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Subject Comment on IASB Discussion Paper "Preliminary Views on Amendments to IAS 19 Employee Benefits"

Dear members of the International Accounting Standards Board,

I would like to take the opportunity to comment on your discussion paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits' (the reporting rules applicable to listed companies' pension plans).

It has become apparent that reporting rules can have far-reaching consequences for pension schemes. The proposals in your discussion paper have consequently attracted considerable attention from civil society and professional organisations as well as in the Dutch Parliament. In preparing this response, I consulted representatives of the Dutch Accounting Standards Board, accounting firms, employers' and employees' organisations, pension fund bodies and supervisory bodies. They agree with the conclusion that your proposals concerning the contribution-based promise and the 'corridor' method are major changes that should not be made before a fundamental review of accounting for pensions has been conducted.

The Dutch Accounting Standards Board has given an extensive response to your discussion paper, to which I would refer you for more detailed comments and for the answers to your questions. I would like in this letter to elucidate a number of key points.

**'Hybrid' pension systems and the current reporting rules**

One of the aims underlying your discussion paper is to introduce improvements to the application of IAS 19 in the near future. The need for such improvements is keenly felt in the Netherlands as the application of IAS 19 is perceived as being restrictive. The strict distinction in IAS 19 between rules for 'defined benefit plans' (under which the pension obligations and the associated assets are fully attributed to the employer) and rules for 'defined contribution plans' (under which the employer's pension obligation is limited to payment of the employer's contribution) does not allow for the possibility that the obligations of a 'defined benefit plan' are not – or not fully – borne by the employer, for instance if obligations are borne by a legally independent pension fund with its own buffers.

In case of a pension fund administering the pension scheme of an employer, the prudential rules in Directive 2003/41/EC[1] apply. This Directive establishes minimum requirements with regard to the own funds and obliges pension funds to draw up annual accounts. Member States can set stricter requirements in this regard.[2] The basic principle of these prudential rules is that a pension fund should fulfil its commitments.

The current reporting rules in IAS 19 do not take these prudential rules into account. Reporting rules force the employer to recognise *the same* obligations in its annual accounts. As a result two entities, the company and the pension fund, recognise the same obligations in their annual accounts. This is not transparent and does not reflect the economic reality of the situation.

Additionally, the strict distinction in IAS 19 between 'defined benefit' and 'defined contribution' does not allow for the more 'hybrid' pension schemes in which the risks are largely borne by members and beneficiaries. The current reporting rules in IAS 19 erroneously hold the employer accountable for those risks. In the Netherlands most pension schemes are average salary pension schemes with conditional indexation. The conditional nature of the indexation implies that participants carry a large portion of the risk as to whether or not indexation will take place. As a rule, a decision on whether or not indexation will be applied must be taken every year by the board of the pension fund. In this connection I would refer to the Dutch Accounting Standards Board's comments in its response to your discussion paper and to the description of the 'variable benefit plan' in the annexe to that response. Finally, the Dutch Pensions Act offers the opportunity to reduce the accrued rights of members and beneficiaries (including early leavers). This leaves the ultimate risk with members and beneficiaries. Whether the employer can still be required in specific situations to provide additional funding depends on the arrangements made ex ante between employer and pension fund.

In their annual accounts companies clearly have to recognise commitments to which they can be held, including promises to make additional payments in the event of insufficient coverage. However, a true and fair view is not presented, to my mind, if a reporting standard compels employers to carry liabilities in their balance sheet in excess of those to which they can be held either on the basis of a legal obligation or a contract with the pension provider. In that case the

[1] Official Journal L 235 of 23.9.2003, page 10
[2] In the Netherlands where an employer is obliged to have a pension fund or an insurance company implement its pension plan, a pension fund is obliged to maintain high buffers for the investment risks; approx. 30% depending on the investment risk. Those buffers are such that the accrued obligations are guaranteed with a 97.5% certainty level. In addition, the employer has to pay a cost-effective contribution in which there is a surcharge for the required buffer.

rules compel entrepreneurs to refrain from accepting any kind of risk. This is at odds with the objectives agreed at the Laeken European Council in December 2001 on solidarity within and between generations, aimed at ensuring adequate and financially sound old age pensions in the light of demographic ageing and a shrinking labour force.

**The meaning of the proposals in the IASB discussion paper**

Although the proposal in your discussion paper introducing the concept of a ‘contribution-based promise’ to replace the definitions of ‘post-employment plans’ and ‘defined contributions plans’ makes the distinction between the rules on defined benefit plans and on defined contribution plans less clear-cut, it does not solve the problems concerning hybrid schemes. I endorse the view expressed by the Dutch Accounting Standards Board that the proposed changes to the definitions are difficult to understand and may have far-reaching implications for pension plans. Nor is it clear how obligations would be measured.

I also agree with the Dutch Accounting Standards Board with regard to the proposal to amend the ‘corridor’. The reasons put forward at the time for introducing the corridor method are still valid today, and such an amendment must be preceded by a fundamental review.

**Proposals for alternative solutions**

It is my belief that reporting rules must enable a true and fair view of the economic reality of a company. This means that the presentation of pension schemes in the annual accounts must reflect a company’s true liabilities. Under the present rules it is not possible, as argued above, to achieve this properly, and your proposals do not offer a remedy to the problem.

Therefore, I propose that these aspects be examined as part of a fundamental review of IAS 19. In the meantime, I believe the current IAS 19 rules should be maintained. I am willing to work constructively towards a solution, in particular involving more ‘principle-based’ formulations which are also in line with other initiatives in this area, and whereby input can also be provided by the Dutch Accounting Standards Board.

One possible approach would be to recognise, besides the employer’s contribution, only a company’s contractual obligations and firm commitments to the pension fund. In addition, the funding arrangements between the employer and the fund would be addressed in the explanatory notes. Information would also be included on the fund’s financial position and the relationship between this financial position and the future level of contributions. Any deficits in the fund and, where relevant, recovery plans to be carried out by the fund would be properly explained in the notes. In this way the user would be given sufficient useful information to assess the company’s liabilities.

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A solution should also be sought for the related problem of applying IAS 19 to listed companies which participate in an industry-wide pension fund. With industry-wide pension funds, the residual risk in 'hybrid' pension schemes is often even more limited for the participating companies than in the case of pension funds linked to a company.

I would be pleased to offer my support to a fundamental review of IAS 19 and to explain my position in further detail.

Minister of Social Affairs
and Employment,

(J.P.H. Donner)