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IAA Secretariat
601-150 Metcalfe
Ottawa
ON Canada K2P 1P1

By email to ISAP3.ED.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.

We understand that the IAA's intended outcome is a model standard for consideration by individual actuarial associations, and hence of itself the new IAA standard will not be binding on actuaries. However, our response is written as if individual actuaries would be required to follow the standard, since that would presumably be the case if the standard is adopted by an individual association.

In summary, we believe that:

- ***any material produced by the IAA that relates to how IAS19 calculations should be performed should be expressed as educational guidance and not be mandatory or quasi-mandatory for actuaries,***
- ***and therefore, descriptions of standard actuarial practice in this document should be limited to behavioural aspects, with elements pertaining to how calculations are performed forming part of a separate educational guidance note that is clearly non-mandatory (an IAN in IAA terminology).***

Our reasoning is unchanged from that set out in our letter of September 28, 2012 on the IAA's statement of intent to publish a model standard. It is not appropriate that the actuary's calculations should be subject to constraints that do not apply to the preparer, or that the actuarial profession should provide accounting guidance that is potentially inconsistent with the views of the accounting/auditing professionals who are opining on the company's financial statements. That would only be a route to unhelpful conflict between actuaries and their clients, who would not have to pay heed to the IAA's views.

As drafted, we believe the ISAP strays too far into the territory of setting out how calculations should be made. The IASB is the appropriate body to govern IAS19 methodology and unless the IASB will add its imprimatur to the IAA's conclusions, then any conclusions about how calculations should be made should not be requirements on the actuary, or even a rebuttable presumption. Our concern is that to do otherwise risks constraining actuaries to a greater degree than intended by the IASB.

If comments about how the calculations should be made are included in a “Standard of Actuarial Practice” then the inference may be drawn that such comments represent “standard practice” that an actuary would have to follow, or at the least would need to justify not following. Anything the IAA says about how the calculations should be carried out can only:

- Repeat the requirements of the standard, which has no useful purpose in a standard of practice (it might have purpose in an educational context).
- Conflict with the requirements of the standard, which is distinctly unhelpful.
- Elaborate the requirements of the standards, which may be helpful as guidance to consider, but is inappropriate as prescription unless endorsed by the IASB, for the reason noted above.

There are examples of both conflicts with, and elaboration of, IAS19 in the existing drafting, which we enumerate below. The former should be eliminated, and we believe the latter would be better carved out into a separate document with a title that does not invite the inference that the actuary should be bound by them, such as an IAN.

Aside from our own view based on fundamental considerations, we have considered the purpose of this draft IASP as set out in paragraph 1.1. To quote: *“Its purpose is to give intended users confidence that:*

- *Actuarial services are carried out professionally and with due care, in compliance with IAS 19, and taking into account the reporting entity’s accounting policies;*
- *The results are relevant to their needs, are presented clearly and understandably, and are complete; and*
- *The assumptions and methodology (including, but not limited to, models and modeling techniques) used are disclosed appropriately.”*

All three aspects listed here could be furthered by setting out standards of behaviour in this standard. None of these aspects will be furthered by going further than the IASB and IFRS IC has done in specifying how the calculations are to be made. Indeed, including such specification in a standard of practice risks damaging the very confidence that the first point aims to achieve, if such prescription by the IAA conflicts with a reporting entity’s accounting policies. Therefore carving out such aspects to a separate IAN would not limit the success of the IASP in terms of its stated purpose, indeed it could enhance it.

Given our overall view, we have grouped our comments are grouped into “Behavioural aspects”, “Calculation aspects” and “Miscellaneous”.

Behavioural aspects

As indicated above we have no problem in principle with setting out standards of behaviour for actuaries in a “Standard of Actuarial Practice”. We offer the following suggestions on the exposure draft.

Paragraph 1.3/2.3- If the IAA continues in including in this statement of standard practice comments about how calculations should be carried out, ***we think it is essential for there to be some guidance as to how the actuary is to behave if the company wishes to follow an accounting policy that conforms to IAS19 but does not conform to the IAA’s elaborations of IAS19 set out in this statement.*** We do not think that the references to IASP1 in paragraph 1.3 are sufficient, as it is unclear whether in this situation the actuary should be “willing to support” (ISAP1 paragraph 3.8.1) or “unwilling to support” (ISAP1 paragraph 3.8.2). Nor do the comments in paragraph 1.3.1 relating to what the law requires necessarily help, they are relevant only to what the law requires, not what it permits.

Paragraph 1.3.1 – We understand from the definition of “law” referred to that “law” would include “accounting standards” so this seems to be saying that following the accounting standard would comply with the ISAP even if such was a deviation from the ISAP. We have no objection to that of course, but the point is already addressed by Paragraph 4.2.5 of ISAP 1 which refers to “financial reporting standards and entity’s accounting policy”. It would seem sensible to harmonise the language between these two documents and perhaps include a cross reference to the wording in ISAP1.

Paragraph 2.1 - this seems to be an elaboration of ISAP1 paragraph 3.2 and it is potentially helpful to indicate that required knowledge goes beyond IAS19 itself. We think it is reasonable to draw a clear boundary around the knowledge of IFRS that an actuary performing IAS19 services might reasonably be required to be familiar with, and we think the existing wording more or less does that, but would benefit from saying “relevant paragraphs of other IFRSs to which IAS19 **specifically** refers...” We think it would also be reasonable to refer to IFRS IC interpretations that specifically relate to IAS19, in particular IFRIC Interpretation 14. The IAA might also wish to compile a list of IFRS IC comments in their regular updates (such as agenda decisions), IASB staff papers etc that it thinks the actuary should be familiar with. We do strongly feel that the requirement should be to be familiar with specific documents identified by the IAA, not a generic “catch all” wording.

Paragraph 2.2 – This appears to say that there may be two different materiality thresholds – one for the advice that the actuary is giving to their contact at the client, and one for what the client actually publishes. Our practical experience is that these things frequently coincide for this type of work, but of course that may not always be so. We think it would be more helpful to rephrase this to suggest that the actuary should obtain guidance from the client on what is material in terms of what the client will publish, and to say that the actuary may assume that the same materiality considerations apply to the actuarial services unless the client has indicated that some different tolerance applies. We do agree that it is helpful to note that the principal reporting entity is the intended user of the actuarial services, not the reader of the company’s financial statements.

Paragraph 2.4 - We read this to say that the actuary may rely on what the principal represents about the existence of nature of any formal or informal practices. So far, so good. However, it is silent upon whose responsibility it is to then decide whether those formal or informal practices give rise to a constructive obligation. We think it should be made explicitly clear at this point in the text that the person ultimately responsible for that determination is the principal, not the actuary.

Paragraph 2.4, second paragraph – we are unclear why this is being called out for special attention over and above what is said in paragraph 2.3.

Paragraph 2.6.1 b (ii) – we think it should be made clear that the actuary need not perform work that the client will not commission. For example, the actuary may recommend that an experience study is made to better understand some assumption or other, but the client may not wish to incur the expense of that work.

Paragraph 2.6.1d - the discussion in paragraph 2.6.1 generally about what sort of things to think about when setting assumptions is potentially useful, though the more detailed comments would be more suitable in an educational guidance document (IAN) than a standard of practice. It would be helpful to make clear in paragraph 2.6.1d that the actuary’s recommendation need not necessarily be a “clean sheet” one. It could be subject to some instruction from the client – such as to develop an assumption which is consistent with the client’s past practice or some client policy or viewpoint. Perhaps that can be “taken as read” but it would be better to put it beyond doubt.

Paragraph 2.7.3 - The actuary appears to be given carte blanche here to use judgement. However we are aware of auditors having firm views in this area as to treatment. Given the wide range of possible treatments, the potential differences between them, and the diversity of existing practice, we believe this area deserves special mention as one where it is important to discuss potential treatments with the client, to encourage the client to engage with their auditors about treatment, and to seek instruction (or at least confirmation) from the client as to the approach the actuary should use. We note that the IFRS IC has recently “downed tools” on the project in this area, so clarity from that quarter is unlikely to be forthcoming soon.

Paragraph 2.7.3 - Also, the issue is relevant to plans where benefits are defined by reference to any assets, whether held within a plan or not, so we would move this out of the section headed “plan assets”.

Paragraph 2.8 – How to attribute benefits to service periods is an accounting policy decision that should be for the principal not the actuary, and whilst the text acknowledges this (“when advising the principal”), it could indicate more clearly that the actuary need not feel bound to single out just one potential treatment

in his/her recommendation – we believe the actuary should be free to set out alternative treatments and the arguments for and against these and consequences, for the client to make a decision and instruct the actuary, ideally having consulted with the auditors.

Paragraph 2.8 – We don't understand what issue the example "how to attribute benefits if a benefit is expressed as a constant proportion of current salary" is specifically trying to highlight. We think the main point in this area that is unclear is how to attribute the benefits to service when the benefit does not depend on service. Also explicitly undecided by the IASB is whether expected future salary growth should be allowed for in making the back-end loading test. So if examples are to be given, we suggest the main areas of doubt are explained more clearly.

Paragraph 2.9 – We suggest all comments on materiality, proportionality, etc are put in the same place and linked together. Specifically, 2.9 seems to elaborate 2.2.2 somewhat and it would be better to bring these together and harmonise the wording.

Calculation aspects

Given the concerns expressed above our recommendation is that all aspects of the exposure draft dealing with how the calculations should be carried out should be part of a separate educational guidance document (IAN), not a "Standard of Actuarial Practice". However our comments on the text as drafted are given below, further subdivided between "Conflicts with IAS19", "Elaborations" and "Redundant text".

Conflicts with IAS19

We have identified the following inconsistencies with IAS19, which we believe should be eliminated.

Paragraph 2.6.3.a.iv - Generally, it is mathematically not possible to calculate a single weighted average discount rate that produces the same present value both the DBO and for other quantities such as the service cost and net interest cost. Actuaries should not be asked to do so! (The word "substantially" offers little comfort here- what is the actuary supposed to do if the specific pattern of cashflows and spot rates leads to a single weighted-average discount rate that gives the same DBO but leads to a substantially different service cost or net interest cost? And what does "substantially" mean anyway.....?)

Paragraph 2.7.4 - The wording about IFRS IC 14 ("whether to apply") seems to imply that there is choice as to whether it is applied or not. Our understanding is that it always applies (although will not always be of relevance). Incidentally, the opportunity to mention the implications of a minimum funding requirement has not been taken, which seems an odd omission given the apparent ambition of the rest of the document, though again is an educational matter rather than one appropriate for a standard of practice.

Glossary definition of "Constructive Obligation" - the definition does not accord with how the IASB describes constructive obligation in paragraphs 4(c) and 61 of IAS19 which say "where the entity has no realistic alternative but to pay.....". The Glossary quotes the IAS37 definition but that is not the same thing as what is said in IAS19. As an educational matter it may be helpful for the IAA to flag the differences in the wording between IAS19 and IAS37 on this point.

Elaborations

As noted above we believe it is inappropriate and a route towards potential conflict for the IAA to elaborate IAS19 unless the IASB will give such elaborations its imprimatur. Specifically:

Paragraph 2.6.3.a.iv- aside from the mathematical difficulty in applying this requirement that we have noted above, we note that this also seems to be completely ruling out the possibility of working with a different discount rate for each future cash flow (as alluded to by paragraph 85 of IAS19) rather than a single weighted average discount rate. The appropriateness of doing or not doing that is a matter of debate, for the IAA to state that "the actuary should" use a single average discount rate seems to restrict the actuary in what he /she can do in a way that the preparer of accounts is not restricted. It is an elaboration of the standard, which is a matter for the IASB.

Paragraph 2.6.3b – Most of this is potentially quite helpful from an educational perspective but there is a danger it is seen as prescription if included in a standard of practice and we do not think it belongs in this document. We recommend removing it (perhaps to a separate IAN) but offer the following comments on the wording:

- Under “Quality”, an inference could be drawn that one has to use “internationally recognised” credit rating agencies. That (as opposed to using agencies that operate only or mostly in the country concerned) is a matter of debate in certain markets, and we don’t think that it is for the IAA to imply one has to, unless the IASB will endorse that. We suggest deleting the words “internationally recognised”. Also we suggest “If using...” rather than “In using...” as there is nothing in IAS19 that says one has to look to credit rating agencies’ ratings to determine what is “high-quality”, even though that is near-universal practice.
- The same paragraph seems to call on the actuary to adjust the bond universe for lags in the credit rating process during “abnormal conditions”, (whatever those might be, which is highly debateable). Actuaries cannot be expected to have the skills or the knowledge to do this. We believe this should be reworded to be more neutral – i.e. not to be worded on the basis that there is an apparent presumption in favour of such adjustments. We think that as an educational matter it is reasonable to flag the issue for awareness.
- There is perhaps an opportunity to draw to the actuary’s attention the recent pronouncements from the IFRS IC about the approach to deciding what is “high-quality” – that relates to our comment on paragraph 2.1 above.
- Under “Market Depth” we doubt the example of the Bank for International Settlements definition of a “deep and liquid” market will be of practical help on this thorny issue. Indeed it may just cause confusion as there is no requirement in IAS19 for the market to be “liquid”, merely “deep”. It is though good to see, as an educational point, a reminder that the market need not be deep at all durations as this is a point that is not always understood although the IFRS IC reinforced it recently.
- Re “Outliers” – from the wording of the last sentence the inference could be drawn that one has to exclude or adjust for outliers. Whilst that will usually be entirely reasonable and we do so in our own standard models, it is not a requirement of the accounting standard. We recommend deletion of the last sentence so the point is simply flagged for awareness. Alternatively the last sentence could make clear that doing nothing is also a possibility.

Redundant text

If the IAA feels it necessary to repeat parts of IAS19 then it would be better to make direct quotes from the standard rather than the current slight paraphrasing which leaves the reader to check if the IAA is saying exactly the same thing as the accounting standard or something subtly different. Directly quoting also better mitigates the risk of changes in the standard overtaking this document as it can be made clear which version is being quoted from.

Specifically, the following text does not convey anything that is not already conveyed by IAS19:

- paragraph 2.6 The last sentence of this paragraph
- paragraph 2.6.3 b.i under “Currency”
- The Glossary definition of “Employee Benefits”.

Miscellaneous

There are various references to paragraphs of IAS19 in the document that do not appear to be correct, for example in paragraphs 1.3 and 2.6.

Paragraph 1.6 - Since publication of the exposure draft this has become out of date, as IAS19 has been modified recently and is set to be modified again before the IAA document is finalised. There also seems to be some redundancy vis a vis the definition of IAS19 in the glossary (which has now also been overtaken by events).

Paragraph 2.6.3.a.iv the words “for disclosures in the IFRS report” are not necessarily the most precise qualifier that could be added, but in any event don’t seem to add anything and could be deleted.

Paragraph 2.7.1 – It might be worth drawing actuaries attention to the different asset values that might be used under a company’s accounting policy (eg bid/mid) as this is not something covered in IAS19 but another standard. The actuary may wish to take instruction on whether they should request a specific type of valuation (eg bid or mid) from those providing the asset value data. We agree that the actuary should be able to rely on asset values provided, and this is worth stating, as the text does.

Glossary definition of Reporting Entity – The definition seems somewhat strange and seems to rely on the actuary second-guessing whether users will rely on the financial statements as their “major” source of information (as distinct from a secondary source?). We feel that a definition based on the relationship (adviser-client) would be more satisfactory.

Summary

The appendix to this letter summarises our comments in the requested response format.

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

Sincerely,



Eric Steedman

Co-lead of Towers Watson’s Global Accounting Team

	Specific Questions asked by the ASC	Response
Q1.	Is the guidance clear and unambiguous? If not, how should it be changed?	We have made some specific suggestions for improvement in our letter
Q2.	Is the guidance sufficient and appropriate? If not, how should it be changed?	We do not consider that all of this guidance is appropriate. Specifically, we believe that those aspects that describe how the IAS19 calculations are made do not belong in such a standard of practice. They might belong in an educational guidance note, an IAN
Q3.	Is it clear how the guidance in the proposed ISAP relates to the guidance in ISAP 1? If not, how should it be changed?	There is scope to tie the document more closely to the wording and concepts of ISAP1; we have made some specific suggestions in our letter.
Q4.	Is the guidance at the right level of detail? If not, what text should be omitted because it is too detailed? In what areas do actuaries need more detailed guidance?	Broadly speaking, the level of detail of the behavioral guidance seems appropriate although we have made some specific suggestions for improvement.
Q5.	The proposed ISAP does not currently provide specific guidance to actuaries advising the reporting entity on the information that should be included in the IFRS report to meet IAS 19's disclosure objectives (the appendix contains educational material on these disclosures). Should the ISAP be expanded to provide guidance in this area? If so, what should the guidance be?	Some guidance around the role of the actuary in the process of a company drafting its disclosures may have some merit. Guidance on what should be disclosed would be inappropriate in such a standard of practice. Discussion on how risk in plans could be assessed and conveyed, as an input to the reporting entity's deliberations around what to disclose, might find place in an educational guidance note.
Q6.	Are there other matters that should be included in this standard on actuarial work in connection with IAS 19 Employee Benefits? Are there some included here that should not be?	See response to Q2.
	General Comments on the Exposure Draft	Please see our letter for our detailed comments