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Submitted via email to iasb@iasb.com and via iasb.org

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Re: Comments on Exposure Draft - Proposed Amendments to IAS 19

Thank you for the opportunity to provide comments regarding Exposure Draft 2010/3, *Defined Benefit Plans, Proposed amendments to IAS 19.* The undersigned organizations jointly represent the interest of defined benefits plans covering a substantial portion of workers in Europe and the United States.

The **American Benefits Council** is a trade association representing primarily large employers and other organizations in the United States that directly sponsor or provide services to health and retirement benefit plans serving over 100 million Americans.

The **AEIP** represents the **European Paritarian Institutions of Social Protection** in Brussels since 1997. The Association gathers 27 leading large and medium-sized Social Protection Management Organizations which equally represent the employees and the employers through a joint governance scheme; plus 39 affiliates from 22 countries. AEIP represents its members' values and interests at the level of both European and International Institutions.

The **National Coordinating Committee for Multiemployer Plans** is a non-profit membership organization founded in 1974 in response to a clear lack of understanding of multiemployer plans that was demonstrated by lawmakers during the enactment of ERISA. It is dedicated exclusively to the advocacy and protection of multiemployer plans, their participants and their families.

<u>Introduction</u>

Our comments will focus on two particular questions that the exposure draft poses. The first of these is Question 1, which asks if we agree with the immediate recognition of all changes in the present value of the defined benefit obligation and in the fair value of the plan assets when they occur. We do not agree with this change, as it is incompatible with the long-term nature of pension obligations, unnecessary to achieve transparency, and in conflict with social policy objectives.

The second question on which these comments will focus is Question 10, which relates to the expansion of the multiemployer plan disclosures. We do not necessarily oppose requiring the disclosure of additional information, however we believe the language in the statement needs to be clarified. As these provisions will apply to companies that participate in a wide array of different types of plans that are governed by an even wider array of laws and regulations, the disclosure requirements need to make it clear that the necessary information is limited to that which is reasonably obtainable, and is unlikely to mislead the reader.

Background Comments on the Role of Accounting Standards

The difficult economy over the last two years has highlighted two concurrent realities. First, the obligations and assets of Defined Benefits (DB), as measured under accounting rules promulgated by both the IASB and the FASB, have demonstrated historic volatility. Second, governments around the world have become acutely aware of the inadequacy of individual Defined Contribution plans (DC) to provide secure retirement income for their citizens. A frequent subject of discussion among government leaders is how to provide secure retirement income from DC plans since DB plans are no longer offered for many employees. Inevitably, these discussions note that the more cost-effective way to provide greater security is through voluntary DB plans. Providing adequate retirement income security through DC plans is currently cost-prohibitive.

The purpose of accounting standards is to provide useful information to investors. Specifically, in announcing the proposed changes to IAS 19, Ms. Patricia McConnell said, “We believe that these changes will provide investors with more easily understandable and useful information. We would like to know if you agree.” Further, in remarks at the IOSCO Technical Committee Conference on 8 October, 2009, United States Securities and Exchange Commission Chairman, Ms. Mary Shapiro said, “We must not lose sight of the fact that the purpose of accounting standards is to provide a clear and accurate picture of a company’s financial condition, which is critical to providing investors a sound basis for relying on those disclosures, and making capital allocation decisions.” And, in a speech before the 2009 AICPA National Conference on Current SEC and PCAOB Developments, Mr. Paul Beswick said, “The purpose of accounting standards is to provide investors with credible, transparent, and comparable financial information they can rely on to make sound investment and credit decisions.” Mr. Beswick is Deputy Chief Accountant at the U.S. Securities and Exchange Commission. Lastly, Charlie McCreevy, European Commissioner for Internal Market and Services between 2004–2010, noted on his visit to Washington that “what is important is that IFRS are high quality standards and that investors in the United States can understand and use financial statements prepared under IFRS."

While we do not agree on the underlying assumptions used by the IASB or the FASB in determining DB plan obligations, there can be no doubt that the promulgation of accounting standards has facilitated comparability among the financial statements of companies that sponsor defined benefits plans. There can also be no denying the direct correlation between the promulgation of these accounting rules and the steady decline in the willingness of companies to sponsor DB plans for their employees. In the United States, the demise of DB plans was exacerbated by the adoption in 2006 of pension funding rules that largely follow the accounting world’s mandate on how to measure pension obligations. In some European countries DB plans are still very common, and the accounting rules must not stimulate the enterprises within these countries to shift from DB to DC.

The absolute drive to promulgate accounting rules that facilitate the sole best interest of investors has proven to be in direct opposition to public policy needs to provide citizens with more secure retirement income. In addition, because the assumptions and methodology required by accounting standards are pro-cyclical, we believe they have contributed to unemployment during the global recession and have deferred economic recovery by discouraging employers from creating jobs.

Because governments must now proactively investigate ways to better secure retirement income, it seems inevitable that they will need to balance national social policy against the unfettered license heretofore granted to independent accounting standards bodies to regulate accounting. At some point, the best interests of investors and the social needs of nations must come into balance.

We recognize that many in the accounting world believe accounting rules simply report obligations that already exist. We disagree. We believe the rules are unnecessarily pessimistic and have driven negative behavior. We strongly urge the IASB to proactively reconsider the fundamental assumptions and methodology used for measuring DB obligations. The IASB should work with relevant government jurisdictions to balance investor needs with public policy needs. We believe that a compromise is both possible and necessary.

Furthermore, we argue against the strict distinction between DB and DC. All kinds of hybrid schemes exist, and accounting rules should recognize the limited obligation of the employer in these cases. In many European multiemployer plans, the employer is not accountable for both actuarial surplus and deficit. This could be recognized by changing paragraph 26 of IAS 19. In case the employer is only accountable for the present and future contributions, the employer should characterize the plan as Defined Contribution.

Discussion of Actuarial Gains and Losses

When actuaries measure pension liabilities, they make a series of assumptions about what both the plan participants, and the plan assets, will do in the future. Some examples of these assumptions are retirement ages, mortality patterns, asset returns, and the discount rate applied to future benefit payments. To the extent that actual experience is close to what the actuary expects, the cost of the plan will be stable and predictable from year to year. As actual experience deviates from expectations, the cost of the plan will vary. Actuaries refer to these deviations as actuarial gains and losses.

In practice, the assumptions that relate to participant behavior, such as retirement and mortality patterns, rarely generate significant cost variations. This is because in these areas, recent experience is an excellent predictor of future experience. For example, if in a given year 500 active employees retire, in the absence of a one-time event that affected the retirement patterns, it is unlikely that the actual number of retirements in the next year will deviate significantly from 500. In contrast, variations in the asset returns and the discount rate applied to future benefit payments often result in large actuarial gains and losses. Among these assumptions, recent experience is a very poor predictor of future experience. To illustrate, if the assets of the plan produce a 15% investment return in a given year, this tells us nothing about what to expect in the next year.

Over time it is necessary for the plan sponsor to contribute assets to the plan to support the future benefit payments. Similarly, it is necessary for the plan sponsor to account for the financial expense associated with the benefit promises it is making. There is no need for these two amounts to be equal, and in practice the expense recognition for a given period and the cash contribution for the same period are rarely equivalent. The frameworks for cash funding are at the discretion of individual sovereign nations around the world, and there is considerable variety among these frameworks.

One of the core features of any systematic method for tracking pension costs is the recognition pattern of actuarial gains and losses. Under some approaches, these gains and losses are recognized gradually over time, while at the other extreme, some approaches recognize gains and losses immediately. As an example, the cash funding rules in the United States currently require the recognition of actuarial gains and losses over 7 years. Thus, when a loss occurs, the plan sponsor must contribute sufficient cash over the following 7 years to offset the loss. When a gain occurs, the sponsor recognizes a credit over 7 years.

The companies that sponsor defined benefit plans generally prefer gradual recognition over immediate recognition. This preference is not due to a desire to hide costs or inflate profits. In fact, when the actuarial assumptions are well chosen, the experience of the plan is just as likely to produce an actuarial gain as it is to produce a loss. Plan sponsors prefer gradual recognition because immediate recognition creates financial volatility that makes it very difficult for them to manage their businesses.

The current IAS 19 exposure draft would radically alter the recognition of actuarial gains and losses under the statement. Rather than the system of gradual recognition currently in place, the companies that sponsor defined benefit plans would be required to recognize all actuarial gains and losses immediately. This pattern of immediate recognition would apply both to the recognition of income and expense for a reporting period, and the presentation of assets and liabilities at the end of a reporting period. This change would provide yet another reason to discourage companies from sponsoring defined benefit plans. As discussed earlier, the purpose of accounting rules should be to provide meaningful information to investors, not drive sponsor behavior that may be contrary to public policy needs.

Long-Term Nature of Pension Funding

The liabilities associated with defined benefit pension plans are extremely long term. The period of time from when a company begins to promise benefits to an employee to when the employee receives his final pension check routinely exceeds 50 years and in many cases reaches 75 years. Thus, companies need to begin setting aside cash and recording pension expense up to 75 years before the cost of the benefit is actually known. During this time period, interest rates will rise and fall, equity markets will advance and retreat, and economies will experience periods of prosperity and periods of recession. It is both unreasonable and unfair to force companies to fully and immediately recognize the impact of each of these events as they occur during the lifetime of the pension plan. Such an approach is similar to a manager asking an employee for a updated project timeline every day while the employee is working on a project that will last for several months.

To get a sense of the volatility that pension plans experience, consider that given their long-term nature these plans typically invest a substantial portion of their assets in the equity markets. From its inception in 1926, there has not been a single 10-year period during which the S&P 500 index did not exceed 20% return in at least one year, and there has only been one 10-year period during which the index did not experience at least one year of negative return. It's a tired cliché to say that the stock market has its ups and downs, but any review of historical equity returns inevitably demonstrates the dramatic truth of this statement.

The true cost of providing pension benefits to an employee is not known until the final payment is made. During the working and retired lifetime of a typical employee, the equity markets will inevitably experience many individual years of extraordinary investment gains and losses. While there needs to be

some systematic approach to recognizing the gradual impact that these gains and losses have on pension costs, there is no rational argument for fully recognizing the impact of each year's fluctuation in the year in which it occurs. Since the actual cost of providing pension benefits is closely tied to the average investment return achieved by the plan, the accounting guidelines should be consistent with this principle by employing a mechanism for averaging actuarial gains and losses over a period of time.

A frequent criticism of the current pension accounting framework is that it lacks transparency, particularly relating to the recognition of actuarial gains and losses. The users of the financial statements do not feel that the current structure provides them with an adequate understanding of the impact of retirement benefits on companies' financial condition. The gradual recognition of actuarial gains and losses was introduced into pension funding because, as discussed above, it is necessary due to the long-term nature of pension liabilities coupled with the short-term nature of economic volatility. The issue of transparency is not a problem with the underlying approach, but rather it is a problem with the ease with which the users of the financial statements are able to understand the approach. Therefore, the correct solution is not to abandon the underlying approach, but rather to clarify its presentation in the financial statements.

Recommendation for Increased Transparency

We recommend that the IASB maintain the current approach of recognizing gains and losses gradually over time. Instead of altering this approach, the IASB should seek to enhance the presentation of these figures in the financial statements to ensure that the readers have a clear understanding of the current position of the pension plans. In this way, the IASB can address the issue of transparency without altering underlying approach.

The current IAS 19 provisions require that companies include 17 separate disclosure items in their balance sheet footnotes, with the majority of these items consisting of several subcomponents. This depth of information provides readers who have extensive retirement plan expertise with a thorough understanding of the position of the retirement plans. However, since the majority of readers lack extensive retirement plan expertise, it is very easy to understand why many people feel that pension accounting lacks transparency.

It would be easy to suggest that the IASB should scale back the pension disclosure information so that it includes only the most critical data necessary to understand the position of the retirement plans. However, such a change would be inappropriate and impractical because the minority of readers who do have expertise in retirement plans would see a reduction in the information available to them. The solution that we propose is to separate the pension disclosure information into two sections, which for convenience we will refer to as 'Basic Information' and 'Supporting Information'. We suggest that the Basic Information consist of the disclosures listed below, with the balance of the current inventory of disclosure items comprising the Supporting Information.

Funded Status of Plans - This table would provide the reader with a basic understanding of the funded status of the retirement plans. To ensure that the information is accessible to all users, it would be limited to only three items:

a) Retirement Plan Liability
b) Retirement Plan Assets
c) Unfunded / (Overfunded) Retirement Plan Liability

Deferred Recognition of Liability / (Assets) – This table would build on the previous table by starting with the plans' funded status, and then offsetting the amounts subject to deferred recognition, which then ties into the amount presented on the balance sheet.

a) Unfunded / (Overfunded) Retirement Plan Liability
b) Liability / (Asset) Subject to Deferred Recognition
c) Amount Recognized as a Liability / (Asset) on Balance Sheet

Components of Pension Expense – A table that shows the components of the retirement plan expense is currently a required disclosure item under paragraph 120A(g) of IAS 19. We suggest including this table under Basic Information.

These three disclosure tables contain the minimum information that is necessary for a reader who is reasonably familiar with accounting and finance concepts, but unfamiliar with the special rules that relate to retirement plans, to understand the impact of the plans on the company's finances.

For example, consider two different companies that each has a retirement plan liability of €1,000 on its balance sheet, but one has no deferred actuarial losses while the other has large deferred actuarial losses. Under the current rules, unless the reader is comfortable with retirement plan accounting, he or she might not be able to discern this information from the current extensive list of disclosures. However, under our suggested Basic Information disclosures, the reader would very easily be able to see that one plan has much less well funded plans, and that it is a deferred liability that is causing the balance sheet positions to be the same.

Expansion of Multiemployer Disclosures

In addition to the dramatic changes that the IAS 19 exposure draft would make to the recognition of actuarial gains and losses, it also includes significant changes to the required disclosure information for companies that participate in multiemployer pension plans. Currently these companies are required to account for the plans as single-employer plans if they are able to obtain sufficient information to do so. If this information is not available, companies are required to account for these plans as if they were defined contribution plans, which in practice means the pension expense for a reporting period is equal to the cash contribution for that period.

Although we are not aware of detailed survey information, our informal understanding is that the majority of companies that participate in multiemployer pension plans account for them as if they were defined contribution plans. Currently IAS 19 requires that companies that use this approach must disclose the extent to which the current surplus or deficit of the multiemployer plan may affect the amount of future contributions. The provisions in the exposure draft would greatly expand this information.

We have several concerns with the additional disclosure items, particularly the possibility that companies will be required to calculate and disclose the amount that would be paid in the event of withdrawal from a multiemployer plan. Paragraph 33A(d) states that companies must disclose the 'details of any agreed deficit or surplus allocation…', or 'the amount that is required to be paid upon withdrawal…' We initially interpreted this statement as meaning that if there is no agreed upon deficit or surplus allocation, the withdrawal amount must be disclosed. However, our informal discussions with IASB staff have indicated that they believe that a narrative response to this question, rather than a

quantitative withdrawal liability estimate, will be sufficient in nearly every situation. For the reasons outlined below, it would be unreasonable and impractical to require that all companies disclose withdrawal liability estimates annually for all of their multiemployer plans.

Our first concern is that this information may simply not be obtainable for many companies. Depending on the methodology used, the calculation of withdrawal liability from a multiemployer pension plan can be a complicated and labor intensive determination. Since it is possible for a multiemployer pension plan to involve thousands of individual employers, the increased administrative burden that this requirement would place on the plans will be extraordinary. It is not clear that all multiemployer pension plans will be able to generate this information for all of their contributing employers each year. Additionally, there are companies that participate in hundreds of multiemployer plans. In addition to the burden that this requirement would place on the plans, these employers would also face a tremendous burden as they attempt to gather this information annually.

The timing of the information may also be problematic. The gathering of financial data generally occurs immediately after the end of the reporting period. For example, a company that reports on a calendar year basis generally will need to receive financial information in January or February of each year. It is highly unlikely that the multiemployer plans will be able to provide year-end withdrawal liability information this quickly. Thus, in order to comply with this requirement, companies would be forced to use information that is more than a year out-of-date. This could be highly misleading to the readers of the financial statements, and would make it nearly impossible to compare the statements of one company to another.

As the companies that report their finances under IAS 19 span a great many countries, there are a great many local laws that would interact with this proposed accounting change. Specifically, the laws that govern multiemployer pension plans vary widely around the globe. In some countries withdrawal liability amounts may be artificially high as a barrier to companies withdrawing, while in other countries the withdrawal liability amount may be unusually low or even non-existent. Adding to the confusion is the fact that in certain areas and industries, participation in multiemployer plans is compulsory, which eliminates the very concept of withdrawal liability.

The extreme regulatory variations will provide the reader with a very confusing and misleading picture of the financial impact of these plans. For example, consider a company that participates in a well-funded multiemployer plan that is governed by laws and regulations that result in extremely conservative withdrawal liability assessments. The artificially high withdrawal liability figure will mislead the reader into believing that the multiemployer plan participation represents a greater long-term financial liability that is actually does. At the other extreme, consider a company that participates in a poorly funded multiemployer plan in which their participation is compulsory. The absence of a potential withdrawal liability assessment would indicate to the reader that the deficit position of the plan is not a long-term financial liability of the company, which is also an incorrect understanding. These situations will work strongly against the objective of comparability of the financial statements from one company to another.

Due to the complexity and variability of multiemployer laws and regulations, it is important that the IASB revise the wording of paragraph 33A(d) to make it clear that narrative information about the possibility of the company withdrawing from a multiemployer plan and the consequences of such a withdrawal is sufficient to comply with the statement. An additional area where clarification is appropriate is paragraph 33A(f)(iii), which asks for a five-year projection of the contributions to the plan.

In many instances this information is likely to be unavailable without significant additional effort and cost on the part of the multiemployer plan. As such, the paragraph should be modified to indicate that this information needs to be provided to the extent that it is readily available.

Summary

We oppose the elimination of the gradual recognition of actuarial gains and losses from IAS 19 for three reasons.

1. Since pension funding is necessarily a very long-term process, it is illogical to require the immediate and full recognition of variations which occur each and every year.

2. To the extent that readers feel the current standard lacks transparency, the answer should be to improve the presentations and disclosures rather than to change the underlying calculations.

3. The increased financial volatility associated with the proposed change would further hasten the decline of defined benefit pension plans, which would be to the great detriment of the millions of people who depend on these plans for financial security.

Regarding the expanded multiemployer disclosures, we are concerned that requiring all of the additional information listed in the exposure draft may place an unreasonable burden on the plans and the sponsors of these plans. We are further concerned that the wide variety of local laws and regulations will make estimates of the amount to be paid upon withdrawal from a plan a confusing and misleading to the readers.

Thank you very much for the opportunity to comment on this very important topic. Please contact us if you require any additional information.

Best regards.

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