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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street

Berlin, 24 September 2008

London EC4M 6XH
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IASB Discussion Paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits'

Dear David

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB Discussion Paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits'. We appreciate the opportunity to comment on the Discussion Paper.

Please find our detailed comments on the questions raised in the Discussion Paper in the appendix. Our main views are summarised below.

- The Board should abandon the new classification (contribution-based promises) and retain the distinction between defined benefit and defined contribution plans according to IAS 19. You will find our proposal how to solve the accounting problems concerning "troublesome plans" in our answer to question 9a.
- The GASB shares the view that deferred recognition for defined benefit promises and the corridor approach should be removed.
- With regard to the presentation of defined benefit promises, we prefer Approach 3 in combination with the expected return method for measuring interest income.

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Should you or your staff have any questions on our comments, please do not hesitate to contact us.

Yours sincerely

Liesel Knorr

President



Appendix – Answers to the questions of the discussion paper

Chapter 1: INTRODUCTION

Question 1

Given the objective of the IASB project to address specific issues in a limited time frame, are there additional issues which you think should be addressed by the Board as part of this project? If so, why do you regard these issues as a matter of priority?

We agree with the Board's decision to divide the project into two phases, a short term project and a comprehensive redeliberation in the long run because in our view on the one hand a short term improvement regarding a limited number of issues seems to be necessary, and on the other hand a fundamental review is complex and requires plenty of time.

Nevertheless, we are very much concerned about the scope of the short term project. The IASB stated that the scope chosen for the first phase addresses current problems for preparers in applying IAS 19 and does not fundamentally change the techniques currently used to measure post-employment benefit obligations (Paragraph 1.6).

On the contrary, the new distinction between contribution-based promises and defined benefit promises represents a fundamental change in the measurement of post-employment benefit plans. As already communicated to members of the IASB, the clear majority of German post-employment benefit plans would no longer be classified as defined benefit but rather as contribution-based promises, i.e. the expected distribution between CB and DB promises under the proposed definitions would lie between 70% CB and 30% DB – from previously 30% DC and 70% DB - in Germany (see answer to question 6).

This demonstrates that the Board has not factually limited the scope to troublesome issues, which are mainly represented by asset-linked promises. We are not aware that, for example, career average plans caused any major problems for preparers in applying IAS 19 in the past.

Chapter 2: DEFERRED RECOGNITION OF CHANGES IN THE LIABILITY FOR DEFINED BENEFIT PROMISES

Question 2

Are there factors that the Board has not considered in arriving at its preliminary views? If so, what are those factors? Do those factors provide sufficient reason for the Board to reconsider its preliminary views? If so, why?



The GASB shares the view that deferred recognition for defined benefit promises and the corridor approach should be removed. Full balance sheet recognition for all post-employment benefit promises is appropriate. In any case, removing the various options currently permitted under IAS 19 should significantly improve comparability of financial statement information among entities.

We agree that the subjectivity inherent in determining the expected rate of return may include the risk to choose a rate with a biased view to trigger a desired impact on profit or loss. However, this risk is inherent to any estimate made for accounting purposes and, in our view, is to be covered by the reporting entity's internal controls, the auditors and the enforcers and not by financial reporting standards. Reflecting the expected return is more appropriate for our preferred financial reporting model for defined benefit plans, i.e. final salary plans. Therefore, actuarial gains or losses on plan assets should be recognised in OCI and expected return in profit or loss, rather than following the proposed treatment in the Discussion Paper.

A minority of GASB members is of the opinion that entities should not divide the return on assets into an expected return and an actuarial gain or loss. Because of conceptual reasons they prefer recognising the actual return in profit or loss.

Chapter 3: PRESENTATION APPROACHES FOR DEFINED BENEFIT PROMISES

Question 3

(a) Which approach to the presentation of changes in defined benefit costs provides the most useful information to users of financial statements? Why?

(b) In assessing the usefulness of information to users, what importance do you attach to each of the following factors, and why:

(i) presentation of some components of defined benefit cost in other comprehensive income; and

(ii) disaggregation of information about fair value?

(c) What would be the difficulties in applying each of the presentation approaches?

We believe that in the long run presentation in the financial statements is an issue that should not be solved on a standard by standard basis, but rather be driven by a principle-based presentation approach that provides users with useful information (i.e. the users of the financial statements shall be able to analyse which economic reasons trigger the change in a liability or an asset). Unfortunately, the Financial Statement Presentation project seems not to have reached a stage yet which gives appropriate answers to the different cross-cutting issues. Specifically, we regret that the IASB decided to limit the scope of the next phase of that project (e.g. exclude the recycling issue).



Regarding the presentation of post-employment benefit promises, we are of the opinion that different components of changes in liabilities and/or assets should be presented separately. The GASB holds the view that:

- Service cost should be reported within operating activities in profit or loss.
- The unwinding of the liability for pensions should be presented within financing costs in profit or loss.
- Actuarial gains and losses should be reported in other comprehensive income (OCI) as far as changes of the liability or the plan assets are concerned which are generally reversible over time. Therefore, effects stemming from changes in the discount rate should be presented as part of OCI.

Of the three approaches considered, we therefore prefer Approach 3 in combination with the expected return method for measuring interest income for the following reasons:

- Approach 1 not only combines information in profit and loss with very different predictive values but it also effectively singles out pensions to be treated in a way not (yet) applicable to other accounting areas.
- Approach 2 seems flawed to us because the financing items are to be recognised outside of profit and loss.
- Approach 3 seems the appropriate compromise since it will recognise remeasurements in OCI and outside of profit or loss, thus separating information with very different predictive qualities. Including interest income from plan assets by applying market yields of high quality corporate bonds at the reporting date on such assets objectifies the difficult question surrounding the determination of interest income from plan assets. On the other hand, it does not take into account the strategic allocation of the plan assets to specific asset categories in any way, which results in an inappropriate reflection of reality. In addition, it is our view that avoidance of potential abuse is not a primary objective of standard setting and we also believe that misuse in the selection of expected return assumptions has been significantly reduced ever since the disclosure requirements were extended and since such misuse was identified and brought to the attention of auditors and users.

A minority of GASB members takes the view that all changes in the defined benefit obligation and in the value of plan assets should be presented in profit or loss. They argue that there is no conceptual basis for recognising items outside of profit or loss. They draw a comparison with IAS 37 which requires entities to recognise changes in liabilities, including changes in long-term liabilities, in profit or loss in the period they occur.



Question 4

(a) How could the Board improve the approaches discussed in this paper to provide more useful information to users of financial statements?

(b) Please explain any alternative approach to presentation that provides more useful information to users of financial statements. In what way does your approach provide more useful information to users of financial statements?

Please refer to our answer to question 3.

Chapter 5: DEFINITIONS - Definition of contribution-based promises

Question 5

Do you agree that the Board has identified the appropriate promises to be addressed in the scope of this project? If not, which promises should be included or excluded from the scope of the project, and why?

We strongly disagree that the Board has identified the appropriate promises to be addressed in the scope of this project.

We believe that the new category will create significant confusion for readers of financial statements, as well as significant measurement complexity and administrative cost for preparers. Presently readers have understood that a DB promise represents an unsettled obligation of an entity that may be subject to significant volatility until settlement. A DC promise on the other hand is understood as having been settled and representing no further substantial exposure to the entity. Once the promised contribution has been paid, a Contribution-Based (CB) category would be unclear in terms of being substantially settled, an effective component of indebtedness or subject to significant volatility. In other words, the present categories are appropriate to distinguish the consequences of retirement obligations:

- obligations that expose an entity to risk and probable future outflows of assets despite present contributions (DB) and
- obligations that neither expose an entity to virtually any risk nor to an outflow of assets in excess of present contributions (DC).

The new category CB would not provide any new or better information.

Therefore, it is our strongly held opinion that the existing characterisation of retirement promises based on the risk they pose to the reporting entity continues to reflect well the differences in economic substance between the two types of promises, remains conceptually well-founded and easy to understand. In contrast, the definition of CB promises is artificial and difficult to understand. The new category of CB promises unnecessarily includes promises that have sat perfectly logically in the DB category and will now, on artificial grounds, be reclassified and be subjected to different measurement and presentation regimes. Finally, the measurement of CB promises is burdened with technical complications and will be costly to implement.

Regarding which promises should be excluded from the scope of this project please refer to our proposal in the answer to question 9a.

Question 6

Would many promises be reclassified from defined benefit to contribution-based under the Board's proposals? What are the practical difficulties, if any, facing entities affected by these proposals?

In Germany, the current distribution (by number of beneficiaries) between DC and DB promises is roughly 30% DC and 70% DB. Because of the high prevalence of cash-balance type plans with fixed and variable discount rate grants as well as fixed currency unit promises, the expected distribution between CB and DB promises under the proposed definitions would be approx. 70% CB and 30% DB. Since there are still a significant number of pensioners and vested terminees receiving or due to receive benefits from former final salary plans, the split for active employees would move closer to an estimated 90% CB – 10% DB in Germany.¹

What is more, the vast bulk of pensions in payment would have been classified as CB during the accumulation phase. We see no justification in changing measurement and presentation for such promises.

The particular difficulties lie in the following:

- *Practical difficulties* – taking account of the risk of a promise may be difficult and clumsy in practice. The following example would not be atypical in Germany: only part of a pension may be legally insolvency insured (there are maximum amounts and indexation is not insured), part of the promise may be CB, another part DB and, finally, part of the benefit may be funded, the other not. Thus, for example, an annual pension of 1,000 CU that hitherto has been valued with one particular actuarial present value, may have to be split into up to four different elements (a DB component and three CB components: one state guaranteed, one funded and one unfunded). The classification, let alone the different methodologies for their valuation, may be academically most challenging and interesting but in our view of little value to the user of financial statements and of high cost to the preparer.
- *Communicating the new classification* – the arbitrary and artificial classification will be difficult to communicate, not least because the results of the widely implemented changes in pension plans undertaken during the last three decades

¹ The estimates of current distribution and that under the proposed regime, although not substantiated in specific surveys, have been confirmed to us by the actuarial profession in Germany, namely by the Pensions Section of the German Society of Actuaries.



in order to reduce the entities' risks will now appear as being much more volatile and riskier than final salary promises.

Question 7

Do the proposals achieve that goal? If not, why not?

The proposals do not achieve the goal because they solve one problem at the expense of opening a greater number of other unresolved issues that – as explained above – will be difficult to solve in practice, are conceptually impure and costly to implement.

Chapter 6: RECOGNITION ISSUES RELATING TO CONTRIBUTION-BASED PROMISES

Question 8

Do you have any comments on those preliminary views? If so, what are they?

As explained above, we strongly recommend the Board to abandon the proposed distinction between CB and DB promises.

Chapter 7: MEASUREMENT OF CONTRIBUTION-BASED PROMISES

Question 9(a)

Are there alternative measurement approaches that better meet the measurement objectives described in this paper? Please describe the approaches and explain how they better meet the measurement objectives.

As noted above, we propose that as part of the limited project the Board should retain the current distinction between defined benefit and defined contribution plans according to IAS 19 and should focus on those pension promises where the current standard results in an inappropriate measurement of the pension obligation, the so-called “troublesome plans”.

1. Accounting for asset-linked promises

Indeed, troublesome pension plans are those under which the employer promises contributions and a return in line with some index (e.g. equity or bond index) or a reference asset. The IASB correctly points out that IAS 19 requires to project the benefits with the assumed rate of return (e.g. 8% if returns are in line with a referenced asset or index) and then discounting these with the IAS 19 discount rate of high quality corporate bonds (e.g. 5%) would lead to an unrealistic value of the pension obligation.



The GASB would recommend **setting the DBO of a pension obligation, which is directly linked to an asset, a group of assets or an index (either actually held or only used as a notional reference asset) and which could be settled by holding such an asset, group of assets or index, equal to the fair value of such asset, group of assets or index** because this meets the substance of these kind of pension promises.

We are of the opinion that the **substance of the promise** itself is the criterion to distinguish between a defined benefit obligation which should be measured according to IAS 19, and others where the defined benefit obligations should be set equal to the fair value of the reference asset.

Furthermore, this measurement attribute has already been used in IAS 19.85 (b). If the formal terms of a plan require an enterprise to change benefits in future periods, the measurement of the obligation reflects those changes. This is the case when actuarial gains have already been recognised in the financial statements and the enterprise is obliged, either by the formal terms of a plan or by legislation, to use any surplus in the plan for the (exclusive) benefit of plan participants. In other words, if there is a legal obligation to use the surplus in the plan for increasing benefits of plan participants, the measurement of the obligation has to reflect the surplus (i.e. the fair value of the plans). This case is very similar to so-called asset-linked promises. In both cases there is a legal and economic connection between the defined benefit obligation and the fair value of the plan assets. Only the extent of the connection differs between the two cases. While in the case described in IAS 19.85 (b), there is only a legal and economic connection if there is a surplus; in the case of an asset-linked promise the legal and economic connection is independent of any additional requirements such as the surplus in the first case. From a conceptual and practical point of view, in our opinion, both cases are the same.

According to this proposal, we are of the opinion that with regard to the substance of the promise there is a major difference between:

- Promise 1: A promise of a lump sum equal to the contributions which are (actually or notionally) invested in a specified zero-bond with a redemption yield of 3 per cent a year at the time of grant and
- Promise 2: A promise of a lump sum equal to the contributions plus a guaranteed fixed return of 3 per cent per year on the contributions.

Considering the first promise, the fair value of the bond will change depending on any changes of the market interest rate. These changes affect the defined benefit obligation because the obligation is directly linked to the value of the asset. Thus, the defined benefit obligation should be measured reflecting the fair value of the specified bond.

Considering the second promise, the beneficiary receives his/her fixed return of 3 per cent per year, independent of any changes of the market interest rate. Thus, because both promises are of a different (legal and economic) substance, it is justified



measuring them on a different basis (i.e. measure the second promise as defined benefit obligation in accordance with IAS 19).

Someone could argue that both promises have to be measured in the same way because they are likely to result in the same lump sum benefit at retirement date if the redemption date of the zero-bond is the retirement date. However, this point would ignore that under the first promise the beneficiary bears an issuer risk, and from an economic point of view, both obligations develop different during their maturity. If both promises would be measured on the same basis, these economic differences would be ignored.

2. Accounting for asset-linked promises plus a guarantee (higher of both promises)

In our opinion, asset-linked promises which comprise an additional guarantee and which would be classified as DC if they didn't contain a guarantee are even more troublesome. With regard to this kind of promise, we would recommend setting the balance sheet liability equal to the maximum of ("the higher of") the fair value of the reference asset (in accordance with our proposal above) and the present value of the guarantee using normal defined benefit measurement methodology, plus the accumulated cost of the guarantee using option-pricing theory.

Common example:

The employer promises to make contributions of 5 per cent of the employee's current salary for each year of service into a fund which invests the contributions in a specified asset. The employer receives from the fund at retirement date a lump sum which is equal to the market value of the specified asset. Additionally, the employer guarantees a minimum lump sum benefit equal to the contributions plus a fixed return on the contributions of 3 per cent per year.

- The balance sheet liability should be set equal to the maximum of ("the higher of"):
 - a) the fair value of the reference asset and
 - b) the present value of the guarantee using normal DB-measurement methodologyplus the accumulated cost of the guarantee using option-pricing theory.
- The current service cost should be set equal to the actual contribution plus the cost of the guarantee determined by applying option-pricing theory.
- Any gains and losses arising will be recognised immediately in profit or loss.
- Notional promises will be dealt with similarly, with the additional component of interest cost being added to the cost of service.
- Higher of promises involving DB/DC and DB promises are dealt with taking the above methodology as well as the best estimate principle applying to the measurement of DB promises into account.
- Appropriate disclosure of the methodology applied should be required.

Plans that contain mortality risk, or define the amount of benefit without reference to an index, continue to fall under the DB definition.

3. Examples in the Discussion Paper

Based on our proposal the classification of the plans in Appendix A of the Discussion Paper would not be changed compared to IAS 19. Only the measurement of the promises 1, 2 and 4 would be modified because only these plans are troublesome.

Promise No.	IAS 19	DP Proposal	GASB proposal described
1.	DB / DB	CB / DB	– For the benefits of the first 15 years: DBO of the pension obligation = Fair value of the assets referenced – For the benefits of the next 15 years: No change from current practice → PUCM
2.	DB	CB	– DBO of the pension obligation = Fair value of the assets referenced
3.	DC	CB	– DC as defined in IAS 19. No change from current practice
4.	DB	CB	– DBO of the pension obligation = Fair value of the assets referenced
5.	DB	CB	– No change from current practice → PUCM
6.	DB	CB	– No change from current practice → PUCM
7.	DB	CB	– No change from current practice → PUCM
8.	DB	DB	– No change from current practice → PUCM
9.	DB	DB	– No change from current practice → PUCM
10.	DB	CB	– No change from current practice → PUCM
11.	DB	DB	– No change from current practice → PUCM
12.	DB	CB	– see below
13.	DB	CB	– No change from current practice → PUCM
14.	DB	CB	– No change from current practice → PUCM

Promise 1

The employer promises a benefit equal to:

- *for the first 15 years of service, a lump sum benefit accumulated as follows: the entity pays contributions of 8 per cent of salary for each year of service and the return on contributions is equal to the return on an equity index.*
- *for the next 15 years' service, a lump sum equal to 3 per cent of final salary for each year of service.*

For the first 15 years of service this promise continues to be classified as defined benefit promise. The DBO of the pension obligation, which is linked to an equity



index and which could be settled by investing the contributions in such asset, is measured by setting it equal to the fair value of such asset.

The promise for the next 15 years' service is a typical defined benefit obligation and should be measured in accordance with IAS 19.

Promise 2

The employer promises to make contributions into a fund of 5 per cent of the employee's salary during the current reporting period for each year of service. The benefit promise at retirement is a lump sum equal to the contributions increased with the compound return on a specified equity index.

We would classify this promise as under IAS 19 as defined benefit promise and setting the DBO of the pension obligation, which is linked to a specified equity index and which could be settled by investing the contributions in such asset, equal to the fair value of such asset.

Promise 3

The employer promises to make contributions into a fund of 5 per cent of the employee's current salary for each year of service. The benefit promise at retirement is a lump sum equal to the contributions paid plus the actual investment returns on those contributions.

We would classify this promise as under IAS 19 as defined contribution promise as no change is required.

Promise 4

The employer promises to make notional contributions of 5 per cent of the employee's current salary for each year of service. The benefit promise at retirement is a lump sum equal to the notional contributions increased by interest compounded at the rate of each year's return on a specified equity index.

We would classify this promise as under IAS 19 as defined benefit promise and setting the DBO of the pension obligation, which is linked to a specified equity index and which could be settled by investing the contributions in such an asset, equal to the fair value of such an asset.

Promise 5

The employer promises to make notional contributions of 5 per cent of the employee's current salary for each year of service. The benefit promise at retirement is a lump sum equal to the contributions plus a fixed return on the contributions of 3 per cent per year.

We would classify this promise as under IAS 19 as defined benefit promise and measure it in accordance with the IAS 19 defined benefit methodology because the promise is not directly linked to an asset and can be appropriately measured by use of the PUCM.



Promise 6

The employer promises to make notional contributions of 5 per cent of the employee's current salary for each year of service. The benefit promise at retirement is a lump sum equal to the contributions plus a fixed return on the contributions of 0 per cent per year.

We would classify this promise as under IAS 19 as defined benefit promise and measure it in accordance with the IAS 19 defined benefit methodology because the promise is not directly linked to an asset and can be appropriately measured by use of the PUCM.

Promise 7

The benefit is a lump sum at retirement equal to 5 per cent of the career average of the employee's salary for each year of service.

We would classify this promise as under IAS 19 as defined benefit promise and measure it in accordance with IAS 19 because the promise is not directly linked to an asset and can be appropriately measured by use of the PUCM.

Promise 8

The benefit is a lump sum at retirement equal to 5 per cent of the employee's final salary at retirement for each year of service.

We agree with the IASB that this promise is a defined benefit promise and should be measured in accordance with IAS 19.

Promise 9

The benefit is a lump sum at retirement equal to 5 per cent of the average of the employee's final three years' salary before retirement, for each year of service.

We agree with the IASB that this promise is a defined benefit promise and should be measured in accordance with IAS 19.

Promise 10

The employer promises to make contributions into a fund for each year of service. The contribution in each period of service is 5 per cent of the average of the employee's salary in the most recent two years of service. The benefit promise at retirement is a lump sum equal to the contributions paid.

We would classify this promise as under IAS 19 as defined benefit promise and measure it in accordance with the IAS 19 defined benefit methodology because the promise is not directly linked to an asset and can be appropriately measured by use of the PUCM.

**Promise 11**

The benefit is a lump sum benefit at retirement equal to the number of years' service multiplied by 5 per cent of the average of the employee's salary in the most recent (ie final) two years of service.

We agree with the IASB that this promise is a defined benefit promise and should be measured in accordance with IAS 19.

Promise 12

The employer promises to contribute into a separate fund 5 per cent of the employee's salary for each year of service. The lump sum at retirement, which is equal to the accumulated contributions plus the investment returns they earn, is converted into a pension at a fixed annuity rate (ie the cost of buying a pension is fixed when the promise is made, rather than being determined by the market rates at retirement date). That pension amount is payable in monthly instalments for the life of the retired employee.

We would recommend measuring the DBO of such an obligation in the accumulation phase analogously to our above proposal (see no. 1 in the answer to question 9a), but in analogy to IAS 21 **plus or minus** an adequate addition/deduction to anticipate the expected loss or gain at retirement age (making a best estimate of the ratio of the value of the guaranteed conversion rate and the IAS 19 discount rate applied as at the relevant valuation date). This measurement concept has the advantage that there will be no "extra jump" in the liability at age 65 because of a "change in valuation method". After retirement the pension will be valued under IAS 19 as a DB promise.

The following explanatory example might make our proposed solution easier to understand:

In a similar situation an employer promises a lump sum at age 65 which is based on contributions and a notional promised return in line with a reference asset. The contributions and returns are fixed in CU1 (units of currency 1). Now the employer also promised to pay the lump sum in another CU2 at a fixed conversion rate of e.g. 1.50 CU1 per CU2. Of course, it is not known what the conversion rate at age 65 will be in order to reflect the ultimate true costs to the employer. But the conversion rates at each balance sheet date are known.

Our view of the correct measurement of this obligation at any balance sheet date is: First, one considers the fair value of the reference asset in CU1. Then one considers the conversion rate of CU1 into CU2. If this conversion rate at the balance sheet date is equal to 1.50, then no "adjustment" to the fair value of the reference asset is necessary to measure the obligation. But if the conversion rate is higher by, say, 10% (i.e. 1.65), then the liability must be increased by 10%, i.e. by the "adjustment ratio" equal to 1.65/1.50).

We consider that the same concept also applies directly to conversions into annuities:



The lump sum calculated as a result of the reference asset is converted at age 65 into a lifetime annuity with a fixed (guaranteed) conversion rate of, say, 15. Of course, it is not known what the annuity conversion rate at age 65 (in line with the correct actuarial assumption under IAS 19 at age 65) will be in order to reflect the ultimate true costs to the employer. But the actuarial conversion rates at each balance sheet date under the IAS 19 assumptions at those dates are known. If at such a date the annuity factor under the IAS 19 assumptions is also 15, then the liability equals the fair value of the reference asset and no adjustment is necessary. If, however, the annuity factor under the IAS 19 assumptions is, say, 18 instead of 15, then the liability must be adjusted (increased) by 20%, viz. by the “adjustment ratio” equal to 18/15.

Promise 13

The employer promises to contribute CU100,000 into a separate fund on the first day of service. The lump sum at retirement is the contribution of CU100,000, plus a fixed return of 0 per cent. The lump sum is converted into a pension at a fixed annuity rate (ie the cost of buying a pension is fixed when the promise is made, rather than being determined by the market rates at retirement date). This generates a benefit of CU1,000 per year for the life of the retired employee.

We would classify this promise as under IAS 19 as defined benefit promise and measure it in accordance with the IAS 19 defined benefit methodology because this plan is not troublesome at all.

Promise 14

The employer promises a benefit of CU1,000 per year for each year after the employee retires until his death, regardless of the service period of the employee.

We would classify this promise further on as defined benefit promise and measure it in accordance with the IAS 19 defined benefit methodology because this plan is not troublesome at all.

Question 9(b)

To what extent should the effect of risk be included as a component of the measurement approach at this stage of the Board’s post-employment benefit promises project? How should this be done?

We believe that the effect of an individual promise’s risk is difficult to include as proposed and, as such, should not be implemented in this limited scope project without a fundamental review of the entire pension’s issue having been performed. We believe that the current approach of allowing for a measure of risk implicitly by requiring high (and not highest) quality corporate bond rates to measure DB liabilities recognises that such risk is only imperfectly but at least consistently measured in practice.

Specifically, changes in own credit risk should not be considered in the measurement of pension liabilities as the entity has no valid settlement alternatives to realise such changes. If the obligation is intended to be settled by running off the liability (i.e. by making payments to the counterparty as they fall due), no credit risk should be included in the measurement because in this case the liability is not impacted by the employer's individual credit risk (i.e. assuming the entity will continue as a going concern, the employer has to pay the same amount of money regardless of his own credit risk). The same applies when the employer intends to transfer the liability to a third party (immediate buy-out). The buyer's future cash flows resulting from the assumed liability are not impacted by the employer's credit risk and, thus, the buyer will not be willing to consider the employer's credit risk in the purchase price of the liability. Of course, it could happen that in connection with such a substitution of the obligor the beneficiaries accept a reduction of their pension benefits to receive their pension claims from a counterpart with a better creditworthiness. But this would result in a different unit of account because the pension promise itself would be altered, and should, therefore, not be included in the measurement of the existing obligation.

Furthermore, we share the opinion expressed in the *PAAinE Discussion paper 'The Financial Reporting of Pensions'* that credit risk is too difficult to measure, because it is affected by the business risk of the entity/entity's assets, the credit risk of the entity and whether the entity's pension liabilities are funded by separate/prioritised assets. Moreover, it is not the same as the general credit rating of the entity, because this credit rating is probably related to liabilities with other priorities and other secured assets than pension assets. In addition, unlisted entities do not have a credit rating; for them, it is impracticable to obtain a market price for the credit risk of their pension liabilities (see *PAAinE Discussion paper 'The Financial Reporting of Pensions'*, Chapter 5, paragraph 7.10 (f)).

Chapter 8: MEASUREMENT OF BENEFITS AFTER THE ACCUMULATION PHASE

Question 10(a)

Do you agree that the liability for benefits in the payout and deferment phases should be measured in the same way as they are in the accumulation phase? If not, why?

We disagree that the liability for benefits in the payout and deferment phases should be measured in the same way as they are in the accumulation phase. In our opinion there is no justification, if any, to treat promises which are identical during the payment phase differently just because of their accounting classification during the accumulation phase. We are not aware of other IFRS that compulsorily treat two issues of exactly the same economic substance differently. In the event that the Board does not change its preliminary views, we strongly request field tests be carried out to understand the level of discrepancies and, in particular, cost to entities having to account for what are most commonly long-term pensions in such a manner



- see also our comment to Question 10(b) - as well as cost to users to understand such different accounting although there is no difference when the payment phase has commenced.

We appreciate that the Board has drawn attention to this contradiction but in our opinion, the two consecutive statements made in section 8.8 and 8.9 are irreconcilable: "The Board is unable to resolve the contradiction in this project as it has limited the scope of the improvements in measurement to CB promises to avoid delaying the project." It then immediately following goes on to say that: "The Board regards its proposed accounting for CB promises as an improvement over IAS 19 and thinks it should not require entities applying improved accounting to revert to an inferior method ...". Surely, time constraints cannot be cited as a justification for pressing ahead regardless of the significant contradiction the proposal contains. This alone should convince the Board to abandon the route it is proposing.

Question 10(b)

What are the practical difficulties, if any, of measuring the liability for a contribution-based promise during the payout phase at fair value assuming the terms of the benefit promise do not change?

In addition to our conceptual arguments against the CB category as outlined above, the new requirements, especially with regard to defined benefit plans which are already in the payout phase, would be very difficult to implement because all defined benefit plans would have to be reviewed as to whether the category has to be changed from DB to CB or not. If so, the benefit obligation would have to be recalculated. In our opinion, the additional costs would clearly be disproportionate to any benefits.

Chapter 9: DISAGGREGATION, PRESENTATION AND DISCLOSURE OF CONTRIBUTION-BASED PROMISES

Question 11(a)

What level of disaggregation of information about changes in the liability for contribution-based promises is useful to users of financial statements? Why?

We believe that the reclassification into CB and DB plans should be abandoned.

Question 11(b)

Do you agree that it is difficult to disaggregate changes in the contribution-based promise liability into components similar to those required for defined benefit promises? If not, why not?

We believe that the reclassification into CB and DB plans should be abandoned.

Question 12

Should changes in the liability for contribution-based promises:



**(a) be presented in profit or loss, along with all changes in the value of any plan assets; or
(b) mirror the presentation of changes in the liability for defined benefit promises (see Chapter 3)?**

Why?

We believe that the reclassification into CB and DB plans should be abandoned.

Chapter 10: BENEFIT PROMISES WITH A 'HIGHER OF' OPTION

Question 13(a)

What are the practical difficulties, if any, in identifying and measuring the 'higher of' option that an entity recognises separately from a host defined benefit promise?

In principle, the embedded option in a "higher of" plan should be "exactly" valued at fair value using option pricing techniques and included in the measurement of the DBO. For practicability reasons, however, we believe that acceptable approximations should be allowed; e.g. the employer may start with the intrinsic value of the option and demonstrate that some additional risk margin to the intrinsic value may be adequate (or maybe percentages depending on age). In many cases the impact of the additional risk margin should normally be immaterial if the value of the guarantee is low when compared to the host defined benefit promise.

Question 13(b)

Do you have any other comments on the proposals for benefit promises with a 'higher of' option? If so, what are they?

No further comments

OTHER MATTERS

Question 14

What disclosures should the Board consider as part of that review?

In accordance with our proposals on the so-called "troublesome promises", incorporating a measurement different from the current IAS 19 measurement for defined benefit plans we believe that the Board should consider appropriate disclosures for such promises, e.g. description of promises and accounting treatment etc. If, however, the Board will not abandon its proposal regarding the new CB category, we expect that much more comprehensive disclosures are necessary to inform the user about the significant change from current practice, the risks



characteristics of this category as well as issues resulting from the fair value measurement in the many cases where no or only few observable market data are available.

Question 15

Do you have any other comments on this paper? If so, what are they?

No further comments