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By email to ISAP3.comments@actuaries.org

Exposure draft: proposed International Standard of Actuarial Practice on IAS 19

Towers Watson hereby submits its comment on the exposure draft of the proposed International Standard of Actuarial Practice on IAS 19 Employee Benefits. Towers Watson has extensive experience in these matters. Our actuaries prepare the IAS19 results on a plan by plan level for thousands of plans around the world, and in addition are the global actuary for over 250 multinational companies, handling over 10,000 benefit plans in our annual review and consolidations of IAS19, US, and other domestic GAAP results for those clients. As such we are familiar with the various ambiguities and practical difficulties in applying the IAS19 standard to employee benefit plans in all significant jurisdictions. When formulating our comments we have been guided by the principles set out at http://www.towerswatson.com/en-US/north-american-retirement-principles in relation to actuarial standard setting.

Generally, we find the current draft a considerable improvement on the previous version and we are pleased to see that a number of our comments have been taken on board. That said, we do have a number of comments on the current draft, some of which are merely drafting suggestions, but others are more substantial.

Overall scope of the document

In general we continue to take the view that much of the material, especially in section 2.6, would be more suitable for an educational guidance note (IAN) than a standard of practice, and that a better route would have been to develop an educational guidance note on IAS19, with perhaps some modest refinement of ISAP1 in relation to behavioural matters. We refer to our previous comment letters of 28 September 2012 and 14 March 2014 to explain our thinking behind this and we continue to have misgivings about the overall scope and nature of the document.

That said, given the route the IAA has taken and that this is now at “final draft” stage, our further comments below are made with the aim of helping the IAA improve the document that it has developed.

Proportionality and materiality

The comment in 2.2.2 “The principal or reporting entity (not the user of the IFRS financial statements) is the intended user of the actuarial services when assessing materiality with respect to the actual services” is helpful but we think it is too limited. We think it would be more helpful if the comment is elevated and amended to note that the principal or reporting entity is the intended user of the actuarial services for all purposes (unless specifically agreed otherwise with the principal), ie not just when assessing materiality.

Paragraph 2.3 (b) – The wording “when doing so will not materially affect the results” implies that there must be absolute certainty on this question, which in practice is rarely the case. We recommend replacing it by “when the actuary considers that doing so will not materially affect the results”.

Interaction with the principal

We note some differences between the various wordings that are used when the actuary is taking input from the reporting entity. For example:

- in paragraph 2.1 the actuary “should seek advice” from the principal in respect of accounting requirements, and is referred to IASP1 2.3 “Reliance on Others”.
- in respect of “constructive obligations” in paragraph 2.4 the actuary “may rely on representations made by the principal” and is referred to IASP1 2.3 “Reliance on Others”.
- in respect of categorisation of employee benefit plans, under 2.5.2, the actuary “should seek guidance from the principal” and is referred to ISAP1 2.8 “Assumptions and Methodology Prescribed”.
- in respect of IFRIC 14 in paragraph 2.8 “unless the actuary is certain”, the actuary also “should seek guidance from the principal” but there is no particular reference to ISAP1.

We are not sure if there is some subtle distinction that the IAA is trying to make here between “guidance” and “advice” and “representation”, but we consider such matters to be similar in nature. These are all matters of accounting policy on which the actuary ultimately needs to take instruction from the principal, at least where the matters are material. We therefore believe that the wording should be harmonised between these various situations to refer to the actuary seeking or taking “instruction”, and that the various references to sections of ISAP 1 are also harmonised to all refer to ISAP1 2.8 “Assumptions and Methodology Prescribed”.

We also believe that the following four items:

- the categorisation of the corporate bond market as “deep” or “non-deep”
- whether there should be a different single equivalent discount rate assumption for service cost compared to DBO, or indeed a fully granular application of the discount rate curve (see below)
- the principles behind the valuation of asset-related benefits
- the attribution of benefits to service periods where this is not clear from IAS19

are also policy matters for the principal, and should be handled in the same way as the above four topics, with the same wording and reference to ISAP1 2.8 “Assumptions and Methodology Prescribed”. This is not to say that the actuary cannot help his/her client form a view as to how to handle these issues, but at the end of the day the principal should “own” the approach to be taken- where these are material matters.

Assumptions

Paragraph 2.6.1 (b) – We noticed some subtly different wording regarding assumptions where the reporting entity can influence future experience. In 2.6.1 (b) (i) regarding financial assumptions the actuary “may… consider” the expectations of the reporting entity, whereas in respect to demographic assumptions in 2.6.1 (b) (ii) the actuary “should review” this same information. We suggest that this wording is harmonised, especially since practice varies as to whether real salary growth is considered a financial or demographic assumption.

Paragraph 2.6.1 (d) – The statement that the actuary should “recommend assumptions” that “would be appropriate to represent the reporting entity’s best estimate”, could be read to indicate that the actuary must make a single point recommendation. We believe it should be made clear that the actuary should also be able to, and indeed in some circumstances it would be more appropriate to, provide advice in terms of ranges of potentially appropriate assumptions. For example it may be more appropriate to comment on the reasonableness of an assumption proposed by the principal, rather than providing the actuary’s view of what this assumption should be. For example this wording could be extended to say: “if making a specific recommendation, recommend assumptions that in the actuary’s opinion, are unbiased and mutually compatible, and, if adopted by the reporting entity, would be appropriate to represent the reporting entity’s best-estimate, or if commenting more generally, consider those requirements for IAS19 assumptions, when formulating his or her comments.”

Paragraph 2.6.3 (a) – This should be expanded to include yield curves developed by the principal/reporting entity. Subsequent references should be adapted accordingly.

Paragraph 2.6.3 (a) (i) – This makes reference to market depth. We believe that the categorisation of the bond market as “deep” or “not deep” is an important accounting policy point which should be handled similarly to matters such as constructive obligations and plan classification, at least for those markets where practice varies (we understand that the IAA has recently made a survey on this matter). We believe this matter warrants being addressed as a completely separate point. See our comments in the section “Interaction with the principal”

Paragraph 2.6.3 (a) (ii) – It would be helpful to expand the current wording to say “such techniques may, *but need not*, take into account…” This change clarifies that an extrapolation from the bond data alone without reference to a different market data source could also be considered appropriate.

Paragraph 2.6.3 (c) – The IAA might wish to refer to the potential importance of reinvestment assumptions when using such models.

At the end of 2.6.3 there is reference to using a different single-equivalent discount rate assumption for determining current service cost based on the projected cashflows attributable to service built up in that year. We note that using a different single equivalent discount rate to calculate the service cost but calculating net interest cost in the normal fashion (ie using the single equivalent discount rate that gives the same DBO) is not mathematically consistent. That may or may not be acceptable on a practical level, but the IAA may want to flag the point for attention. More generally, we feel that the existing commentary falls between two stools and therefore makes half a point. If the IAA wishes to avoid an incomplete comment it could extend the commentary to also refer to the potential for a fully granular application of a yield curve to the entire pension accounting, which would mean calculation of interest cost for each cashflow separately and summing, and the IAA could also refer to the different potential ways of calculating interest cost in such a framework. Generally however, these are questions of how the discount rate curve is applied, not questions of setting the assumption per se. As such we think these questions should be considered similarly to other accounting policy matters - see our comments in the section “Interaction with the principal”. All that said, our view is that a detailed exposition of the different possible treatments is an educational matter, not one for a standard of practice- the standard should confine itself to the behavioural question of taking instruction. (This is a practical illustration of our concerns about the scope of this document).

Assets

Paragraph 2.7.3 – It is not clear how one should interpret the wording “the actuary should ensure that the valuation of the employee benefits is consistent with the nature of the linked asset”. It appears to be some form of elaboration of what IAS19 says (which we believe should be avoided for the reasons set out in our 14 March 2014 comment letter). The word “ensure” feels very directive but we are unclear as to what it is directing the actuary to do and would not know how to operationalise this apparent instruction in practice.

Does it for example preclude the actuary from following a client instruction to work with a valuation that is independent of the asset mix, for a benefit where the market-consistent valuation would be independent of the asset mix[1]?

We also note that the IAA’s Statement of Intent for ISAP3 noted that this issue was one better handled in educational guidance rather than this standard (“hybrid plans”). We would agree with that in terms of any statement about how to calculate, as distinct from how to behave.

Given the wide range of possible treatments for such benefits, the potential differences between them, and the diversity of existing practice, and the lack of any prospect of clarification from the IASB soon (even if a research project is in the early stages) we remain of the view that the most helpful thing the IAA can say is to encourage the actuary to discuss potential treatments with the principal, encourage the client to engage with their auditors about treatment, and seek instruction (or at least confirmation) from the principal as to the approach to use. See the section “Interaction with the principal” above.

Appendix

As the appendix is described as being provided for informational purposes and is not part of the ISAP, its status is unclear to us. Generally we suggest that the ISAP should not attempt to summarise or paraphrase IAS19. The dangers of trying to do this are illustrated by the statement in the document that gains and losses “are recognized immediately in Other Comprehensive Income” – that statement is made about both post-employment benefit plans and other long-term employee benefit plans, and is incorrect for the latter.

[1] For example a simple promise to pay, in one years’ time, a sum equal to the then market value of a pool of assets held by the reporting entity today.

The commentary on areas in which the actuary might provide valuable input for a reporting entity is helpful to actuaries in thinking about how they could help their clients but its status as an appendix to a model standard seems somewhat unclear – it might better belong in an educational guidance note.

We also have the following specific comments on this section:

- We are sceptical that post-employment medical benefit plans with no life-time claims limit are unusual in all jurisdictions
- The commentary says that IAS19 "refers to IFRS 7 (paragraph B19) for the principles to be used to quantify 'reasonably possible' variations". We cannot identify such a reference in IAS19. This may be an interpretation of BC239(c) of IAS19 but we do not read that as specific direction to use the IFRS7 approach – it only notes that "requiring sensitivity on the basis of changes in the relevant actuarial assumption that were 'reasonable possible' at that date is consistent with the sensitivity disclosure requirement of other standards such as IFRS 7." In any event paragraph B19 is in a section of IFRS 7 dealing with "market risk"; it has nothing to say about non-market driven assumptions such as a longevity assumption.

Glossary

The glossary defines a constructive obligation in terms of the IAS37 wording ("valid expectation") although it does also refer to the IAS19 wording ("no realistic alternative"). Before including the IAS37 wording in this standard we recommend that the IAA should confirm with the IASB whether the IAS37 definition has any relevance to IAS19 work as it is not clear to us that is has. Specifically, we are concerned that it may be misleading to include the IAS37 definition without reference to other wording within IAS37 that may be relevant to the practical treatment of an IAS37 constructive obligation, specifically the definition of an "obligating event" which includes the "no realistic alternative" wording.

Miscellaneous

Paragraph 1.2 – We wonder if the position of actuaries who are employed by the reporting entity should be specifically mentioned also. It may be necessary to distinguish between those who have some sort of "internal consultancy role" which is advisory, and those actuaries within reporting entities who are making decision that are reserved to the reporting entity – for example the choice of assumptions or questions of policy.

Paragraph 1.6 – In the final sentence we suggest the word "relevant" is better than "applicable".

Paragraph 2.1 – Whilst the phrase "an IFRS that is an interpretation of IAS19" may be technically correct, it is somewhat cryptic and we suggest it would be more helpful and clear to refer to relevant IFRS IC interpretations explicitly.

Paragraph 2.3 (c) – We suggest the word "propose" rather than "adopt" as ultimately it is the responsibility of the reporting entity to adopt the assumptions to be used.

Paragraph 2.6.1 (b) (i) – the term "market-implied expectations" would seem to cover some of the items in the list that follows, but not all – for example "forecasts of inflation, employment data and projections" are not normally market-implied. We recommend some rewording to refer to both market-implied and other information.

We would be pleased to meet with you or have a telephone discussion to elaborate on our comments.

Sincerely,

Eric Steedman

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