Ministry of Social Affairs and Employment

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Re Comment on IASB Exposure Draft "Defined Benefit Plans - Proposed amendments to IAS 19"

Dear members of the International Accounting Standard Board

Thank you for giving me the opportunity to comment on the Exposure Draft: Defined Benefit Plans (Proposed amendments to IAS 19) which aims to introduce improvements in the application of IAS 19 in the near future.

In my letter of 6 October 2008 on your discussion paper on this subject I underlined that accounting standards must enable a true and fair view of the economic reality of a company, but that such a view is not presented if an accounting standard compels employers to carry liabilities in their balance sheet in excess of those to which they can be held. I proposed these aspects to be examined as part of a fundamental review of IAS 19. I also pointed out that accounting standards can have far-reaching consequences for pension schemes. They might compel entrepreneurs to refrain from accepting any risks. Such consequences would be at odds with the objectives ensuring adequate and financial sound old-age pension systems in the light of demographic ageing and shrinking labour force.

Former Commissioner Mr Charlie McCreevy reassured me in this respect. In his letter of 13 November 2008 he wrote me that this topic is of significance to Europeans of all generations, that he is fully aware of the sensitivity of pension accounting due to its broad economic implications, and that the IASB is committed to carry out impact studies and post-implementation reviews. He assured me that there will be a thorough impact assessment and careful analysis before any decision on endorsement in Europe is made.

The Exposure Draft contains among others additional proposals regarding how risk-sharing and conditional indexation affect the IAS 19 measurement of defined benefit obligations and also proposes improved disclosures. These steps are in the right direction to fit hybrid pension schemes in the accounting standards. However, the Exposure Draft does not present a satisfactory solution for the hybrid pension systems in which the obligations of a defined benefit plan are not

fully borne by the employer, but by a legally independent pension fund, as is the case in the Netherlands.

This issue has the full attention of civil society and professional organisations as well as of the Dutch Parliament. In preparing this comment, I consulted representatives of the Dutch Accounting Standards Board, employers' and employees' organisations, representatives of pension funds and supervisory bodies. They fully support the proposals in this letter to solve this issue. These proposals have also been discussed between IASB members and representatives of my Ministry. I highly appreciated your attention in this respect. The views expressed in this letter received wide support from the accounting firms I consulted. The Dutch Accounting Standards Board has given an extensive response to your Exposure Draft, to which I refer for more detailed comments and for the answers to your questions.

Plans with shared funding and shared risk by employers and employees

Accounting for defined benefit plans should aim at quantifying the obligations of the employer under such plans. It must deal with the situation in which the employer has obligations towards employees, as happens in many countries. But it must also deal with the situation in hybrid systems in which the employer is obliged to pay a bill from the pension fund and that bill is calculated according to the law, as is the case in other countries. And it should fully recognise caps on the obligations of the employer and risk-sharing by members and beneficiaries in those hybrid systems.

The proposed amendments in the Exposure Draft in respect of shared funding (paragraph 64A) allow the taking into account of the effect of any requirement for employees to reduce or eliminate an existing deficit. But even if these corrections can properly be made, they are still adaptations to the IAS 19 method to measure the defined benefit obligation. Different discount rates, the possibility under Dutch law to limit the obligations of the employer and limits on additional contributions by the employer, the use of conditional defined benefit obligations, the possibility to reduce the rights of members and beneficiaries if the pension fund is not sufficiently funded (see Annex I), and recent developments in the Netherlands resulting in further limiting the obligations of employers regarding pensions (see Annex II): they all may lead to a presentation of liabilities in the balance sheet in excess of those these employers may hold.

Many problems are ultimately related to the fact that the criteria for the existence of a constructive obligation in paragraph 26 of IAS 19 are not decisive if the plan calculation is based on a target level of pension (the plan benefit formula) and employer's obligations are limited ex ante. This can be solved by adding to Paragraph 25 of IAS 19 (or by adding to the examples provided in paragraph 26 of IAS 19):
"The calculation of the periodic contribution payable may be based on a target or aspired level of post-employment benefits. When the entity has no further legal or constructive obligation other than to pay the agreed contributions for any service period and the participating (former) employees are properly informed about this limitation of the entity's obligations such a plan classifies as a defined contribution plan."

To some hybrid pension plans the above suggestion to paragraph 25 does not apply. These plans should definitely be classified as a defined benefit plan. But the measurement of the obligation should not be reflected by the performance target and other criteria as mentioned in paragraph 85 c, which refer to the rights of members and beneficiairies, but by the limits by caps and risk-sharing arrangements in the formal terms of the plan. This can be solved by adding to paragraph 85 the following point d:
"(d) the formal terms of the plan limit the legal and constructive obligation to pay additional contributions to cover a shortfall in the fund's assets."

Multi-employer plans (MEPs)

I appreciate the amendments in the Exposure Draft relating to multi-employer plans (MEPs). In MEPs the residual risk for the participating companies is even more limited than in the case of a company pension fund. The proposals mentioned above regarding the paragraphs 25 and 85 also apply to MEPs. But as IAS 19 and consequently also the Exposure Draft deals with MEPs, potential multi-interpretations should be avoided as much as possible.

In the current paragraph 32b of IAS 19 an enterprise has to account for its proportionate share of the defined benefit obligation in the same way as for any other defined benefit plan where sufficient information is available. An exemption is granted if there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual enterprises participating in the plan.

But more important than the fact whether a consistent and reliable basis for allocating the obligation, plan assets and cost to individual enterprises participating in the plan can be realised is the fact how such a result affects individual entities' future contributions. And in a multi-employer plan the individual employer's contribution is not based on the allocation of these aspects to that individual enterprise but on the obligations, plan assets and costs of all the enterprises participating in the plan.

So, further accounting guidance for MEPs will be improved by changing the current paragraph 32b as follows:
"the plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the consequence that allocating the obligation, plan assets and cost to individual entities participating in the plan does not result in an asset or liability that reflects the extent to which the surplus or deficit in the plan will affect the individual entities' future contributions."

I refer to the comments by the Dutch Accounting Standards Board in this respect.

Final remarks

I have not discussed your proposals about disclosure in further detail, but I assume those proposals will not lead to higher administrative costs than appropriate.

I hope that the above suggestions, which I will also send to Commissionar Barnier and Commissionar Andor of the European Commission, are properly taken into account when preparing the final standard and I am happy to discuss these

proposals further with you either in London or The Hague if this might be helpful.

Minister of Social Affairs
and Employment,

J.P.H. Donner

Annex 1

Some characteristics of the Dutch pension system.

- All pension arrangements must be separated from the employer and be put in a legally separated pension fund. (In this way article 6a of Directive 2003/41/EU is implemented).
- All arrangements between the employer and the pension fund must be included in an administrative agreement which for example must state: "if there is an additional contribution deposit obligation on the part of the employer: the conditions under which there is an additional contribution deposit obligation and how the amount of that obligation is determined".
- The pension fund has to draw up its own annual accounts. (In this way article 10 of Directive 2003/41/EU is implemented).

- There are no differences between the rules in the Pension Act and the accounting rules in the valuation of assets/investments as these must be valued at fair value. The rules in the Pension Act not only determine the contribution the employer has to pay, but they also determine the assessment whether, and if so, which liabilities exist as at the balance sheet date, in addition to those contributions to be paid to the pension provider (the residual risks of the employer).

The differences can be demonstrated as follows:

	IAS	**Dutch Pensions Act**
The value of the technical provisions	IAS 19 uses a method (the projected unit credit method) which requires an enterprise to attribute benefits to current period and prior periods and in which calculations are made to employees individually, a method which allows for less elements of solidarity between employers and members/beneficiaries than the way the technical provisions are calculated according to the Dutch Pensions Act.	the present value of the projected future outgoing collective cash flows resulting from the pension commitments that have accrued up to the date on which the value is set. Article 15 paragraph 4 (a) of Directive 2003/41/EU also uses the words "accrued pension rights".
To measure the obligations	IAS 19 requires the use of market yields on high quality corporate bonds.	the projected future outgoing collective cash flows are discounted by the use by pension funds of the current nominal term structure of interest rates
Conditional indexation	The Exposure Draft includes the conditional indexation in the measurement of the defined benefit obligations,	The provisional granting of supplements (in other words: the conditional indexation) is only allowed if there is consistency between the expectations created, the financing and the effecting of the supplements provisionally granted. Financing these supplements can be done by creating technical provisions or by over-return, and all financing methods in between. It only becomes a liability when future surplus returns are realized
Own funds	IAS 19 does not take this into account.	In excess of the technical provisions a pension fund will set the regulatory own funds so that the probability of the pension fund having less assets at

		its disposal than the amount of the technical facilities within a year is reduced to 97,5 %. This safeguards all accrued rights.
Reduction of pension rights	IAS 19 does not take this into account.	A pension fund may reduce acquired pension rights and entitlement to a pension benefit under specific circumstances.

Under these conditions the premium of the employer is determined and its residual risks are mitigated. Assumptions which differ from these conditions do not play a role in investment and funding decision of the funds management, and ultimately has no relevance in the measurement of the ultimate costs to the employer.

Annex II

Present developments in the Netherlands diminishing the employer's involvement in the pension scheme

In the past few years many pension schemes changed from final salary schemes to average salary pension schemes with conditional indexation. The conditional nature of the indexation implies that the members/beneficiaries carry a large portion of the risk as to whether or not indexation will take place. Decisions whether indexation will be applied fully, partly or not must be taken by the board of the pension fund every year and are subject to availability of funds.

In the Pension Accord Spring 2010, the employers federations and trade union federations agreed that more comprehensive automatic cost increases (for both employees and employers) in occupational pensions in the second pillar must be prevented and that pension contracts must be adjusted to include more conditional elements, based on the presumption that the related contributions are stable and cover costs, to take into account increased life expectancy and to be able to withstand negative developments on the financial markets.

On 18 August 2010 it was announced that fourteen Dutch pension funds must start reducing pension rights and benefits from 1 January 2011, as their shortfalls have grown too large. So the provision in the Dutch Pension Act for a pension fund to reduce acquired pension rights and entitlement to a pension benefit is not purely theoretical.

The present draft legislation in Dutch parliament aims to allow pensioners to be represented on both the board of a pension fund as well on its participants' council. If that draft is adopted the influence of the employer in the decision-making of the pension fund will be further diminished.