternative transition approach.

It should be borne in mind that when IFRS was adopted by the EU, under IFRS 1 institutions could choose between retrospectively applying IAS 19 or, for actuarial gains and losses, fully recognising the existing value against retained earnings. We question if the retrospective application of the new rules would also imply that for those institutions which applied the reset option having to reverse it by computing their defined benefit obligations under the new IAS 19 as if that reset option had not existed. Additionally the ED implies changes in measurement, and reclassifications between retained earnings and accumulated OCI. Hence, an alternative such as one along the lines envisaged in IFRS 1 could deserve further consideration.