Committee of European Banking Supervisors
CEBS

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Dear Madam, dear Sir

Discussion paper Preliminary Views on Amendments to IAS 19 Employee Benefits

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 Discussion Paper - Preliminary Views on Amendments to IAS 19 Employee Benefits.

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 benefit promises to the extent that they may have a material impact on banks' financial position and, potentially, on key components of prudential regulatory capital.

While CEBS agrees with the overall purpose of the discussion paper, i.e. to improve the accounting for post-employment benefit promises, we have some comments and concerns about the process being followed and on the proposals put forward in the paper to achieve these objectives. In the following, CEBS would like to set out its main concerns in this respect.

Regarding process, we are aware that the Board would like to address certain issues in the relatively near term, but given the importance and complexity of the issues surrounding pension schemes, we would prefer the IASB to defer substantive changes to the standard until a draft comprehensive revision is available for discussion.

Turning to our comments, we limit these mainly to Chapters 2 and 3 of the discussion paper, dealing with the deferred recognition of changes in / presentation approaches to defined benefit promises. Detailed comments on those issues are provided in appendix to this letter

Regarding Chapters 4 to 10, we would like at this stage to offer only two high level comments, mainly regarding contribution-based promises:

- We noted that fair value would be the default measurement basis for contribution-based promises. However, we are unsure about what would be the exact definition of fair value applying to this kind of transaction. In particular, we are not sure that the exit price would be a meaningful measurement basis in such a situation, where a number of important valuation parameters would have to be entity-specific.
- In the preliminary approach, we are not convinced that the suggested definition of contribution-based promises would be clear enough to avoid implementation issues regarding whether or not some pension schemes would have to be classified as defined benefit plans as both types could in specific circumstances exhibit similar characteristics. This could complicate rather than simplify implementation of the standard. We would welcome the exploration of inclusion of a high level principle that could lead constituents in identifying the most appropriate accounting method.

The comments put forward in this letter and in the related appendix have been coordinated by CEBS's Expert Group on Financial Information (EGFI) - 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. Didier Elbaum (+33.1.4292.5801), Chair of the EGFI or Mr. Ian Michael (+44.20.7066.7098).

Finally I would like to apologise for the delay in providing our comments on this Discussion paper which reflects the pressure of work we are facing due to the financial crisis. I nevertheless hope that the Board will be able to take our comments into account.

Yours sincerely,

Kerstin af Jochnick
Chair, Committee of European Banking Supervisors

Appendix

General comments

As mentioned in the cover letter CEBS agrees with the overall purpose of the discussion paper, i.e. to improve the accounting for post-employment benefit promises. However, we do feel also that this project should not be rushed but rather be considered in conjunction with the intended work towards the definition by the IASB and the FASB of a common standard on post-employment benefit promises. Indeed, we noted that some of the proposals contained in the discussion paper would be inconsistent with some of the main features of FAS 158.

The scope of the discussion paper is limited to four issues. While those issues address key aspects of the accounting for post-employment benefit promises, CEBS is of the view that other aspects, such as the definition of pension liabilities, disclosures and consolidation issues, could improve the understandability of accounting information related to employee benefits and therefore should also be considered in future steps of this project (see our answer to question 1).

CEBS in principle concurs with the elimination of the deferred recognition of some gains and losses arising from defined benefit plans, especially as it contributes to reducing some of the drawbacks associated with such an option, as mentioned in paragraph 2.7 of the discussion paper. However, the removal might intensify the effects of the DP proposals on the current defined benefit plan calculation method in some European jurisdictions where pension schemes at present do not fully qualify as final salary systems. For example, under the Projected Unit Credit Method, the amount of the obligation may, for some plans, be overestimated at the beginning of an employment, due to the current provisions of IAS 19.83a. and 84 which state that the obligation is calculated on the basis of the estimated future salary increase. This intensification may not be the objective of the proposed removal of deferred recognition of some gains and losses.

At the same time, we would like to encourage the IASB to undertake field studies in different environments in order to carefully analyse the impact of this proposed change, as it would have important impacts on the financial position of a number of institutions. Until such a study is undertaken CEBS is not convinced that the proposed change will benefit important objectives of the Board, such as the faithful representation aspect of the standards.

Nevertheless, if the Board effectively decides to go ahead with the proposed changes, these should be accompanied by specific transitional provisions given the possible impacts of changing the current deferred model in certain jurisdictions.

Specific comments

Additional issues to be addressed in the project (Question 1)

As noted in our general comments, CEBS considers that although some key aspects contributing to an improvement of accounting for post-employment benefit promises are addressed, the IASB should, in the next steps it will take regarding this project, also put due emphasis on a number of other issues.

One of the issues CEBS deems especially relevant in that context is the definition of pension liabilities. We are aware that the current requirements for defined benefit plans are written with final salary schemes in mind. In practice financial institutions that have outsourced their pension obligations fully, or to some extent, to separate entities are experiencing difficulties in reflecting their residual financial risks in the current definition of pension liabilities. We believe that this issue should be addressed in any further steps in this project.

Another issue regards reinforced disclosures. In particular we are of the opinion that there is a need for more qualitative disclosures on actuarial assumptions (such as on mortality rates), both qualitative and quantitative information on the sensitivity of changes in these assumptions as well as on how the assumptions stand the test of time. For instance, according to IAS 19 120 A (o) 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. We suggest that these kinds of disclosures, that are currently required only for medical schemes, could be extended to other defined benefit plans.

For example, detailed disclosures relating the calculation of fair values (sensitivity to estimates…) could also be required.

Finally, it would be useful to know the Board's intentions as regards the consolidation of separate pension plan entities in the context of the revised consolidation standard that is currently being prepared.

Recognition of changes in the value of plan assets and in the post-employment benefit obligations in the financial statements in the period in which they occur

As stated in the general comments section of this letter, in principle we agree with this proposal. However, the suggested review of the definition of pension liabilities might have implications for the calculation of plan assets and the recognition of changes.

Whether the return on assets should be divided into an expected return and an actuarial gain or loss

We agree that returns on assets should not be divided into an expected return and an actuarial gain or loss, as this would eliminate a source of complexity and potential arbitrage and subjectivity in the setting of the expected rate of return. Also here we note that the review of the definition of pension liabilities could have implications for the inclusion of returns on plan assets.

Whether unvested past service cost should be recognized in the period of a plan amendment

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 dependant on the volatility of estimates.

Presentation of changes in defined benefit costs (Question 3)

The presentation of changes in defined benefit costs is of particular importance for a number of institutions. In that respect, rather than expressing a preference for one of the three approaches, CEBS deems preferable at this stage to put forward a number of considerations regarding the different approaches:

- Approach 1, which recognizes all gains and losses through the income statement, has the appeal of being the simplest to implement. However, we are aware that this approach is not the most transparent as it would not separate gains and losses arising from events that have different predictive implications, as is the case, in different ways, for approaches 2 and 3. We also believe that Approach 1 might trigger a reduction of the equity investments of pension plans in order to limit the resulting short term volatility in the profit or loss account of the sponsoring entity.

- Approach 2 presents in profit or loss only service cost and related changes arising from assumptions other than financial. All other costs are presented in other comprehensive income. We consider that this approach is not sufficiently discussed. As mentioned in the discussion paper, approach 2 is inconsistent with most other IFRS that require interest cost to be recognized in profit or loss. Moreover, we do not see enough conceptual justification to consider differently changes in estimates arising from financial assumptions than changes in estimates arising from demographic assumptions.

- Approach 3 requires recognizing the changes in asset value and in liabilities resulting from financial assumptions in other comprehensive income, and the other components of the pension costs in profit or loss. We believe that this approach, while allowing the recognition of interest cost and asset income in profit or loss, would alleviate some of the concerns a number of constituents may have as regards the volatility of pension costs born from very long term - and potentially subjective- assumptions. We noted that the Board finds it difficult (as developed in paragraph 3.29) to identify interest income separately from other changes in the value of plan assets. We are not convinced that such a treatment would be that difficult to implement. As a matter of fact, if we agree that the use of expected return on plan assets should be avoided, we believe that using dividends received from equity and interest earned on debt would be easy to implement. We are aware that the Board is concerned about the potential lack of neutrality of such a treatment, but as mentioned above other treatments might have behavioural impacts as well.

Moreover, as already stated in our comment on Approach 2, we do not see enough conceptual justification to consider differently changes in estimates arising from financial assumptions than changes in estimates arising from demographic assumptions. We believe that, as is currently the case in one of the options opened in IAS 19, changes from demographic assumptions could be reported in other comprehensive income along changes in financial assumptions.

To conclude we believe that selection of approaches 1, 2 or 3 – or other approaches - cannot be done in an appropriate manner until more fundamental analysis has been performed on the definition of pension liabilities. In the meantime we hope that progress in the IASB-project on Performance Reporting will be helpful in addressing presentation of all kinds of changes in fair values.