ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION

24 February 2014

Ms. Akemi Miura
Mr. Michael Stewart
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH, UK

Dear Akemi, dear Michael,

We are pleased to respond to your outreach request on **IFRIC 14 - The Limit on a Defined Benefit Asset, Minimum Funding requirements and their Interaction**. We offer below our observations. The tight timeframe has precluded us from seeking an official approval within the IAA; even our fast track procedure due process would take too long. This is thus an informal response by the Pensions & Employee Benefits Accounting Subcommittee of the IAA.

For the issue you described in your mail of 5 February, you had asked the following three questions to each of which we respond below:

Q1. In your jurisdiction, is it common that;

(a) the trustee of a pension plan acts on behalf of the plan's members and is independent from the employer; and

(b) the trustee has discretion in the event of a surplus arising in the plan to use such a surplus to augment the benefits payable to members [and/or wind up the plan through the purchase of annuities for members]?

If so, please explain the typical characteristics of pension plans, the power of the trustees and any other relevant facts.

A1 (a) Many countries require by law (or relevant court rulings) the managers of a plan to act on behalf of the plan's members but the plan may not be constituted under trust law, for example in many continental Europe countries such as The Netherlands or Germany.

The sponsor may be represented on the plan's management body but may not have control of decisions taken, albeit often being in a position to influence decisions.

In the UK, the trustee of a pension plan has a legal responsibility to act on behalf of the plan's members and must act independently from the employer.

A1 b) This is common in the UK, but no general position prevails. Typical characteristics and trustee powers vary widely:

Secretariat: 601–150 Metcalfe, Ottawa, ON Canada K2P 1P1 Tel.: +1-613-236-0886 Fax: +1-613-236-1386
secretariat@actuaries.org / secretariat@actuaires.org — www.actuaries.org / www.actuaires.org

- The power of trustees to spend "surplus" to augment members' benefits without requiring employer consent is unusual but does exist in a number of pension schemes (i.e. in the large majority of cases, employer consent is required). Some UK pension schemes even require trustees to spend "surplus", for example on discretionary pension increases.

  In each case, "surplus" is defined according to assumptions set by the trustees and sponsor under UK law. In the current legislative and economic climate, "surplus" is nearly always different (and generally lower than) the difference between assets and liabilities as determined under IAS19. It can be said that true surplus is only known at the date a plan is wound up, any measure of surplus prior to that is an estimate based on assumed future experience of the plan.

- The power of trustees to amend certain terms of the scheme (e.g. the rate of exchange of pension for cash at retirement) which can affect "surplus", without requiring employer consent is quite widespread.

- The power of trustees to reduce "surplus" by reducing investment risk in the pension scheme applies to all UK pension schemes. Indeed, the power of trustees to purchase annuities (even if not in wind-up) applies to all UK pension schemes (as all trustees have full control over investments and annuities are just another investment).

- The power of trustees to trigger wind-up varies considerably in the UK. In some pension schemes, the trustees do have that power unilaterally, but probably in most UK schemes it requires a series of events to be triggered (e.g. employer not paying contributions) before a pension scheme can be put into wind-up.

- In the event of wind-up it is commonly the case that the trustees are required to spend any surplus that exists on augmenting members' benefits. Refunds of surplus to employers are typically only available after members' benefits have been augmented up to the maximum level permitted by regulations. But there are still a large number of pension schemes where refunds of surplus to employers are permitted on a wind-up provided members' benefits have been settled in full.

Q2. *If you answered 'yes' to Question 1, what is the predominant interpretation on whether the employer has an unconditional right or not to a refund? In addition, would you please briefly describe the rationale for that interpretation?*

A2. There is no predominant interpretation in the UK – lawyers opine their views in individual cases which vary widely according to their circumstances:

- It is very unusual in the UK for an employer to have the unilateral right to withdraw cash (i.e. take a refund) from an on-going pension scheme which is in "surplus". If a right exists (for the employer to take a refund) it will likely have many conditions which need to be satisfied first before doing so.

- The first issue to test, therefore, is whether the employer has the ability to access "surplus" through reductions in future [the equivalent of service cost] contributions. In

Secretariat: 601–150 Metcalfe, Ottawa, ON Canada K2P 1P1 Tel.: +1-613-236-0886 Fax: +1-613-236-1386
secretariat@actuaries.org / secretariat@actuaires.org — www.actuaries.org / www.actuaires.org

considering whether employers have an unconditional right to "surplus" in this way, it should not be overlooked that funding agreements in the UK require the joint agreement of trustees and employers (and trustees have the unilateral right to affect investment strategy with consequent impact on "surplus"). As DB schemes have closed in the UK, a number of DC schemes have been established (within the same legal structure as the DB scheme) which have the theoretical ability to tap into "surplus" in the DB section for the purposes of reducing the employer's DC funding requirement.

- Where trustees have the power to spend "surplus" on augmenting members' benefits, some companies / lawyers are seeking to restrict that power – specifically to avoid the IFRIC14 issue. However, this is a tortuous process as trustees typically have to approve rule changes (and why would they agree to restrict their powers?).

- Then the wind-up rules have to be examined. Where employers do not have the unconditional right to surplus on wind-up some are considering trying to amend their pension scheme rules to give them some power to a refund – again to avoid the IFRIC14 issue (and, again, this will typically require trustees to approve the rule changes).

- Where the trustees have powers to spend "surplus", an employer's right to a refund and recognition of an "asset" is restricted. This is something the auditor may want to consider if the pension plan or the "surplus" are material to the reporting entity's IFRS financial statements.

Q3. *On the basis of your response to Question 2, to what extent do you observe differences in the accounting between entities? If you observe differences in the accounting between entities, that is caused by a difference in the terms of the contracts or other facts, please explain it, briefly*.

A3. Specifically referring to the question of whether (and how much of) a surplus is irrecoverable, we observe wide differences in accounting at reporting entity level in the UK. As this is driven by the particular drafting of individual pension schemes' rules (which are not in the public domain), there is no way of telling what is driving these differences, i.e. whether it is due to different rules or different interpretations or both. For example, a recent analysis of FTSE100 companies and their pension schemes [c.f. http://www.jltpcs.com/uploads/pdfs/8903%20FTSE%20100%20as%20at%2031%20September%202013.pdf] observed 16 companies reporting an irrecoverable surplus under IFRIC14 (out of the 89 companies with DB pension schemes) and the largest irrecoverable surplus exceeded £1billion.

We are at your disposal to elaborate on specific points as required.

Yours sincerely,

Alf Gohdes, Chairperson
IAA Pensions and Benefits Accounting Subcommittee

Secretariat: 601–150 Metcalfe, Ottawa, ON Canada K2P 1P1 Tel.: +1-613-236-0886 Fax: +1-613-236-1386
secretariat@actuaries.org / secretariat@actuaires.org — www.actuaries.org / www.actuaires.org