Pension Fund Association

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Contact **Masahiro Inaba**

03 September 2010

Dear Sirs,

Exposure Draft ED/2010/3: Defined Benefit Plans Proposed amendments to IAS 19

We express our sincere respect to the International Accounting Standard Board for the publication of the Exposure Draft ED/2010/3 “Defined Benefit Plans-Proposed amendments to IAS 19”, inviting comments in order to amend current IAS19 scheduled in 2011.

Pension Fund Association is an organized body, established by Employees’ Pension Insurance Law to take over pension rights of active employees from where they have been working for, passing them to their next corporate pension plans if certain conditions are met, and undertake responsibility to pay pension benefits of early leavers (28million) and pensioners (5million), based on monies accumulated and received from their former employers’ pension plans. Those funded assets within our organization are over the level of Yen 10 trillion. Besides these operations, Pension Fund Association is providing information concerning corporate pensions, presenting proposals or requests to relevant authorities and/or regulators, thus promoting the significance and development of corporate pension plans.

In the course of the amendment, IAS 19 *Employee Benefits* as authentic global accounting standards, should be thoroughly validated, through careful consideration from various viewpoints with particular attention on the actual situations of corporate pension plans in each jurisdiction.

Pension Fund Association has a pivotal role as the national center of corporate pension plans in Japan, and on behalf of them, we will present our comments on the exposure draft in the following.

1. Recognition of the net defined benefit liability (asset) in the statement of financial position (Question 1)

The exposure draft proposes that entities should recognize changes in the net defined benefit liability (asset) when they occur. However, in order to evaluate the propriety of this proposal, the significance of defined benefit obligations and the way they be measured, should be fully reviewed beforehand. At least, it is *condicio sine qua non* that the defined benefit obligation should be reasonably measured, reflecting real features of defined benefit pension plans at the date of date of measurement.

As to the defined benefit obligation based on the current projected unit credit method, there have been various issues pointed out until now, including how and to what extent future salary increase should be assumed (it's not a simple matter of estimation, of course), and how cash balance plans could be appropriately treated in the present accounting framework. Particularly, in the case of cash balance plans, it is well known that there are certain examples where benefit obligations of such plans may not be properly estimated in relation with corresponding balances of pension accounts, depending on measurement methods. Those technical uncertainty or diversity would bring certain bias or noise, whatever it may be called, into the financial statements, hampering fair judgment of the investors.

We consider it is too early at this very moment to apply the immediate recognition non-selectively as in this proposal without resolving these fundamental issues, therefore we do not agree with the board on the matter.

Corporate pension plans are typically long term projects stretching over several ten years. Therefore, entities will have to recognize their long term unstable benefit outflows as liabilities on one hand. Corporate pension plans, on the other hand, have a socio-economic function to be able to provide pension assets being invested over a longer period, because those assets have strictly limited accessibility by their nature. Thus corporate pension plans have an important role in the equity market, as institutional investors with abilities to keep investing their assets over a longer term, and there is a significant meaning in the socio-economic context to utilize these features effectively. For this purpose, it would be desirable to have an assessment framework allowing for short-term volatility occurring in the process for entities to maintain corporate pension plans. In this sense, the way how the accounting standards should be established, would inevitably bring a substantial influence on the formation of the framework.

For the treatment of actuarial gains and losses, the combined application of "deferred recognition in the balance sheet" with "corridor approach " as in the current standards is an excellent way for a long term social system to absorb short-term and cyclical volatility in changes in the asset and/or the liability. Accordingly, we would propose for the board to keep this option as in the current standard, however, with improved disclosures.

2. Recognition of unvested past service cost when the related plan amendment occurs (Question 2)

The Exposure Draft proposes the change in the recognition of unvested past service cost, that is, it should be recognized when the related plan amendment occurs rather than be recognized gradually over several years as in the current standard.

However, pension alterations such as benefit increases are expected to have a positive influence on boosting motivation among employees to future periods. In this meaning, amortizations of past service costs within expected remaining service periods should be admitted without regard to that the past service cost is vested or not. In other words, we do not accept the non-selective application of the immediate recognition of past service cost, which appears due to the simple fact that past service cost is a change in the defined benefit obligation over the past periods, because the long ongoing effects of the plan alteration certainly never fit the immediate recognition.

3. Presentation of an expected return on plan assets (Question 5)

Applying the discount rate for the calculation of the defined benefit obligation which has no direct relationship with plan assets, in order to estimate the expected return on plan assets, has no convincing basis, providing misleading information to the investors. Also, the non selective application of the discount rate to that estimation could bring a sizable effect into equity markets, frequently driving pension plans' asset allocations to move into those with return targets of bond oriented portfolios, thus distorting pension plans' investment policies which are primarily built on long-term viewpoints. Accordingly, we do not agree with the board on the matter.

Plan assets are composed of various kinds of investment vehicles, and yield on plan assets as a whole can be divided into an expected return estimated on the current asset allocation and another amount that results from all other changes in fair value. The rate of an expected return relative to the plan assets is closely connected with the long term investment target for the pension plan, and it would be reasonable to use this rate to calculate the finance cost on plan assets.

It should be noted that we can cope with the exclusion of arbitrariness in the setting of an expected return rate through an expanded narrative explanation on the way how the rate is set, and advanced disclosures of the pension asset portfolios.

4. Risk-sharing features in the estimate of the defined benefit obligation (Question 13(g))

We have, in Japan, "substitute portion" benefits paid exclusively by Employees' Pension Funds (EPFs) which have distinct risk-sharing features between EPFs and the government, in which EPFs are substituting for the government, providing the principal part of salary related benefits in the Employees' Pension Insurance, the public pension for the private sector , besides those pension plans as explained in the Exposure Draft. (Paragraphs 64A, and BC92-BC96) By 2004 Law Amendment, the government has the final responsibility to take the financing as well as the actuarial risk of providing the substitute portion benefits, whereas EPFs have only the responsibility to take the investment risk with respect to the financing. Please note that EPFs are established with approval of the Ministry of Health, Labor, and Welfare based on Employees' Pension Insurance Law.

However, in the Japanese accounting standards, obligations for the substitute portion are calculated in the same way as defined benefit obligations in general. The evaluated amount in this manner is certainly different from the residual, which is called " legal minimum reserve" , of the financing provided by the government, which clearly does not reflect the actual responsibility of EPFs for the substitute portion.

In the circumstances, it is necessary to make the accounting standards in respective jurisdictions revised so that benefit obligations can be measured appropriately, including those of pension plans which have their own risk-sharing features with the government.

It should be urgently requested for the board to review these issues on the risk-sharing features including the cases stated above and to get the quick solution for them.

End of comments.

If you have any questions on this letter, please contact Masahiro Inaba, Chief Actuary (inaba@pfa.or.jp) or Noribumi Yokota, Actuary (noribumi-yokota@pfa.or.jp).

Yours sincerely

PFA

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