STAFF PAPER

18-19 September 2012

IFRS Interpretations Committee Meeting

Project	**IAS 19 *Employee benefits***		
Paper topic	IFRIC Draft Interpretation D9–Scope of a draft interpretation		
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Introduction

1. At its meeting in July 2012 the IFRS Interpretation Committee (the Committee) discussed the scope of its work in the reconsideration of the draft interpretation D9 *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions.*

Proposals on scope in D9

2. The original proposals on scope in D9 were set to cover plans with a promised return on actual or notional contributions. The Committee had also previously reached consensus that the plans that fall within the scope of D9 are defined benefit plans because the employer retains some risk in respect of the guaranteed return. If not for this guarantee these plans would be classified as defined contribution plans.

3. Some respondents to D9 pointed out that a number of plans provide a promised increase that is not linked to the return on any specific assets, eg where the return is linked to an inflation or equity index or is based on some other measure such as corporate performance. Other respondents pointed out that D9 plans exist side by side on a continuum between plans that are clearly defined benefit and those that are defined contribution plans. In their view it was not clear why the scope of the interpretation should be limited to plans

that would be defined contribution but for a guaranteed return on actual or notional contributions and why the scope excludes other types of guarantees. They considered it more reasonable to include all of these guaranteed plans within the scope of the interpretation rather than choose only the ones where the guarantee is directly linked to the return on contributions.

Discussions and tentative decisions at the July 2012 Committee meeting

4. The Committee discussed the scope of D9 at its meeting in July 2012. The Committee tentatively decided to slightly revise the scope of its work on benefit plans with a promised return on contributions made or notional contributions. This was to clarify that an employee benefit plan would fall within the scope of its work if the employer has a legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay for all employee benefits relating to employee service in the current and prior periods in respect of :

    (a) a promised return on actual or notional contributions; or

    (b) any other benefit guarantee based on the value of one or more underlying assets.

5. The change that was made to the scope at the meeting in July was the inclusion of other benefit guarantee based on the value of one or more underlying assets.

6. The Committee also tentatively decided that the scope of its work should include not only post-retirement benefits but also other long-term benefits.

7. It was also decided at the July meeting that staff would undertake further outreach on scope and bring this issue back to the Committee as members raised concerns that it was important to ensure that the scope of the proposals was sufficiently narrow.

Objective of this paper

8. The objective of this paper is to ask the Committee to make a decision on the scope of the draft interpretation. Staff thinks that it is important for the Committee to make a decision on the scope before proceeding with the

project as this decision will affect other parts of the project, especially measurement.

9. At the Committee meeting in July, some members were concerned that the scope recommended by staff, and tentatively agreed to by the Committee, was too broad. A broad scope may slow the project down substantially and might cause problems similar to those the IASB faced after issuing its discussion paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* in 2008, where respondents criticised the IASB, for example, for including defined contribution plans within the contribution-based promises category.

10. However, the scope of the Committee's work is narrower than the scope the IASB proposed for contribution-based promises in the 2008 discussion paper. Appendix A shows what kinds of plans were included within the scope of the 2008 Discussion Paper for contribution-based promises, within the scope of draft interpretation D9 and are included our current proposals.

Staff analysis

11. Staff has now conducted the additional outreach which was discussed at the July 2012 Committee meeting and believes it has gathered enough information to make a recommendation to the Committee on the scope of the draft interpretation it is working towards.

Types of plans to be considered

12. In the outreach performed, which is outlined in agenda paper 5a for this meeting, the staff has identified two general types of employee benefit plans that should be considered when determining the scope of the Committee's work. The staff have identified these two types as:

    (a) plans with a guaranteed return on contributions made; and

    (b) 'cash balance plans'.

13. Respondents to the outreach did not identify any additional types of plans that are common which the Committee should consider in its work.

Plans with a guaranteed return on contributions made

14. Draft interpretation D9 was developed to deal with plans with employee benefit plans with a guaranteed return on contributions or on notional contributions made to these plans.

15. These employee benefit plans are generally set up the following way. The employer makes regular contributions to the plan. The employee receives a pension based on the performance of the assets in the plan. The employer does however provide a guarantee of the minimum performance of the assets in the plan (ie guarantees a minimum return on the contributions made). Consequently, under these plans the employee receives a benefit that is the higher of the contributions plus the actual return on the assets in the plan and the guaranteed amount. These plans may be funded or unfunded.

16. The guaranteed return could be a fixed percentage, could be a numerical amount or may refer to a reference rate, for example the yield on government bonds, an equity index or a price change index. Some of these plans offer a combination of fixed and variable guaranteed return.

17. The employer may also guarantee a return on contributions made by employees. The contributions made by the employees may be either contractual or voluntary. Some plans and the associated guarantees are contractual, between the employer and the employee, whereas in some jurisdictions they are required by law.

18. The types of plans discussed in this section seem to be most common today in continental Europe.

Plans with a higher of guaranteed return on contributions made

19. A variation of these guaranteed plans are plans with a higher of guaranteed return on contributions made.

20. In these cases the employers set up employee benefits plans where the employer promises the higher of more than one specified amount to the employee (in other words the benefit plan includes an embedded option or guarantee). In these benefit plans the higher of benefit behaves economically

like a combination of a return on the underlying assets, with an option to put the assets back to the plan. Such plans are therefore said to contain a 'higher of option'.

21. Under the current IAS 19 these plans are accounted for as defined benefit plans. However, the measurement approach in IAS 19 for defined benefit plans may not measure the liability for these plans correctly, as it is not clear how to measure the 'higher of option' (ie the option or the guarantee) and it may therefore in some instances not be measured. The main problem in the measurement approach is that IAS 19 requires a single point estimate. Therefore the intrinsic value of the embedded option can be captured but the time value is ignored.

Career average plans

22. One issue that the IASB raised in its 2008 discussion paper on employee benefits was the similarity between plans with a guaranteed return of 0% on contributions made and career average benefit plans[1].

23. In the discussion paper the IASB proposed that career average plans should be accounted for in the same way as was proposed in that paper for contribution-based promises. This was done because career average plans are economically equivalent to plans with a fixed return of 0%. This therefore raises the question whether career average plans should be included within the Committee's current work on plans with a guaranteed return.

24. Although these plans may be similar in design we believes that career average plans should not be included within the scope of the Committee's current work, specifically as the calculation of the benefit obligation may be in part dependent on the employee's future salary.

Other issues to consider

25. It seems that in some instances employers may take action to decrease (or try to eliminate) the investment risk they are exposed to from benefit plans with a

[1] A career average employee benefit plan is set up in such a way that the benefit is a lump sum equal to a specified percentage of the career average of the eomployee's salary for each year of service.

guaranteed return on the contributions made. This is most commonly done by entering into an agreement with an insurance company. The insurance company then guarantees a specific return on the contributions the employer makes to the benefit plan.

26. We are of the opinion that the fact that the employer has entered into an agreement with an insurance company does not change the fact that the employer may be ultimately responsible for the guaranteed return, depending on the terms of the benefit. Buying insurance on the return on the contribution does not change these facts. The employer will have a separate asset[2] from this insurance contract. These plans would therefore also be considered plans with a guaranteed return on contributions made.

27. Another issue that came to our attention during the outreach we performed on plans with guaranteed return on contributions made is that there seems to be diversity in practice in how these insured plans mentioned above are accounted for. In some jurisdictions it seems that they are accounted for as defined contribution plans, based on the assumption that the employer has eliminated all investment risk, by entering into an agreement with an insurance company, although the employer may still be ultimately responsible for the guaranteed return. In other jurisdictions these plans seem to be accounted for as defined benefit obligations.

28. This information is not relevant for the Committee's current work on a draft interpretation, but the Committee might consider addressing this issue in the future. Paragraphs 46-49 of IAS 19 discuss the accounting for insured benefits.

Cash balance plans

29. The other type of employee benefit plans that we have found that should be covered by the Committees work are 'cash balance plans'. The main feature of these plans is that the employee receives a guaranteed benefit based on a

[2] Paragraph 115 of IAS 19 discusses plan assets from insurance contracts.

specified return on ‘notional’ contributions by the employer to an employee benefit plan.

30. The main difference between these plans and the plans with guaranteed return on contributions made is that the contributions in the ‘cash balance plans’ are almost always notional.

31. The guaranteed return can be a fixed percentage, could be a numerical amount or may refer to a reference rate, for example the yield on government bonds, an equity index or a price change index. Some plans may offer a combination of fixed and variable guaranteed return.

32. The plans may be funded or unfunded (for the unfunded plans the contributions and the return on contributions are notional). If these plans are funded they may be funded with assets that have a different return than the return promised by the plan. There may therefore not be any link between the return on the assets in the plan and the return on the contributions. This fact that there may not be a link between the return on the assets and the return on the contributions causes these plans to have notional contributions although they may be funded.

33. These ‘cash balance plans’ seem to be most common in North America and Japan.

Staff recommendation

34. As can be seen from the descriptions above the two types of plans identified by staff, plans with a guaranteed on return on contribution and ‘cash balance plans’ have very similar features and have the common feature of guaranteeing a return on the contributions made to these plans. ‘Cash balance plans’ may not even be considered a separate type of plans, rather a subgroup within plans with a guaranteed return on contributions made. We therefore think that ‘cash balance plans’ should be included in the Committee’s work.

Other types of plans

35. Staff does however acknowledge that there are probably many types of employee benefit plans that may have similar features to the plans discussed

above, but because of the structure of these plans will not fall within the scope of the Committee's work and therefore perhaps end up being accounted for differently than the plans that will fall under the scope of the Committee's work. There are many different types of employee benefit plans in use throughout the world and as with other obligations the features of these plans will govern how they are accounted for.

Proposals on scope

36. We believe that we have in our outreach identified the most common types of employee benefit plans with promised return on contributions or notional contributions made. Our outreach has also confirmed that there seems to be a need for a further clarification of how to account for these plans as the current IAS 19 does not provide the best answer on how to account for them.

37. We are of the opinion that the employee benefit plans that should fall within the scope of the Committee's work should have the following characteristic:

    (a) the plans would be classified as defined contributions plans under IAS 19 if not for the guarantee provided by the employer on the return of the contributions made;

    (b) the contributions made to the plans can be notional contributions (ie whether the plans are funded or not should not affect the accounting for these plans);

    (c) there should be a guarantee of return by the employer on the contribution (notional contributions) made;

    (d) the benefit under the plans should not be dependent or future events (ie salary changes, vesting or demographic risk); and

    (e) the guarantee under the plan may be based on the value of one or more underlying assets.

38. We made a recommendation to the Committee at its meeting in July 2012 on the scope of its work on these plans. That recommendation was based on the original scope of draft interpretation D9 and consideration of the feedback

that was received on the proposals in D9. That recommendation meets all the criteria mentioned in the paragraph above.

39. We suggest that the draft interpretation should include in its scope not only post-retirement benefits but also other long-term benefits as the Committee tentatively agreed to at its July 2012 meeting. This recommendation is made because the current IAS 19 deals not only with post-retirement benefits but also other long-term benefits. It does therefore seem logical that any draft interpretation dealing with employee benefit plans with a promised return on contribution and notional contributions should apply to the same rage of benefits in this respect as IAS 19.

40. We therefore suggest the following scope. That a employee benefit plan or other employee long-term benefit would fall within the scope of the draft interpretation if the employer has a legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to cover all employee benefits relating to employee service in the current and prior periods in respect of :

(a) a promised return on contributions, actual or notional ; or

(b) any other guarantee on contribution, actual or notional based on the value of one or more underlying assets.

Alternative scope

41. If the Committee thinks that the scope recommended above is too broad, it could consider a narrower scope. That scope could include only plans that have benefits that vary with return on assets and benefits with a ‘higher of option’ where one of the benefits varies with the return on assets.

42. For benefits that vary with the return on assets, the assets could be notional (ie the assets do not actually have to be held be the employer or the benefit plan). Making a reference to assets rather than contribution or notional contribution enables the removal of the reference to contributions, especially the somewhat confusing reference to notional contributions.

43. The need for the assets to vary with the asset returns eliminates plans with fixed guaranteed return of 0% from the scope of the work. The plans with fixed returns have caused much of the scope problems in the past when addressing plans with a guaranteed return on contributions. These problems were in part due to the fact that other benefit plans such as career average are economically equivalent to plans with a fixed return on contributions of 0%.

44. The scope of the Committee's work would then be the following:

A employee benefit plan or other employee long-term benefit would fall within the scope of the draft interpretation if the employer has a legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to cover all employee benefits relating to employee service in the current and prior periods for benefit plans:

(a) with a variable return on the assets or notional assets in the plan; or

(b) with a 'higher of option' where one of the benefits varies with the return on assets or notional assets.

45. However, if this narrower scope option is chosen, then the problems in accounting for plans with a fixed return on assets or contributions may not be addressed in this project and may therefore have to be addressed separately. The staff therefore suggests the wider scope option.

Question for the Committee
The staff recommends using the scope in paragraph 40 above in the Committee's work to prepare a draft interpretation on accounting for employee plans with guaranteed return on contributions or notional contributions, does the Committee agree? If not, how should the scope be defined?

Appendix A

A1. Comparison of what kinds of plans were be included within the scope of the 2008 Discussion Paper for contribution-based promises, the proposals in D9 and our current proposals

	Included in scope		
	2008 DP	D9	Staff proposal
The main objective of the definition of contribution-based promises is to separate promises that depend on the return on assets or indices from promises that do not. The following promises are examples of contribution-based promises as described by the 2008 Discussion Paper:			
• promises that IAS 19 classifies as defined contribution plans	Yes	No	No
• promises of a return based on notional contributions	Yes	Yes	Yes
• promises that guarantee a fixed return on contributions, including a fixed return of 0 per cent	Yes	Yes	Yes
• promises expressed as a fixed lump sum at retirement that is not dependent on service. Such a promise can also be expressed as a single contribution for the first period of service and a 0 per cent return on the contribution.	Yes	No	No
• career average promises (ie promises based on the average of the employee's salary over his or her entire service period)	Yes	No	No
• average salary promises based on the average of the employee's salary over past and current service periods	Yes	No	No
• promises that a lump sum will be converted into an annuity at a fixed annuity rate	Yes	No	No
• promises in which specified amounts that are not dependent on service are paid in regular instalments after retirement	Yes	No	No
• promises with a 'higher of option'	N/A	Yes	Yes