International Actuarial Association
Association Actuarielle Internationale

31 December 2018

Board Members
Financial Accounting Standards Board

By e-mail to: Russell G. Golden, Chairman (rggolden@fasb.org)

Ladies and Gentlemen,

The International Association of Actuaries (IAA) is a collaboration of actuarial organizations across the globe that as part of its objectives deals with actuarial issues that are multi-national in scope. This letter is being sent by the IAA's Pension and Benefits Accounting Subcommittee. It has not been subject to the due process required for it to constitute a formal view of the IAA. Thus, these comments do not represent an official view of the IAA.

Although we work relatively closely with the IASB, we're not aware of any previous correspondence between the FASB and the IAA. As chair of the subcommittee, I appreciate the opportunity to write to you and share some observations regarding pension accounting for your consideration and review.

As part of the agenda discussions that took place during your September 20, 2017 Board Meeting, you considered whether to begin a pension project. In the end you decided no, and in listening to tape of the discussion our impression is that your reasoning was that defined benefit (DB) plans are increasingly less relevant and less important and it's not worth the cost to add a project (our words, not yours).
While perhaps this is the case in the US, in other countries with significant multi-national corporation presence it is not necessarily the case. **In some countries defined benefit plans continue to predominate and we do not see any evidence in those countries that they are likely to become less important or relevant.** Many employees in these countries work for US multi-nationals, and US accounting treatment is a key driver of pension provision decisions in those countries.

In other countries where there is some move away from DB Plan the move is not necessarily a simple shift to traditional Defined Contribution (DC) plans. Various arrangements that are neither traditional DB nor DC plans are becoming more common in a number of countries.

When SFAS #158 was promulgated, the FASB indicated (as described in B27 and B28, et al) that they recognized the concerns that had been raised regarding measurement, and that those concerns would be addressed in a second phase. Objections had been raised that placing a liability on the balance sheet before concluding on how to appropriately measure that liability was perhaps placing the cart before the horse, however constituents generally understood FASB's position that resolving the measurement issue could significantly delay the project and that improvements in reporting were urgent and shouldn't be delayed. However, that resulted in a lack of clarity and at best, inconsistent practice as to how to appropriately measure certain

types of plans. At worst, it led to recording of inappropriate liabilities with potentially inappropriate actions taken as a result of accounting for those liabilities.

One example of the above is cash balance or hybrid plans. The EITF issued guidance in 2003 regarding cash balance plans that resulted in inconsistent accounting between various types of cash balance plans. We realize that FASB staff later researched whether cash balance plan accounting was problematic, and the Board concluded in August of 2014 that it was not, but we don't know the basis for that conclusion and still have the inconsistent practice concerns outside the US.

Another example is the definition of DC plans in ASC 715. DC plans with "collective" features have emerged or are under development in several European countries such as the Netherlands, Denmark, Germany and the United Kingdom as well as some Canadian Provinces and more recently Japan. These new plans are different from hybrid DB plans because there is no form of risk-sharing by the employer. All risk (investment return, longevity etc.) remains with the employees. From a purely economic perspective, we believe these plans should be treated as DC plans, and indeed this is their classification under IFRS. However, as described on the attached paper, the current wording in the ASC can present an obstacle to confirming their DC status under US GAAP.

As a result of these issues, we encourage FASB to reconsider its decision to forego further improvements to pension accounting and to keep the commitments made when SFAS # 158 was issued.

Thank you very much for your consideration. If you have any questions about this letter, please contact me at +61 2 92295216 or Jim Verlautz at +1 612-642-8819.

Sincerely,

Tim Furlan, Chair
IAA Pension and Benefits Accounting Subcommittee

cc: Bruce Cadenhead, Chair, US Academy of Actuaries Pension Committee

DEFINED CONTRIBUTION ACCOUNTING ISSUES UNDER US GAAP

A key difference between the ASC 715 and IAS 19 definitions of DC plans is that the ASC definition (unchanged from SFAS #158 and essentially the same as United States, 26 U.S.C. §414(i)), focuses on the benefits receivable by the employee instead of the potential cost to the employer. The ASC 715-70-20 Glossary states the requirements, two of which can be seen as problematic:

- Provision of an "**individual account for each plan participant**"; and
- "The benefits a plan participant will receive depend **solely on the amount contributed to the plan participant's account, the returns earned on investments of those contributions**, and the forfeitures of other plan participants' benefits that may be allocated to that plan participant's account."

Prior to 1998, IAS 19 also defined DC plans based on the benefit receivable by the employee, but the definition introduced in that year's revisions moved the focus to the downside cost risk faced by the employer (IAS 19 BC28-29). The key provision stated in IAS 19.8 is that the entity "will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods." Whether an account is purely "individual" or "collective" or a mixture of both elements is not a deciding factor. The additional guidance under ASC 715-70-15-2, intended for plans with both DC and DB characteristics, actually adds to the confusion in some cases. It states that such a plan "… requires careful analysis. If the substance of the plan is to provide a defined benefit, as may be the case with some target benefit plans, the accounting requirements shall be determined in accordance with the provisions of Subtopic 715-30 or 715-60 applicable to a defined benefit plan …". Given that DC plans typically have a target level of benefits in mind, US corporations sponsoring such a "defined ambition" DC plan could face the interpretation that their plan must be classified as a DB plan, even in the absence of any guaranteed benefits or any legal or constructive obligation to ever pay any additional contributions to top up assets for past service benefits.

The definition of DC plans according to ASC 715, particularly the "individual" requirement, has already created unwanted consequences for preparers of financial statements. For example:

- **In the Netherlands**, "Collective Defined Contribution" (CDC) plans are commonly treated as DC plans under IFRS, but often as DB plans under US-GAAP, simply because these CDC plans do not have individual accounts. In some cases, the accounting rules for multiemployer plans apply, but there are also many cases with only one participating employer.
- **In Germany**, the accounting treatment for the new "Collective Individual Defined Contribution" (CIDC) plans – coming into effect in 2018 – remains to be clarified. Most of these plans will essentially have individual accounts during the accumulation phase, but often not entirely because of collective asset buffers used to smooth the asset return. This raises the theoretical question, based solely on the wording of the ASC, as to whether there is a maximum buffer size above which the

accounting classification could as a worst case assumption switch from DC to DB. We do not share this view due to the fact that asset buffers are - in terms of the asset management of a CIDC plan - part of the risk management and influence only the return of the employees account based on the contributions to the employees account. Furthermore, one could argue that the individual accounts do not exist during the decumulation phase, as German labor law mandates that benefits be paid as life-long annuities from the plan, with rules that exempt the employer from longevity risk.

- **In the United Kingdom**, a Government consultation for the introduction of CDC plans has just been launched in November 2018, with a high probability that a CDC variant will be introduced into the British occupational pension landscape from 2020. Ultimately these plans may well be closer to the Netherlands' CDC plans than to Germany's CIDC plans, and face similar uncertainty with regard to US GAAP accounting treatment.

In summary, the ASC's wording, presumably originally envisioned for DC plans available in the US, can cause DC plans in other countries to be potentially unnecessarily classified as DB under US GAAP. In addition, the lack of comparable accounting between IFRS and US GAAP can discourage the implementation of the above new European DC plans made possible by recent regulatory changes. These plans all have "collective" elements, but a change from "individual" and "collective" does not in these cases introduce DB risk to the employer. Presumably the key question a user of an entity's financial statement would pose is: "is there any risk that the employer will be required to put additional money into the plan?" The accounting would then vary by whether the answer to that question is yes or no. If no, then the plan in all cases would be classified as DC, a distinction made clear under the IFRS definition. But the corresponding definition under US GAAP leads to the seemingly unwarranted application of DB accounting rules, which in turn could lead to arbitrary liabilities or assets in the entity's balance sheet. In a worst case, this could have the potential to confuse and mislead the users of financial statements.